

STRATEGIC REVIEW PREPARED FOR THE LIPA BOARD OF TRUSTEES



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Table of Contents

1.	OVERVIEW OF THE STRATEGIC REVIEW PROCESS	1
2.	LIPA SITUATION ASSESSMENT	
2.1.	LIPA'S HISTORY AND ROLE	6
2.2.	FINANCIAL OVERVIEW	19
2.3.	RATE ANALYSIS	26
3.	SUMMARY OF STRATEGIC OPTIONS AND CURRENT CONCLUSIONS	31
4.	STRATEGIC OPTIONS CONSIDERED	
4.1.	STATUS QUO	37
4.2.	ENHANCED STATUS QUO	42
4.3.	PURCHASE OF L.I. GENERATING ASSETS/ PROPOSED MSA AMENDMENT	46
4.4.	BARRETT PURCHASE OPTION	51
4.5.	MSA RENEWAL AND/OR RESTRUCTURING	56
5.	CURRENT CONCLUSIONS	71
6.	APPENDIX	
6.1.	LIPA'S DEBT SCHEDULE	73
6.2.	LONG ISLAND GENERATING ASSETS VALUATION ANALYSIS	74
6.2.1.	PSA Extension Valuation Analysis	76
6.2.2.	Merchant Basis Generation Valuation Analysis	83
6.2.3.	Barrett Valuation Analysis	100

1. Overview of the Strategic Review Process

OVERVIEW OF THE STRATEGIC REVIEW PROCESS

The Long Island Power Authority (the “Authority”) is a corporate municipal instrumentality and a political subdivision of the State of New York created by the Long Island Power Authority Act (the “LIPA Act”). The Authority, through its wholly-owned subsidiary, the Long Island Lighting Company (collectively with the Authority referred to as “LIPA”), provides retail electric services in Nassau and Suffolk Counties and the Rockaways, New York.

On June 25, 2009, the LIPA Board of Trustees voted to engage Lazard to update LIPA’s 2005 Strategic Organizational Review. In accordance with this engagement, LIPA has indicated that the goal of the updated strategic review process is to evaluate whether the current public/private partnership between LIPA and National Grid for the operation of the Transmission and Distribution (“T&D”) system is optimal, or whether practical changes can be identified to improve upon LIPA’s ability to:

- Further reduce or stabilize rates for customers on Long Island
- Further reduce LIPA’s debt
- Further enhance Long Island’s environmental profile
- Further enhance economic development on Long Island

Lazard held numerous meetings and discussions with LIPA’s management, advisors and consultants in considering the options, issues and conclusions discussed in this report. This report is an exposition of a presentation provided by Lazard to LIPA’s Board of Trustees on September 24, 2009, and except where expressly noted, any analysis contained herein is presented as of that date.

Lazard’s advice is being provided on an independent, consultative basis; accordingly, Lazard is being compensated at a fixed rate without fees tied to any course of action LIPA may choose. Lazard’s engagement with LIPA concluded as of December 31, 2009.

KEY QUESTIONS FACED BY LIPA AND LAZARD'S CURRENT CONCLUSIONS

Question 1

Q: Are there enhancements to the current public/private partnership structure to help LIPA improve upon its ability to meet its statutory goals of improved system reliability, reduced costs and economical supply of energy?

A: The current public/private partnership structure continues to largely meet its statutory goals, but it may be possible to address the issues and complexities of the status quo, as described more fully in this report.

The key reasons for this conclusion include: (1) the current public/private partnership for the ownership and operation of the T&D system is different than the approach used by the balance of U.S. utilities, either public or private, and creates complex decision-making processes; and (2) it is difficult for LIPA and/or National Grid to identify/offer enhancements to derive further benefits from integrated electric T&D system and National Grid's local gas distribution ("LDC") operations because of the issues associated with separation of ownership and operations of the T&D system.

It is important to note that no uniquely beneficial option has been identified which would immediately and substantially reduce rates on Long Island. Further, a review of the current public/private partnership structure is essential in order to improve upon LIPA's ability to further stabilize rates in the future. *For further observations see section 4.1.*

Question 2

Q: Should LIPA proceed with the significant energy efficiency investment required to meet its proportionate share of New York's 15x15 Goal^(a)?

(a) In January 2009, Governor Paterson announced a 45x15 Goal, in which 30% of New York's energy needs would be met through renewable energy by 2015, and electricity usage would be decreased by 15% by 2015. LIPA's current Energy Long Island program was developed prior to the 45x15 Goal announcement.

A: LIPA does not expect its current Efficiency Long Island (“ELI”) Program to meet the 15x15 Goal. Pursuit of the 15x15 Goal could therefore produce an improvement in the status quo and should be studied and implemented as merited, but only with ongoing cost/benefit analysis and with ongoing checks to ensure efficacy; these measures, if effective and targeted at peak demand reduction, could provide further alternatives to developing new fossil fuel generation.

The key reasons for this conclusion include: (1) energy efficiency programs could represent a cost-effective energy resource for LIPA, potentially reproducible on a large scale; (2) these programs could facilitate other policy goals, such as retirement of old and inefficient plants; and (3) there are substantial upfront costs, with few precedents for decreasing customer demand to the extent targeted by the 15x15 Goal. *For further observations see section 4.2.*

Question 3

Q: How should LIPA proceed with respect to National Grid’s offer to sell the Long Island Generating Assets^(a) to LIPA in exchange for certain consideration and, as requested by National Grid, a long-term extension and other material amendments to the Management Services Agreement (“MSA”)?^(b)

A: As there is no compelling economic rationale that has been identified, among other factors, LIPA should not proceed with the purchase of the Long Island Generating Assets, though it should consider what changes to the Power Supply Agreement (“PSA”) it might seek if National Grid seeks to sell these assets; renegotiation of the MSA should be handled separately.

(a) The Long Island Generating Assets, as defined by National Grid, consist of (1) the oil and gas-fired generating plants on Long Island formerly owned by LILCO and now owned by National Grid (“Genco”), (2) the Glenwood and Port Jefferson Generation Stations (the “Glenwood and Port Jefferson Generation”), (3) the Spagnoli Road Site and (4) various items including working capital and \$184 million for previously funded pension/OPEB liabilities that National Grid claims it is owed by LIPA.

(b) The specifics of National Grid’s offer are subject to a confidentiality agreement between National Grid and LIPA.

The key reasons for this conclusion include: (1) no compelling economic justification for the purchase has been identified; (2) while modest theoretical ratepayer benefits could be identified, there are also material unquantified risks and liabilities that could raise rates; and (3) there remains an unclear relationship of the value of the assets to the price proposed by National Grid, even before proposed changes to the MSA are considered. *For further observations see section 4.3.*

Question 4

Q: How should LIPA proceed with respect to the Barrett Purchase Option?

A: As there is no compelling economic rationale that has been identified, among other factors, the Barrett Purchase Option should be allowed to expire on September 30, 2009

The key reasons for this conclusion include: (1) no compelling economic rationale has been identified for exercising the Barrett Purchase Option; (2) the uncertainties surrounding when LIPA may require new generation capacity with estimates ranging from 2016 to 2023 depending on a variety of factors, including economic and population growth on Long Island and the potential impact of energy efficiency programs among others; and (3) the availability of other generation sites or resources to meet the needs of LIPA's customers, when needed. *For further observations see section 4.4.*

Question 5

Q: How should LIPA approach renewal/restructuring of the MSA?

A: LIPA should continue to evaluate all available options in respect of the MSA to ensure proper negotiating leverage and maximum transparency, including the ability to single-source or competitively procure T&D services, and should simultaneously study the comparative benefits and issues of privatization or municipalization, in whole or in part.

However, LIPA currently lacks the detailed information to properly evaluate the MSA as compared with other options it could pursue. Once the requisite detailed information is obtained and these options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

Because of the importance and complexity of this process, LIPA should not wait until 2013 to engage in this work and decide on a course of action. LIPA's evaluative process should be handled in a manner that is agnostic to outcome (other than in respect of ratepayer considerations), and in a way that does not create conflicts in respect of the evaluation of privatization or municipalization.

The key reasons for this conclusion include: (1) potential enhancement to negotiating leverage resulting from the flexibility to single-source (with National Grid or another third party) or competitively procure the MSA; (2) in the case of privatization, potential enhancements to the T&D system's operations and costs resulting from private sector ownership, potential benefits from fully integrating ownership and operation of the T&D system, removal of New York State involvement in Long Island's energy market, as well as a potentially significant reduction in LIPA's debt, albeit offset by higher capital costs; (3) in the case of full municipalization, potential benefits from fully integrating ownership and operation of the T&D system, while retaining the cost benefits (e.g., tax free financing, absence of income taxes or profit motive) of governmental ownership, albeit with challenging changes required to LIPA's organization in order for municipalization to be successful; (4) the absence of detailed information required for LIPA to properly evaluate any of these options; and (5) the inability of LIPA to determine, at this time, a course of action for the long-term structure of the T&D system without a market test of the ultimately identified options. *For further observations see section 4.5.*

2. LIPA Situation Assessment

2.1 LIPA's History and Role

SITUATION ASSESSMENT – LIPA’S HISTORY AND ROLE

LIPA’s Creation – Facts^(a)

On May 28, 1998, LIPA acquired by way of a merger (the “Merger”) the Long Island Lighting Company (“LILCO”) and became the supplier of retail electric service on Long Island and the Rockaways. As part of the Merger, LIPA retained only the following:

- The electric transmission and distribution systems (the “T&D system”)
- Certain agreements and contracts for power supply and transmission
- An 18% undivided ownership interest in Unit 2 of the Nine Mile Point (“NMP2”) nuclear generating station^(b)
- Certain other assets and liabilities, primarily regulatory assets and liabilities assumed from LILCO and relating to the Shoreham Nuclear Plant

The remainder of LILCO’s electric service assets (including all of its fossil-fueled generating units), and its entire gas supply system, were transferred to certain wholly-owned subsidiaries of KeySpan Corporation (“KeySpan”). At the time of the Merger, the Authority entered into a series of operating agreements with KeySpan for the provision of electric service on Long Island. These agreements (collectively, the “Operating Agreements”) include:

- The Management Services Agreement (the “MSA”)
- The Power Supply Agreement (the “PSA”)
- The Energy Management Agreement (the “EMA”)

(a) Source: LIPA.

(b) There are a variety of strategic issues which LIPA might consider that are beyond the scope of this report including, for example, the optimal strategic course for this ownership interest.

Each agreement was with a separate KeySpan subsidiary, including KeySpan Generation (“Genco”), the subsidiary to which LILCO transferred its fossil fuel generating facilities. The Operating Agreements provide LIPA with the operating personnel and a significant portion of the power supply resources necessary for LIPA to provide electric service to its customers.

In 2006, National Grid plc, a company organized under the laws of the United Kingdom, (“National Grid”), acquired KeySpan in a merger. KeySpan and its subsidiaries continue to exist as subsidiaries of National Grid^(a).

LIPA’s Creation – Selected Observations

LIPA represents a public/private partnership with few, if any, directly comparable peers. The creation of LIPA was largely successful in enhancing reliability and reducing base electric rates on Long Island, although fuel and purchased power costs have continued to fluctuate (as is the case for other electric utilities), and the structure employed has created ongoing complexities and inefficiencies, as discussed more fully in section 4.1.

The government’s involvement and role in the Long Island energy system was justified on the grounds that various constituencies believed that the Shoreham situation was critical and the government possessed, at that time, unique capabilities not shared by private-sector parties. The Merger resulted in the electric T&D system being operated by the same entity that owned and operated the gas LDC system on Long Island, creating an integrated energy system, which led to shared services resulting in operational synergies for both LIPA and KeySpan and a significant number of common assets, which are shared by LIPA and KeySpan (now National Grid) and used in the operation of both the electric T&D system and gas distribution system, to mutual advantage.

It is worth noting, however, that while the Merger divided ownership of LILCO, it did not fully separate its operations. The gas distribution system is owned and operated by KeySpan, the

(a) Lazard acted as financial advisor to KeySpan in connection with the National Grid merger, and in respect of various matters regarding KeySpan’s business arrangements with LIPA.

electric generation assets are owned and operated by KeySpan, and the electric T&D system is owned by LIPA, but operated by KeySpan.

Accordingly, the Operating Agreements are complex to administer, because the ownership and operations of the T&D system are separated. These complexities have increased following the National Grid/KeySpan transaction, because of National Grid's internal approval processes and non-local nature.

LIPA's Purpose and Role – Facts ^(a)

As provided in the LIPA Act, the Authority is responsible for providing safe, reliable, low cost and environmentally sound electricity for its customers. LIPA oversees the operation of the T&D system and manages the Operating Agreements with a staff of approximately 100 and with the support of outside financial, engineering, accounting and legal advisors and consultants. During the terms of the Operating Agreements, the National Grid workforce or its sub-contractors perform the day-to-day operations and maintenance of the T&D system.

LIPA's Purpose and Role – Selected Observations

LIPA's role is to manage the Operating Agreements for the T&D system and to act as a resource planner to ensure that an adequate, efficient and environmentally sound portfolio of generation resources is serving Long Island. As such:

- LIPA is not an entity currently organized to operate a T&D system
- LIPA is not an entity currently organized to own, manage or operate significant generation assets

The public/private partnership has been largely successful in meeting its original goals for the past 11 years:

- LIPA's ability to finance the entire system on a tax-exempt basis reduced customer base rates

(a) Source: LIPA.

- LIPA's ability to operate the system on a not-for-profit basis and not pay federal taxes enables base rates to be lower than if the system were owned by a private sector utility

LIPA's Governance/Management Structure – Facts^(a)

LIPA is governed by its Board of Trustees, whose 15 members are volunteers and are appointed in the following manner:

- 9 appointed by the Governor of New York State, including the Chair
- 3 appointed by the President Pro Tempore of the New York State Senate
- 3 appointed by the Speaker of the New York State Assembly

LIPA's management team consists of professionals primarily with utility operations, legal, environmental and financial experience. Approximately 100 LIPA employees oversee Operating Agreements covering approximately 2,150 National Grid employees (on a full-time equivalents basis): 1,400 through the MSA and 750 through the PSA.

New York State government approvals are required for a variety of LIPA decisions and actions in a manner that is different than for private sector utilities. LIPA decisions and actions may require approvals from the following New York State government bodies:

- The Public Authorities Control Board ("PACB")
- The Office of the Comptroller ("Comptroller")
- The Attorney General

Additionally, a diverse and active group of constituencies interact with and impact LIPA including State, Local and Federal government, environmental groups, labor, and other local interest groups.

(a) Source: LIPA.

LIPA's Governance/Management Structure – Selected Observations

The process for selecting, attracting and retaining members of LIPA's Board and management is different than processes typically conducted by private sector companies. LIPA is also subject to executive compensation and other workforce restrictions that are different than for private sector companies.

While all investor-owned utilities must manage challenging regulatory matters, LIPA's Board and management face a complex political and regulatory environment that is impacted by a diversity of factors and constituencies, and in which its actions are subject to public scrutiny by the following:

- Various branches of New York State government
- Various branches of the Federal government
- Local Long Island political leaders
- Myriad local interest groups

Finally, LIPA's management faces a complex approval and implementation process, with multiple levels of approvals required from various New York State agencies.

LIPA's Debt – Facts

LIPA was able to finance the Merger with 100% tax-exempt debt, as it is a governmental, not-for-profit entity. At the time of the Merger, a significant amount of the debt that LIPA assumed from LILCO and then refinanced with tax-exempt debt was related to the Shoreham project (the “Shoreham Debt”).

After a ten-year construction period beset by cost overruns and delays, LILCO operated the Shoreham reactor intermittently over a two-year period, before it was shut down in June 1989. The final Shoreham project cost, including decommissioning costs, was more than \$6 billion.

The Authority had originally intended for debt equal in amount to the Shoreham Debt to be retired by 2013 through a series of scheduled and optional debt repayments. However, the anticipated optional debt payments were foregone by LIPA in order to subsidize customer fuel and purchased power costs, a practice which LIPA has since ceased, as well as to finance LIPA's capital expenditure program.

Currently, LIPA has approximately \$6.8 billion of debt outstanding, and, further, approximately \$2.5 billion in long-term capital leases.

LIPA's Debt – Selected Observations

The use of tax-exempt debt to finance the Merger materially reduced rates for LIPA's customers. Also, the ongoing use of tax-exempt debt, and LIPA's almost 100% debt capital structure, continues to provide rate benefits.

No practical option has been identified that would relieve LIPA and its customers of their obligations to service its outstanding debt. For LIPA to retire debt more quickly than currently scheduled, temporary rate increases would be required (or LIPA's capital budget and/or discretionary

(a) Source: LIPA.

programs would need to be modified, subject to reliability and service quality goals), after which LIPA customers should enjoy reduced rates resulting from lower debt balances and associated costs.

The legislation U.S. Senator Charles Schumer has proposed to extend the Rural Electrification Act to include public utilities in urban and suburban regions, including LIPA (the “Schumer Legislation”), could provide ratepayer savings if effected. The proposed Schumer Legislation would provide LIPA access to lower-cost U.S. government-backed loans, carrying interest rates estimated at 2.0-3.0% (LIPA’s current average borrowing cost is 5.1%). LIPA has estimated that the Schumer Legislation could ultimately produce approximately \$150 to \$175 million in annual interest savings. The probability of successful consideration and passage of this proposed legislation is unknown.

MSA – Facts^(a)

The MSA provides for National Grid (the “Manager”) to perform, in accordance with selected policies and procedures, the day-to-day operation and maintenance of the T&D system, including, among other functions:

- Transmission and distribution facility operation
- Customer service, billing and collection
- Meter reading
- Financial and operations reporting, planning, engineering and construction

The T&D system administered by the MSA and the gas LDC system in Long Island (which is owned by National Grid) share a variety of common assets. LIPA controls the performance of the T&D system through specific standards for performance as well as incentives and penalties to the Manager, as detailed in the MSA. The pricing for the MSA has been set through negotiations between LIPA and the T&D system operator, with the current payment structure consisting of both a fixed-fee component and a sales volume-related component. The MSA is currently scheduled to expire by its terms on December 31, 2013.

MSA – Selected Observations

The public/private partnership administered through the MSA has provided customers with effective, reliable and safe service for the last 11 years. Since 2004, LIPA has been recognized as one of the most reliable electric utilities in New York State using a variety of metrics, including:

- Service restoration times
- Frequency of interruption
- Duration of outages

(a) Source: LIPA.

Additionally, integrated operation of the gas LDC system owned by National Grid and the T&D system owned by LIPA results in cost savings for both systems.

The MSA has resulted in a bifurcation of roles between LIPA and National Grid, and this division results in complexity and inefficiencies as neither party has full control or full information. Additionally, there are also different incentives for the owner of the system (LIPA) and the operator of the system (National Grid). Furthermore, the MSA has proved difficult to administer and different contract models have been tried with varying degrees of LIPA operational control, all with mixed results.

LIPA should seek to maximize its flexibility and negotiating position in preparation for the expiration of the MSA and, as noted herein, should consider other alternatives to the MSA.

PSA – Facts^(a)

The PSA provides for the sale to LIPA of all the capacity and, to the extent LIPA requests, energy from the Genco generating assets. These sales are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission (“FERC”), which are reset at five-year intervals.

The PSA provides LIPA with all of the capacity from the Genco generating assets. However, LIPA has no obligation to purchase energy from Genco and is able to purchase energy on a least-cost basis from all available on-Island sources, as well as off-Island sources, to the extent available through existing transmission interconnection limitations of the T&D system.

The PSA provides incentives and penalties for Genco to maintain the output capability of the Genco generating assets, as measured by annual industry-standard tests of operating capability, and to maintain and/or make capital improvements which benefit plant availability.

The PSA is currently scheduled to expire on May 28, 2013 and is renewable at LIPA’s sole option for 15 years on substantially similar terms. There is the possibility that Genco may be sold to a third party prior to the expiration of the PSA. Under the terms of the PSA, if Genco is sold to a third party, LIPA has the right to terminate the PSA. Additionally, LIPA possesses consent rights over the sale of any individual Genco generating asset subject to the PSA, and possesses a right of first refusal as to any individual Genco generating assets proposed to be sold to a foreign buyer.

(a) Source: LIPA.

PSA – Selected Observations

The PSA provides important protections for LIPA and ratepayers, including stability of capacity prices and for the supply of electricity. However, it does not provide protection against fluctuations in energy costs, which affect electricity costs.

Shortcomings of the PSA include:

- Many of the generating plants owned by National Grid are old and inefficient
- The PSA contains few incentives designed for LIPA's benefit:
 - There are limited performance incentives for the generating owner
 - There is no incentive for the generation owner to retire old and inefficient plants
 - The generation owner is incented, but not obligated, to invest capital in aging generation assets
- LIPA has limited control over the generation assets and no direct ability to force retirement of old plants that run infrequently

National Grid may sell its Long Island Generating Assets (which include the Genco assets); in that context, and given LIPA's role, LIPA should seek to address various shortcomings in the PSA, including those related to performance incentives and control over retirements.

Long Island Power Supply Profile and Resource Plan – Facts^(a)

Of the approximately 7,000 MWs of generation capacity available to LIPA, 57% is supplied by Genco through the PSA, with the remaining capacity provided by other on-Island and transmission line resources.

- 87% of LIPA’s capacity is fossil fuel fired: dual fuel (42%), gas (17%) and oil (28%)^(b)
- Nuclear (4%), renewables (7%) and refuse (2%) account for the remaining capacity^(b)

LIPA has developed a long-term electric resource plan as detailed in the “Draft Electric Resource Plan 2009-2018” released in March 2009. A central question raised by the Resource Plan is when new generation capacity will be required. Currently, LIPA anticipates that new capacity would be needed by 2016 under “status quo” assumptions. However, projections that assume the attainment of Governor Patterson’s goal to decrease electric usage 15% by 2015 through energy efficiency-related initiatives (the “15x15 Goal”), could defer the need for new capacity until 2023. Additionally, other factors, such as economic and demographic trends, could also affect the time when new capacity would be needed.

(a) Source: LIPA.

(b) Generation profile percentages from LIPA Draft Electric Resource Plan 2009-2018.

Long Island Power Supply Profile and Resource Plan – Selected Observations

LIPA has proven to be an effective sponsor of new generation and transmission capacity. Since 2001, LIPA has entered into contracts for over 1,700 MW of capacity, including, but not limited to, the Cross Sound Cable, the Neptune Cable and the Caithness Generating Station. However, in respect of future resource planning, no precedents exist for the effective implementation of large-scale, system-wide energy efficiency initiatives, and LIPA estimates that significant investment would be required to effect the efficiency gains embodied in the 15x15 Goal. Additionally, efficiency initiatives may have limited near-term impact on LIPA’s ability to retire old, inefficient plants.

LIPA should continue its ongoing resource planning work, considering all cost-effective and environmentally sound options for meeting the needs of its customers, including:

- Energy efficiency
- Renewables
- Participation in any uprates to the capacity of Nine Mile Point 2
- New, highly efficient, conventional generation
- Transmission

2.2 Financial Overview

LIPA FIVE-YEAR FINANCIAL PROJECTIONS – INCOME STATEMENT

LIPA expects relatively slow demand growth over the next five years, primarily as a result of the current and anticipated economic environment. Notably, energy efficiency measures could affect demand growth over time, which could benefit ratepayers, depending on the cost to implement these measures and their efficacy.

LIPA's rates are high because of the burden of its large debt balances, high energy commodity costs and local property taxes (among other factors), and volatile because of fluctuating energy commodity costs.

(\$ in millions)

	2009E	2010E	2011E	2012E	2013E	2014E	Average % of Revenue
Sales of Electricity (MWh)	19,525	19,756	19,821	19,900	19,925	19,951	
Revenues	\$3,489	\$3,702	\$3,953	\$3,907	\$3,930	\$3,990	100.0%
Expenses							
Fuel & Purchased Power Costs	\$1,746	\$1,848	\$2,026	\$1,937	\$1,880	\$1,901	49.4%
Operations & Maintenance	853	917	971	1,000	1,062	1,083	25.6%
General & Administrative	40	39	38	40	42	43	1.1%
T&D Depreciation	141	144	150	159	168	177	4.1%
Acquisition Adjustment Amortization	114	114	114	114	114	114	3.0%
PILOTS and Revenue Tax	248	261	275	286	298	311	7.3%
Total Operating Expenses	\$3,141	\$3,322	\$3,574	\$3,537	\$3,564	\$3,629	90.4%
Operating Income	\$348	\$380	\$378	\$370	\$366	\$361	
Other Income and Deductions	33	37	41	46	45	44	1.1%
Interest Expense	329	341	344	341	336	330	8.8%
Excess of Revenues Over Expenses	\$52	\$75	\$75	\$75	\$75	\$75	1.9%

Source: LIPA and LIPA Five-Year Financial Projections.

LIPA DEBT OVERVIEW ^(a)

LIPA's debt balances have remained relatively constant since its inception, although they are currently projected by LIPA to decline between now and 2013.

(\$ in millions)

	<u>T&D and Acquisition Bonds</u>	<u>Shoreham Settlement Bonds</u>	<u>Total</u>
Original 1998 Borrowing	\$6,586	\$146	\$6,732
2000 Additional Borrowing - Shoreham Settlement Bonds	--	325	325
New Money Issuances: 2000 - December 31, 2009	1,358	--	1,358
CP Issuances (Net) 1998 - December 31, 2009	200	--	200
CAB Accretion through December 31, 2009	--	278	278
Principal Payments: 1998 - December 31, 2009	(2,053)	(206)	(2,259)
Net Refundings for Debt Service Savings: 1998 - December 31, 2009	37	5	42
Net Variable Rate Debt Restructuring through December 31, 2009	25	--	25
Balance at December 31, 2009	\$6,154	\$548	\$6,701
Scheduled Principal Payments: December 31, 2009 - December 31, 2013	(758)	(159)	(917)
Planned CP Retirement	(100)	--	(100)
New Money Issuances: December 31, 2009 - December 31, 2013	515	--	515
CAB Accretion through December 31, 2013	--	118	118
December 31, 2013 Projected Debt Balance	\$5,810	\$506	\$6,317

Source: LIPA and LIPA Five-Year Financial Projections.

(a) Includes commercial paper issuances.

LIPA CREDIT AND CASH FLOW SUMMARY

LIPA's credit and cash flow profile reflects the significant Shoreham Debt balance and related annual debt service costs, which reduce LIPA's financial flexibility to pay down substantial amounts of debt and/or freely invest capital in the system. In 2010, for example, LIPA projects that it will invest less than half as much capital in the system (\$257 million) as it will spend on total debt service (\$538 million).

(\$ in millions)

	2010E	2011E	2012E	2013E	2014E	
CASH FLOW SUMMARY	Excess/(Deficiency) of Revenues Over Expenses	\$75	\$75	\$75	\$75	\$75
	Plus: Depreciation & Amortization	258	264	273	282	291
	Plus: Net Interest Expense	341	344	341	336	330
	Plus: Other ^(a)	(136)	44	63	96	26
	Operating Cash Available for Debt Service and Coverage	\$538	\$727	\$752	\$789	\$723
	Less: Capital Expenditures	(257)	(289)	(300)	(292)	(292)
	Less: Total Debt Service	(538)	(550)	(594)	(491)	(493)
	Net Cash Flow	(\$257)	(\$112)	(\$142)	\$7	(\$62)
	Proceeds of Bonds and Notes Issuances	200	175	140	0	55
	Change in Total Funds	(\$57)	\$63	(\$2)	\$7	(\$7)
RATE COVENANT TEST	Operating Cash Available for Debt Service and Coverage	\$538	\$727	\$752	\$789	\$723
	Less: Senior Lien Debt Service	(\$482)	(\$487)	(\$554)	(\$451)	(\$453)
	Less: Subordinate Debt Service	(48)	(55)	(32)	(32)	(32)
	Less: Subsidiary Unsecured Debt Service	(8)	(8)	(8)	(8)	(8)
	Total Debt Service	(\$538)	(\$550)	(\$594)	(\$491)	(\$493)
	Revenue Excess (Deficiency)	\$0	\$177	\$158	\$299	\$230
	Memo: Coverage Ratios ^(b)					
	Coverage on Senior Lien Debt	1.12x	1.49x	1.36x	1.75x	1.59x
	Coverage on Senior Lien and Subordinate Debt	1.02x	1.34x	1.28x	1.64x	1.49x
	Coverage on Total Debt Service	1.00x	1.32x	1.27x	1.61x	1.47x

Source: LIPA Five-Year Financial Projections.

(a) Includes Shoreham adjustments, deferred fuel cost reconciliation and 2006 recovery, NMP2 adjustments and other.

(b) While LIPA's financial documents provide that PILOT and capital lease payments are made after debt service, S&P treats those payments as an operating expense for purposes of calculating coverage ratios to reflect their annual occurrence.

SELECTED RECENT RATING AGENCY COMMENTARY

LIPA's A-/A3 credit rating reflects the stable cash flow profile of its T&D operations and LIPA's authority to set its own rates. However, credit rating agencies have expressed concern regarding LIPA's substantial fuel costs, the total amount of debt outstanding and high customer rates that restrict financial flexibility. In addition, credit rating agencies note that any diminution of LIPA's authority to set rates (e.g., because of PSC regulation) would limit LIPA's financial flexibility, potentially precipitating a downgrade of LIPA's credit ratings and thereby significantly increasing customer rates.

Selected Recent Rating Agency Commentary:

RATING AGENCY	RATING/ OUTLOOK	DATE OF REPORT	SELECTED COMMENTARY
Fitch	A-/Negative	08/22/2008	<p>LIPA's Rating Outlook remains Negative despite Governor Paterson's recent veto of the 'LIPA bill'... Fitch viewed the LIPA bill as a credit concern as it could affect LIPA's ability to continue to adequately recover total costs on a timely basis in the future. While LIPA's ability to recover its costs is essentially left unchanged with the veto of this bill, Fitch believes the political pressure for regulatory oversight of LIPA's rates continues to persist.</p> <p>LIPA's rating affirmation reflects the system's primarily transmission and distribution based business, reasonable power supply strategy, adequate financial performance, favorable customer base, and reliable electric service. A key credit strength, particularly over the past few years, has been LIPA's utilization of a fuel and purchased power cost adjustment.</p> <p>Credit concerns include LIPA's high electric rates, concentrated commodity exposure in more volatile fuels, and above-average leverage for the rating category. Additionally, energy sales growth is beginning to decline, due to the regional and national economic slowdown, which could put added pressure on rates in the future.</p>

RATING AGENCY	RATING/ OUTLOOK	DATE OF REPORT	SELECTED COMMENTARY
STANDARD & POOR'S	A-/Stable	01/21/2009	<p>In our opinion, the ratings reflect the following strengths: LIPA benefits from a stable revenue stream, due to its principal role as a provider of transmission and distribution (T&D) services to a broad and affluent customer base whose residential customers account for slightly more than half of operating revenues... There is no meaningful competition for the authority's T&D customers... LIPA has sound-but-volatile liquidity in the form of unrestricted cash and cash equivalents.</p> <p>The stable outlook reflects our assessment of LIPA's stable, suitable financial performance; its sound liquidity; a secure customer base; favorable customer demographics; the benefits of the transmission and distribution scope of operations; and the removal of legislative uncertainties surrounding the availability and timeliness of surcharges that allow LIPA to recover most changes in variable costs.</p> <p>We believe these concerns temper LIPA's credit strengths: Although LIPA has not increased its 9.6 cents per kilowatt-hour (KWH) base rate in a decade, its fuel and purchased power surcharge adds about 10 cents per KWH to rates following numerous adjustments. The combined base rate and power costs of about 20 cents per KWH is very high and could constrain financial flexibility... The authority's rates incorporate high fixed costs that are a product of debt service on nearly \$7 billion of debt, contractual commitments to make capacity payments to energy providers, and payments in lieu of taxes (PILOTs)... Its debt leverage is 97% of capitalization, and equals more than \$6,000 of debt per customer. This is extremely high in our opinion, particularly for a utility with little generation... Management projects only modest debt reduction during the next five years.</p> <p>We believe the National Grid contracts have both positive and negative credit quality attributes. National Grid cannot compete with LIPA for retail load, but its generation units have high production costs. Two recently energized underwater transmission cables provide access to the PJM Interconnection and New England independent system operator markets. While these cables reduce LIPA's exposure to National Grid's high production costs, the cost of reserving National Grid capacity does not abate when LIPA purchases power from others. Debt service costs of nearly 3 cents per KWH are very high, in our view. Other high fixed costs include capacity payments to National Grid and PILOTs. LIPA's average retail rate of nearly 20 cents per KWH is very high from a regional perspective, and limits financial flexibility.</p>

RATING AGENCY	RATING/ OUTLOOK	DATE OF REPORT	SELECTED COMMENTARY
 Moody's Corporation	A3/Stable	01/13/2009	<p>The affirmation of the A3 credit rating reflects the strength of the LIPA statute which we believe allows for full unregulated recovery of LIPA's costs, including the cost of the decommissioned nuclear plant (\$4 billion); strong and reliable performance of the transmission and distribution system; an affluent and stable customer base; a strong risk management program and a critical focus on resource adequacy.</p> <p>The A3 rating also factors in the pressure of commodity price volatility on rates and liquidity; weak security provisions; high debt leverage and substantial floating interest rate risk exposure...LIPA's politically appointed board is subject to political pressures, making rate increases difficult to implement if financial projections fail to materialize.</p> <p>LIPA's competitive position is pressured because LIPA's energy supply is derived largely from oil and gas fired generating units in which the fuel has been subject to global price pressures. LIPA's retail rates for residential customers have increased from 13.69 cents/KWH in 2001 to 20.59 cents/KWH in 2007...While electricity is an essential service, there are limited competitive alternatives and Long Island's more affluent population can better afford higher electricity prices.</p> <p>The pressure of rate increases is reflected in the continued attempt to regulate LIPA and the increased political risk LIPA faces from unhappy ratepayers. Most recently, legislation which would have required PSC oversight of LIPA's rates was subsequently vetoed by the Governor. LIPA has in the past successfully defended litigation brought against LIPA challenging LIPA's rates and rate-setting process.</p> <p>Moody's affirmed the stable outlook on LIPA bonds. The outlook reflects the satisfactory match of its liquidity to fuel and interest rate risks; LIPA's stable and affluent customer base; and a strong state statute that allows full cost recovery.</p> <p>The rating could be upgraded if the uncertainty regarding LIPA's rate-setting authority is resolved and it protects LIPA's ability to recover its costs on a timely basis to ensure debt service is paid according to schedule. Also important is LIPA making further progress towards fuel diversity and control of the fuel costs.</p> <p>The rating could be downgraded should current fuel and interest rate risk level increase or liquidity weakens further, or if LIPA's costs and its retail rates were to become regulated.</p>

COMPARATIVE CREDIT STATISTICS PROFILE

LIPA should theoretically be able to operate on a highly leveraged basis because of its authority to set its own rates, and because, as a governmental entity, its capital structure can be financed almost entirely with tax-exempt debt. Nevertheless, in comparison to the credit metrics of utilities of moderate credit quality (e.g., BBB), LIPA's credit profile demonstrates the burden of the Shoreham Debt. Further, LIPA's cash flow profile also reflects the significant Shoreham Debt, which reduces LIPA's financial flexibility to pay down substantial amounts of debt and/or freely invest capital in the system.

No option has been identified to relieve LIPA and its customers of their obligations to service the debt inherited from LILCO, or other debt outstanding, other than temporary rate increases, or a modification in LIPA's capital budget and/or discretionary programs (subject to reliability and service quality goals), after which LIPA customers should enjoy reduced rates resulting from lower debt balances and associated costs.

	LIPA	Selected Regional Investor Owned Utilities						
		S&P BBB Guidelines ^(a)		Consolidated Edison	National Grid	Northeast Utilities	NSTAR	Pepeco
		Worse	Better					
S&P Credit Rating / Outlook	A- / Stable			A- / Stable	A- / Stable	BBB / Stable	A+ / Stable	BBB / Stable
Debt / EBITDA	11.0x	5.0x	4.0x	4.0x	6.0x	4.9x	2.7x	5.5x
FFO / Total Debt	4.8% ^(b)	12.0%	20.0%	14.9%	9.9%	11.1%	25.1%	10.3%
FFO / Interest	2.0x ^(b)	2.0x	3.0x	3.5x	2.5x	3.2x	5.3x	2.7x
Total Debt / Capitalization	94.9%	60.0%	50.0%	49.4%	85.3%	60.6%	57.7%	59.1%

Source: LIPA Five-Year Financial Projections; Company filings and Wall Street research.

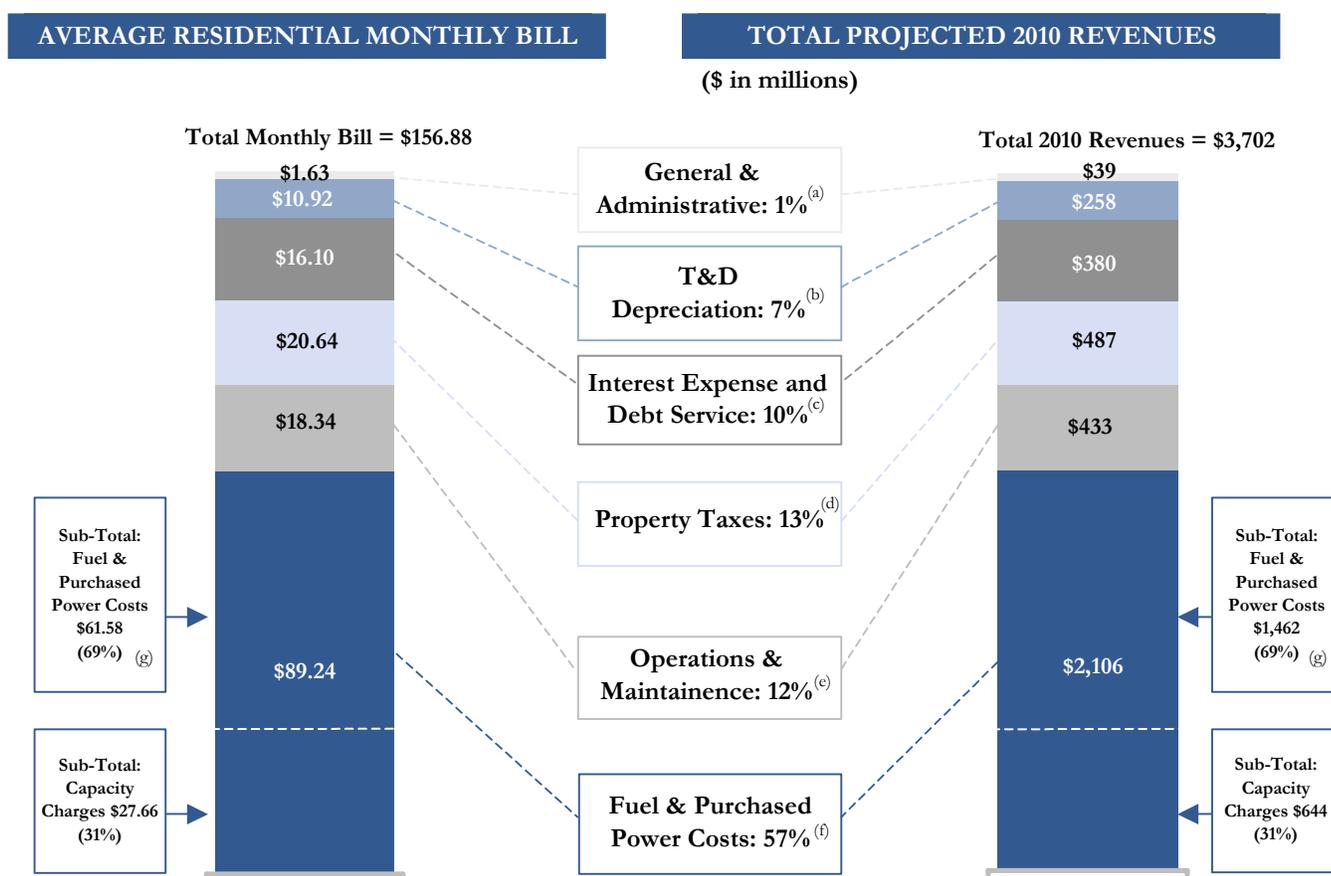
Note: Metrics on a projected 2009 basis; capital leases not included in total debt figure.

- (a) Credit metric ranges implied for a company with a business risk profile of "Excellent" and a financial risk profile of "Aggressive", for which the expected credit rating under S&P methodology would be BBB. FFO/Interest range is not provided by S&P and estimated per Lazard analysis.
- (b) LIPA FFO calculated as cash flow from operations before working capital and other charges.

2.3 Rate Analysis

LIPA RATE STACK ANALYSIS – 2010 CUSTOMER MONTHLY BILL AND TOTAL REVENUES

A few items account for the bulk of the cost of Long Island electric service. For example, the actual operation and investment in the electric system is expected to account for only 20% of the expected average customer bill in 2010, while fuel and purchased power, property taxes and interest on LIPA’s debt is expected to account for 80% of the average customer bill.



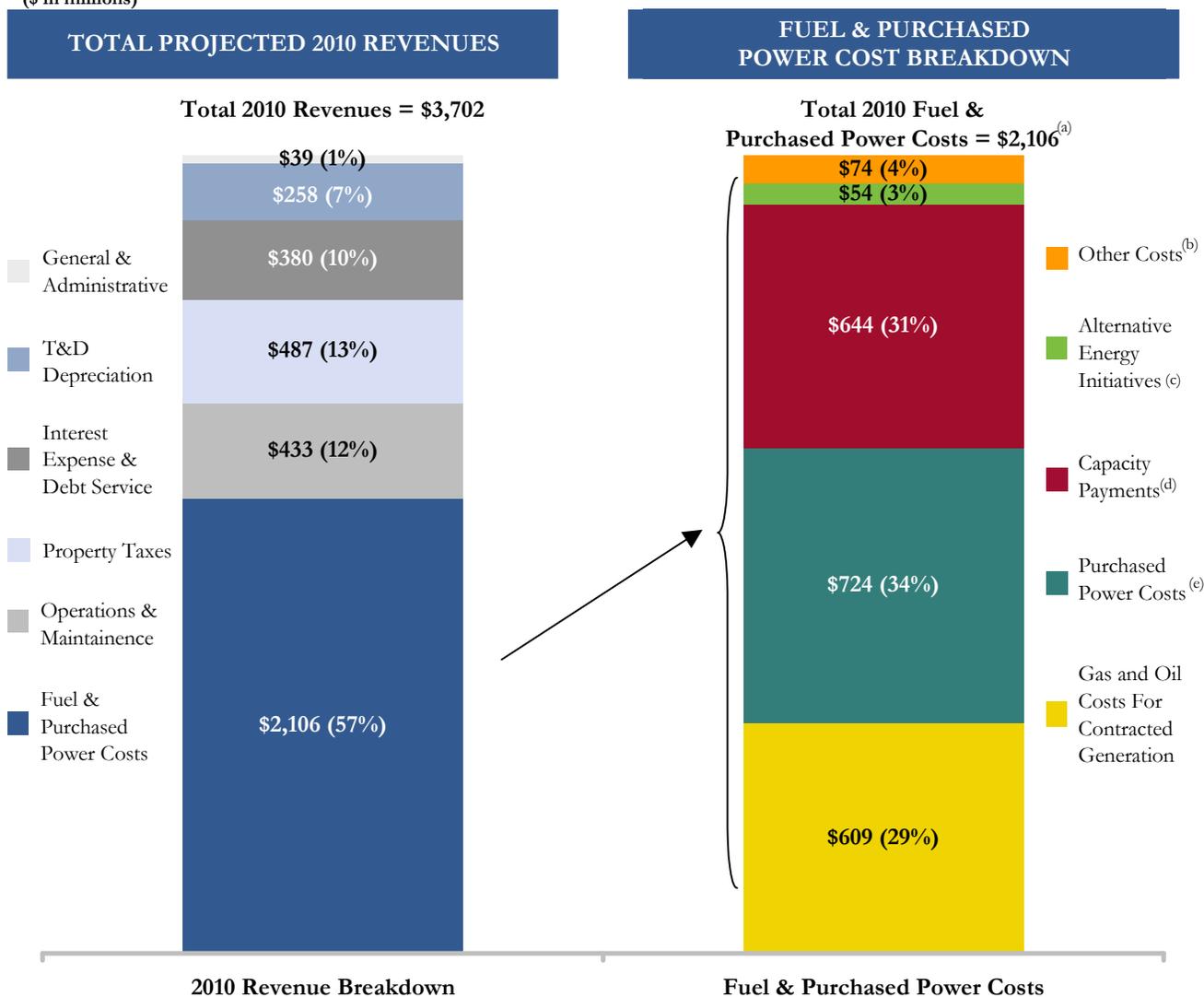
Source: LIPA 2010 Approved Budget.

- (a) Includes LIPA salaries of \$17 million or \$0.71 per average monthly bill in 2010.
- (b) Includes depreciation on NMP2 and amortization of acquisition adjustment.
- (c) Includes interest expense, other income and excess of revenues over expenses.
- (d) Includes T&D property taxes, revenue PILOTs, NYS assessment and PSA property taxes.
- (e) Excludes PSA property taxes and NYS assessment.
- (f) Includes implied PSA capacity charges of approximately \$258 million.
- (g) Includes alternative energy initiatives and other costs, net of amortization and deferrals.

BREAKDOWN OF FUEL AND PURCHASED POWER COSTS

More than half of LIPA's projected 2010 revenues is expected to be associated with recovery of fuel and purchased power costs from a variety of sources.

(\$ in millions)



Source: LIPA 2010 Approved Budget.

- (a) Excludes amortization of 2003 deferral, deferred 2009 fuel recovery (refund) and deferral settlement benefits.
- (b) Includes NYISO charges, ISO-NE charges, PJM charges, PSM/EMA costs and other wheeling charges.
- (c) Includes 50 MW solar initiative, RGGI (carbon) costs, hydro power purchases and refuse-derived fuel.
- (d) Includes implied PSA capacity charges of approximately \$258 million. Excludes NMP2 charges which are categorized as O&M expense.
- (e) Includes nuclear fuel expenses associated with NMP2 and hedging program expenses.

CHALLENGES TO DECREASING LIPA'S RATES

There are no easy solutions for reducing the major components of LIPA's rates, and no uniquely beneficial option has been identified which would immediately and substantially reduce rates on Long Island.

LIPA's Debt – Facts ^(a)

LIPA's total debt is \$6.8 billion, and it has a further \$2.5 billion in capital leases. These amounts represent a significant burden on LIPA's cash flows, with LIPA expecting to spend \$538 million on total debt service costs in 2010.

LIPA's Debt – Observations

The use of tax-exempt debt to refinance LILCO's debts reduced rates for LIPA's customers at the time of the Merger.

No option has been identified that would relieve LIPA and its customers of their obligations to service the debt inherited from LILCO, or other debt outstanding, other than to accelerate prepayment via temporary rate increases, or a modification in LIPA's capital budget and/or discretionary programs (subject to reliability and service quality goals), after which LIPA customers should enjoy reduced rates resulting from lower debt balances and associated costs.

PSA Property Taxes, PILOTs and Revenue Taxes – Facts ^(a)

LIPA's property taxes, PILOTs and revenue taxes total \$487 million annually. LIPA has previously decided not to pursue its contractual rights through the PSA to challenge the amount of current property tax assessments related to the Genco plants. Property taxes on the Genco plants, which have a FERC regulated book value of \$514 million, are \$181 million annually.

(a) Source: LIPA.

PSA Property Taxes, PILOTs and Revenue Taxes – Observations

LIPA is currently reviewing whether or not to pursue these contractual rights to reduce property tax assessments; the estimated potential savings are believed to be significant.

If LIPA were successful in challenging its property taxes, local municipalities would be forced to either balance their budgets on a reduced revenue base, or increase property taxes for other local real estate.

O&M Expenses – Facts ^(a)

In 2010 O&M expenses are expected to account for only 12% (\$433 million) of LIPA's revenues. Additionally, 62% (\$267 million) of LIPA's expected 2010 O&M expenses are MSA-related.

O&M Expenses – Observations

It is unclear how much could be saved by running the T&D system differently; this absence of clarity is exacerbated by:

- The separation of ownership and operations
- The absence of transparency from National Grid regarding the underlying costs of supplying T&D services under the MSA

Given the relatively small contribution of O&M costs to overall rates (12%), however, it may not be possible to produce more than incremental enhancements. Also, it is critical to take into account any potential effect on service levels from reduced O&M spending.

(a) Source: LIPA.

Fuel and Purchased Power Costs – Facts ^(a)

Fuel and purchased power costs^(b) represent the most significant component of LIPA's rates. For 2010 these costs are estimated to be \$2.0 billion, or 57% of LIPA's total revenues. Of this amount, fuel and purchased power costs represent \$1.5 billion with capacity charges representing \$644 million.

LIPA's generation fleet is principally fueled by natural gas and oil (87% of capacity), commodities whose prices are volatile.

Fuel and Purchased Power Costs – Observations

LIPA, like all utilities, is affected by volatility in global commodity prices, particularly natural gas and oil, whose prices are difficult to predict. Additionally, National Grid's Long Island Generating Assets are old and inefficient, thereby increasing the amount of fuel LIPA consumes to service customers, though these plants supply a relatively small portion of LIPA's overall energy requirements.

Resource planning options may be initially expensive, whether they include construction of new generating plants, repowering, renewables or transmission, though these options may provide important benefits over the long-term. Additional consideration must be given to any large-scale energy efficiency investment plan, as these are relatively unprecedented and unproven, though they offer attractive potential benefits.

(a) Source: LIPA.

(b) Fuel and purchased power costs consist primarily of gas and oil costs for contracted generation, purchased power costs, capacity payments and alternative energy initiatives.

3. Summary of Strategic Options and Current Conclusions

STRATEGIC OPTIONS AND CONSIDERATIONS

In 2005, LIPA considered various strategic questions affecting its business and relationship with others.

2005 Strategic Review – Facts^(a)

In the context of discussions regarding whether LIPA should exercise rights it held with respect to Genco, during 2004-2005 LIPA, with the assistance of FTI Consulting and other advisors, undertook a study to consider whether LIPA should either acquire generation or pursue an alternative strategy.

The “2005 Organizational Study” examined the alternatives of LIPA (i) acquiring its own generation, (ii) selling to the private sector the electric T&D system (privatization), (iii) continuing the existing public/private model, or (iv) full municipalization.

For the reasons set forth in detail in the 2005 Organizational Study, LIPA elected to continue with its current model (rather than examining privatization), albeit with significant modifications to the MSA agreement.

In respect of LIPA acquiring its own generation assets, the 2005 Organizational Study found, among other conclusions, that other generation resources (either increased import capability via transmission cables or new on-Island generation resources) were available to supply future capacity needs, and it was unlikely that any subsequent sale of the Genco plants by LIPA would create a competitive generation market on Long Island. The option held by LIPA to acquire Genco at fair market value was allowed to subsequently expire, and LIPA later obtained options to purchase certain Genco assets at their net book value.

(a) Source: LIPA and FTI Consulting.

2005 Strategic Review – Selected Observations

A principal conclusion of the 2005 Organizational Study was that, regardless of the structural model ultimately chosen for LIPA, customer rates on Long Island would remain high until LIPA's debt was substantially retired.

The 2005 Organizational Study also concluded that competitive bidding for a new MSA posed risks as compared with a re-negotiation with KeySpan, including:

- That costs under a re-bid contract could be greater (e.g., common facilities would have to be leased at market-based rates)
- The winning bidder would have to negotiate acquisition of the workforce
- The potential that no single entity could replace KeySpan to assume all of the services provided under the current MSA
- That KeySpan possessed “intellectual property” created over the life of the MSA contract that would be difficult for a third-party to replicate
- The complexity of unbundling an integrated energy system on Long Island

The 2005 Organizational Study did not address a number of complex issues that would be required for LIPA to determine the best possible long-term structure for the T&D system on Long Island, as are more fully discussed in section 4.5 of this report.

2009 Negotiations and Agreements – Facts ^(a)

During March 2009, LIPA and National Grid senior executives held a series of discussions concerning certain strategic objectives of the two organizations, and in particular regarding the approaching March 31, 2009 expiration date of the Barrett Purchase Option. These discussions led to an agreement that National Grid would grant LIPA a further extension, until June 30, 2009, of the Barrett Purchase Option exercise deadline. Additionally, based on National Grid's indication that it was considering selling the Long Island Generating Assets, LIPA expressed an interest in exploring an acquisition of these generation assets.

The parties therefore agreed that LIPA would conduct a preliminary study of whether it should seek to acquire these generating assets, to be completed by June 30, 2009. National Grid subsequently offered to sell the Long Island Generating Assets to LIPA in exchange for certain consideration and, as requested by National Grid, a long-term extension and other material amendments to the MSA.

For the reasons described elsewhere in the report, LIPA did not choose to pursue a purchase of the Long Island Generating Assets or, as had been requested by National Grid, a long-term extension and other material amendments to the MSA. National Grid may now initiate a process to sell these assets to a third-party.

^(a) Source: LIPA.

2009 Negotiations and Agreements – Selected Observations

As a result of the negotiations and National Grid's demands, LIPA was faced with a number of near-term questions:

- Are there enhancements to the current public/private partnership structure which would help LIPA improve upon its ability to meet its statutory goals?
- Should LIPA proceed with the significant energy efficiency investment required to meet the goals of New York's 15x15 Goal?
- How should LIPA proceed with respect to National Grid's offer to sell the Long Island Generating Assets to LIPA in exchange for certain consideration and, as requested by National Grid, a long-term extension and other material amendments to the MSA?
- Should LIPA exercise the Barrett Purchase Option?
- How should LIPA approach renewal/restructuring of the MSA?

KEY QUESTIONS FACED BY LIPA AND CURRENT CONCLUSIONS

Question 1

Q: Are there enhancements to the current public/private partnership structure to help LIPA improve upon its ability to meet its statutory goals of improved system reliability, reduced costs and economical energy supply?

A: The current public/private partnership structure continues to largely meet its statutory goals, but it may be possible to address the issues and complexities of the status quo, as described more fully in this report.

Question 2

Q: Should LIPA proceed with the significant energy efficiency investment required to meet its proportionate share of New York's 15x15 Goal?

A: LIPA does not expect its current ELI Program to meet the 15x15 Goal. Pursuit of the 15x15 Goal could therefore produce an improvement in the status quo and should be studied and implemented as merited, but only with ongoing cost/benefit analysis and with ongoing checks to ensure efficacy; these measures, if effective and targeted at peak demand reduction, could provide an alternative to developing new fossil fuel generation.

Question 3

Q: How should LIPA proceed with respect to National Grid's offer to sell the Long Island Generating Assets to LIPA in exchange for certain consideration and, as requested by National Grid, a long-term extension and other material amendments to the MSA?

A: As there is no compelling economic rationale that has been identified, among other factors, LIPA should not proceed with the purchase of the Long Island Generating Assets,

though it should consider what changes to the PSA it might seek if National Grid seeks to sell these assets; renegotiation of the MSA should be handled separately.

Question 4

Q: How should LIPA proceed with respect to the Barrett Purchase Option?

A: As there is no compelling economic rationale that has been identified, among other factors, the Barrett Purchase Option should be allowed to expire on September 30, 2009.

Question 5

Q: How should LIPA approach renewal/restructuring of the MSA?

A: LIPA should continue to evaluate all available options in respect of the MSA to ensure proper negotiating leverage and maximum transparency, including the ability to single-source or competitively procure T&D services, and should simultaneously study the comparative benefits and issues of privatization or municipalization, in whole or in part.

However, LIPA currently lacks the detailed information to properly evaluate the MSA as compared with other options it could pursue. Once the requisite detailed information is obtained and these options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

Because of the importance and complexity of this process, LIPA should not wait until 2013 to engage in this work and decide on a course of action. LIPA's evaluative process should be handled in a manner that is agnostic to outcome (other than in respect of ratepayer considerations), and in a way that does not create conflicts in respect of the evaluation of privatization or municipalization.

4. Strategic Options Considered

4.1 Status Quo

SUMMARY OF THE STATUS QUO OPTION

Question 1

Q: Are there enhancements to the current public/private partnership structure to help LIPA improve upon its ability to meet its statutory goals of improved system reliability, reduced costs and economical energy supply?

A: The current public/private partnership structure continues to largely meet its statutory goals, but it may be possible to address the issues and complexities of the status quo.

Status Quo Option – Key Elements

The current structural landscape of the Long Island energy markets reflects the integrated operation of the electric and gas systems on Long Island by National Grid, providing cost benefits to both National Grid and LIPA, LIPA ownership of the T&D system and private ownership of generation. LIPA, like all T&D utilities in New York, procures energy and capacity from third parties.

The status quo, however, is marked by a variety of complexities and inefficiencies resulting from the separate ownership and operation of the T&D system. There are at least two key issues in this regard. First, the current public/private partnership for the ownership and operation of the T&D system is different than the approach used by the balance of U.S. utilities, public or private, and creates a complex decision-making process. Second, it is difficult for LIPA and/or National Grid to identify/offer enhancements to derive further benefits from integrated T&D system and LDC operations because of the issues associated with the separation of ownership and operation of the T&D system.

The status quo would reflect a continuation of the current public/private partnership model, wherein LIPA's role would continue to be that of a contract manager and resource planner.

Status Quo Option – Key Decisions Facing LIPA

LIPA should determine whether there are enhancements to its current structure that should be pursued to improve upon LIPA's ability to:

- Further reduce or stabilize rates for customers on Long Island
- Further reduce LIPA's debt
- Further enhance Long Island's environmental profile
- Further enhance economic development on Long Island

Status Quo Option – Current Conclusions

The current public/private partnership structure continues to largely meet its statutory goals to the benefit of ratepayers, with the factors most impacting LIPA's rates (e.g., Shoreham Debt, fuel and purchased power costs, property taxes) not necessarily directly related to LIPA's current structure. No uniquely beneficial option has been identified which would immediately and substantially reduce rates on Long Island.

There is a clear urgency, however, for LIPA to make a decision with respect to the long-term structure of the electric T&D system, given the identified complexities and inefficiencies of the current public/private partnership and the approaching expirations of the PSA and MSA in 2013.

Lazard studied various options related to the PSA and MSA, including, in the case of the MSA, single-sourcing or competitively procuring a revised contract, privatization and full municipalization. LIPA currently lacks the detailed information to properly evaluate the MSA as compared with other options it could pursue. Once the requisite detailed information is obtained and the options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

As is more fully detailed in section 4.5, elements of the needed decision-making tools and information include:

- Whether and how the T&D system's operations could be enhanced with integrated operations and ownership, in either private or municipal ownership scenarios
- What operational and financial resources and expertise would be required to separate operation of the electric T&D system from the gas LDC system on Long Island
- A full accounting of the overhead and shared services costs allocated to the electric T&D system by National Grid in the MSA contract
- Estimates of the costs of separating these systems and relevant shared assets
- Whether there are improvements to the MSA that are attractive to ratepayers, including adjusted terms or a new operator
- How the costs of running a separated electric T&D system, either fully municipalized or privatized, would compare to a continuation of the current public/private partnership structure
- What potential enhancements to the T&D system's operations and costs could result from private sector ownership
- What changes would be necessary to LIPA's organization and governance as part of any municipalization

Given the limitations of the status quo and the possibility of improving upon it, Lazard recommends that LIPA implement a process to obtain the requisite detailed information to evaluate alternatives to the status quo, and, thereafter, test the market to determine which alternatives would best serve ratepayers. Because of the importance and complexity of this process, LIPA should not wait until 2013 to engage in this work and decide on a course of action.

POTENTIAL BENEFITS AND CONSIDERATIONS OF THE STATUS QUO OPTION

Status Quo Option – Potential Benefits

- The current structure provides safe, reliable electricity to customers on Long Island
- LIPA continues to largely meet the original goals of the Merger
- LIPA is organizationally suited to its current key responsibilities of contract management and resource planning
- National Grid and LIPA continue to benefit from cost savings associated with integrated gas and electric operations
- Significant changes of the status quo to an alternative system would inevitably produce “breakage” costs
- National Grid is an experienced T&D operator with a high-quality workforce and financial strength
- The T&D system’s resource needs are well met, as there is adequate generating capacity on Long Island; as estimated by LIPA, no new generation may be needed until 2016 to 2023, depending on the investment in, and effectiveness of, LIPA’s energy efficiency programs and other factors. Much of the generation capacity serving the system, however, is old and inefficient
- The PSA provides important protections and certainty regarding LIPA’s capacity needs, accounting for almost 60% of LIPA’s capacity. LIPA is able to maintain these protections through 2028, irrespective of who owns the generation fleet
- The integrated and “turnkey” nature of the MSA reduces contract liability exposure as compared with the potential administration of contracts with multiple counterparties for operation of the T&D system

Status Quo Option – Considerations

- The status quo reflects informational and control limitations resulting from the separation of ownership and operation of the T&D system
- There is a complex decision-making process for LIPA because of myriad approvals required for most substantive activities
- The complexities of the status quo increased following the National Grid/KeySpan transaction because of National Grid’s internal approval processes and non-local nature
- It is difficult for either LIPA or National Grid to identify/offer enhancements to drive further benefits from integrated gas and electric operations
- LIPA’s relatively high fuel and purchased power costs reflect a variety of issues, including regional premiums for fuel and purchased power, exacerbated by difficulties of physical delivery to Long Island
- The need for significant “standby” capacity to serve LIPA’s peak demand levels
- It is difficult for LIPA to effect retirement of older, inefficient plants on a cost effective basis
- LIPA’s difficulty in siting new generation or transmission on a cost effective basis to decrease rates and enhance the environmental profile of the system, reflecting historically high building costs on Long Island, among other factors
- The burden of LIPA’s debt on rates, which should be reduced over time as the Shoreham Debt is amortized
- The burden of property taxes on rates (representing 41% of PSA expenses, for example); LIPA estimates that the potential savings from challenging property tax assessments could range from \$100 million to \$200 million annually

4.2 Enhanced Status Quo

SUMMARY OF THE ENHANCED STATUS QUO OPTION

Question 2

Q: Should LIPA proceed with the significant energy efficiency investment required to meet its proportionate share of New York's 15x15 Goal?

A: LIPA does not expect its current ELI Program to meet the 15x15 Goal. Pursuit of the 15x15 Goal could therefore produce an improvement in the status quo and should be studied and implemented as merited, but only with ongoing cost/benefit analysis and with ongoing checks to ensure efficacy; these measures, if effective and targeted at peak demand reduction, could provide further alternatives to developing new fossil fuel generation.

Enhanced Status Quo Option – Key Elements

The Enhanced Status Quo option assumes significantly enhanced energy efficiency initiatives in pursuit of Governor Patterson's goal of decreasing electricity usage by 15% by 2015 (the "15x15 Goal"). The key elements of such initiatives would likely include:

- Deployment of smart meters
- Enhancements to various building and appliance standards and codes
- Programs tailored to specific customer load sources: new and existing residential, new and existing commercial and low-income housing

The goal of these initiatives would be to generate a 15% reduction in LIPA's load as compared with its status quo projections, and thereby generate the following benefits, among others:

- Benefits to customers in the form of lower total bills
- Environmental benefits from reduced electric generating production
- Benefits accruing from potential retirement of old and inefficient units
- Avoided construction of new fossil fuel generation on Long Island as a result of reductions in peak demand

Enhanced Status Quo Option – Key Decision

- Whether LIPA should proceed with the upfront investment required to implement a long-term, comprehensive program in pursuit of attaining the 15x15 Goal
- What the appropriate pace of investment for LIPA is, and whether these initiatives can be pursued in the near-term on a cost-effective basis for ratepayers

Enhanced Status Quo Option – Current Conclusions

- LIPA should study and implement efficiency and renewables initiatives as merited, but only with ongoing cost/benefit analysis and with ongoing checks to ensure efficacy
- LIPA should further cooperation with other load serving entities in New York to catalyze changes to standards and codes
- LIPA should ensure, until the efficacy of energy efficiency programs is clear, and given their limited precedent on a large scale, that adequate generation is available so as to prevent the occurrence of energy shortages on Long Island

POTENTIAL BENEFITS AND CONSIDERATIONS OF THE ENHANCED STATUS QUO OPTION

Enhanced Status Quo Option – Potential Benefits

- Energy efficiency programs could represent a cost effective energy resource potentially reproducible on a large scale
- Energy efficiency programs reduce ongoing fuel costs
- Lower energy costs resulting from reduced demand
- Reduction in carbon emission and other emission allowance costs
- Anticipated reductions in peak demand, if realized, could reduce capacity requirements and potentially facilitate retirement of old and inefficient plants
- The environmental benefits of reduced electric generation production
- The ability of LIPA to implement energy efficiency initiatives on an incremental basis, in contrast to other resource options (e.g., construction of new generation plants)
- Energy efficiency measures could provide a potential alternative to construction of new generation, when needed
- The broad constituency benefits of pursuit of energy efficiency measures, in contrast to the complexities of other resource options
- The benefits of energy efficiency measures last beyond the 20-year projection range used by LIPA

Enhanced Status Quo Option – Considerations

- There are substantial and immediate upfront costs to pursue 15x15 Goal, as estimated by LIPA
- Few precedents exist surrounding decreasing customer load to the extent targeted by the 15x15 Goal
- The NY ISO may discount the impact of energy efficiency measures on customer load for purposes of reliability requirements, meaning that reductions in required capacity may trail actual program effectiveness
- Enhancements to standards and codes represent a key means to attain the 15x15 Goal and requires coordination among State and local government
- The external costs of these measures are not included in current cost estimates for the 15x15 Goal
- Energy efficiency initiatives should decrease total customer bills but increase rates on a \$/kW basis, complicating the perceived appeal of these initiatives

4.3 Purchase of L.I. Generating Assets/Proposed MSA Amendment

SUMMARY OF PURCHASE OF L.I. GENERATING ASSETS/MSA AMENDMENT OPTION

Question 3

Q: How should LIPA proceed with respect to National Grid's offer to sell the Long Island Generating Assets to LIPA in exchange for certain consideration and, as requested by National Grid, a long-term extension and other material amendments to the MSA?

A: As there is no compelling economic rationale that has been identified, among other factors, LIPA should not proceed with the purchase of the Long Island Generating Assets, though it should consider what changes to the PSA it might seek if National Grid seeks to sell these assets; renegotiation of the MSA should be handled separately.

Purchase of L.I. Generating Assets/MSA Amendment Option – Key Elements

National Grid offered LIPA the opportunity to purchase the Long Island Generating Assets in exchange for certain consideration. In addition to the purchase price, and as a condition of purchasing the generation assets, National Grid requested a long-term extension and other material amendments to the MSA.

The purchase price for the Long Island Generating Assets would be financed with newly-issued LIPA debt. Upon purchasing the Long Island Generating Assets, LIPA would enter into an operating agreement with National Grid or another third party.

National Grid proposed the following timeline in respect of its proposal:

- September 30, 2009: Execute a Long Island Generating Assets/MSA Amendment MOU
- December 31, 2009: Execute a Long Island Generating Assets Purchase Agreement/MSA amendment and extension

Purchase of L.I. Generating Assets/MSA Amendment Option – Key Decisions Facing LIPA

In considering the purchase of the Long Island Generating Assets/MSA Amendment option, it is necessary to determine the following:

- Whether to proceed in negotiations with National Grid with the intent of (a) negotiating a purchase agreement for the generation assets and (b) a long-term extension and other material amendments to the MSA, each by December 31, 2009
- Should LIPA enter the generation business at this scale, in one step?
- What are the ratepayer benefits that would motivate a transformative decision such as this?

Purchase of L.I. Generating Assets/MSA Amendment Option – Conclusions

- LIPA should not purchase the Long Island Generating Assets as there is no compelling economic rationale that has been identified for doing so, among other factors
- As National Grid may sell the Long Island Generating Assets to a third party, or third parties, LIPA should consider what modifications to the PSA it might seek in the context of such a transaction
- LIPA should address the MSA separately from any consideration of the Long Island Generating Assets

POTENTIAL BENEFITS AND CONSIDERATIONS OF THE PURCHASE OF L.I. GENERATING ASSETS/MSA AMENDMENT OPTION

Purchase of L.I. Generating Assets/MSA Amendment Option – Potential Benefits

- The cost of capital advantage resulting from LIPA ownership could create ratepayer savings, depending on the purchase price
- Owning the generation assets would provide LIPA with full control over the generation assets, including retirements and repowerings and new development sites
- If LIPA gains full control over the generation assets, potential environmental benefits resulting from accelerated plant retirements could be realized
- The potential for enhanced efficiency and quality of operations resulting from control and clarity over O&M expenses and capital investment
- Owning the generation assets would avoid risks that could be associated with a third party purchasing the generation assets from National Grid
- The theoretical potential to “flip” assets and re-sell to third parties at higher prices and with purchased power agreements more attractive to LIPA than the current PSA

Purchase of L.I. Generating Assets/MSA Amendment Option – Considerations

- The existing PSA provides important protections for ratepayers preventing, among other things, an increase in capacity costs if the assets were sold by National Grid to a third party
- Valuation of the assets indicates that National Grid’s proposed price is too high, even before accounting for the cost of National Grid’s requested long-term extension and other material amendments to the MSA, as well as other critical risks and issues as identified herein
- The desirability of expanding New York State government’s role in New York energy markets
- LIPA does not currently possess the organizational structure, senior management and infrastructure required to own and operate the assets
- LIPA would become responsible for paying the retirement, decommissioning and environmental remediation costs of a large and aged fleet^(a)
- The opportunity cost of LIPA capital that could be used for other purposes (e.g., T&D system investment, energy efficiency, renewables, participation in an uprate of Nine Mile Point 2, etc.)
- The risk of credit rating agency downgrades related to the issuance of significant new debt and change in business model to include generating assets
 - Lower credit rating would significantly increase LIPA’s cost of capital, resulting in higher customer costs
- The increased cost of capital for LIPA resulting from a change in business mix
- Procurement rules complicate the prospect of LIPA-owned generation
- Other increased costs that could result from LIPA-owned generation (e.g., operating contracts, increase in LIPA staffing, etc.)
- Workforce issues could require an operating contract rather than direct operation by LIPA, presumably with attendant complexity

(a) Currently, under the PSA, if National Grid or any successor were to elect to retire a plant subject to the PSA, National Grid, and not LIPA, would be responsible for paying these costs unless any retirement was due to a “major failure” as agreed to by both parties.

- The “Qualified Management Contract” rules applicable to tax-exempt bond financed property may result in a complex, suboptimal operating arrangement
- The support of State, local and other constituencies is unclear
- A “Flip” strategy has a highly uncertain outcome, has the potential to destroy value, is outside LIPA’s business model and could ultimately increase costs to ratepayers

4.4 Barrett Purchase Option

SUMMARY OF THE BARRETT PURCHASE OPTION

Question 4

Q: How should LIPA proceed with respect to the Barrett Purchase Option?

A: As there is no compelling economic rationale that has been identified, among other factors, the Barrett Purchase Option should be allowed to expire on September 30, 2009.

Barrett Purchase Option – Key Elements

LIPA has the option to purchase the E.F. Barrett Generation Station (“Barrett”) for its accounting net book value, which was last estimated at \$93.1 million as of March 31, 2009. The option was exercisable until September 30, 2009, but could be extended to December 31, 2009. In order to extend the option to December 31, 2009, LIPA must in return extend the PSA by one additional year (the PSA would then expire in 2014).

As contemplated, after exercising the option LIPA would:

- Need to obtain regulatory approval for the proposed arrangements before the closing could become effective (e.g., PACB, Comptroller)
- During the pendency of these approvals, conduct a competitive RFP process seeking to identify a third party with whom LIPA would enter into a series of arrangements providing for:
 - Purchase of the site from LIPA
 - A construction agreement for a 500 MW combined cycle gas turbine (“CCGT”) generating plant on the site that would take into account the timing of LIPA’s additional generation resource needs, which are currently identified as 2016, but may not be until 2023, depending on the efficacy of the 15x15 Goal program and other factors
 - A long-term power purchase agreement (“PPA”) for the future plant output with LIPA
 - Upon closing of the transaction, enter into an operating agreement with National Grid

- Upon construction of the new CCGT unit (in 2016-2023), one of the currently operating steam units (Barrett 1) would be retired, for a net capacity increase on the site of approximately 300 MW

Barrett Purchase Option – Key Decisions Facing LIPA

- Whether or not to exercise its option to purchase Barrett on September 30, 2009, or extend the option until December 31, 2009 in exchange for a one year extension of the PSA
- If the Barrett Purchase Option were exercised, how might LIPA address the complex approval and RFP process contemplated during the pendency of the transaction, as described above
- Whether or not a partner could help LIPA facilitate this initiative

Barrett Purchase Option – Conclusion

- The Barrett Purchase Option should be allowed to expire on September 30, 2009

POTENTIAL BENEFITS AND CONSIDERATIONS OF THE BARRETT PURCHASE OPTION

Barrett Purchase Option – Potential Benefits

- Barrett would provide LIPA with control of a site on Long Island to achieve two resource planning goals:
 - Help supply Long Island’s energy needs with new, more efficient generating plants
 - Retire older, less efficient existing generating plants and thereby reduce SO₂, NO_x and CO₂ emissions
- Modest cost of capital savings (approximately \$4 million annually) resulting from removing the existing Barrett plant from private sector ownership
- Cost of capital benefits if a repowering were financed with tax-exempt debt (as compared with being financed by a private-sector owner)
- Several LIPA repowering studies have concluded that Barrett is a logical site for a repowering, because of existing site infrastructure, size, location and community support, among other factors
- The purchase could represent a public statement of LIPA’s commitment to repowering Long Island with cleaner, more efficient generation
- Owning Barrett could provide LIPA with direct insight into local energy markets

Barrett Purchase Option – Considerations

- LIPA has alternative uses for the capital that would be required to purchase the Barrett assets (e.g., T&D system investment, renewables, energy efficiency, participation in an uprate of Nine Mile Point 2, etc.)
- Valuation of Barrett indicates that the purchase price under the option is too high, under almost any scenario, even before accounting for other critical risks and issues as identified herein
- LIPA's projected resource needs may not require new generation to come on-line until 2016, and possibly as late as 2023
- LIPA due diligence has raised some concerns over the condition of the Barrett generating units
- LIPA would bear the carrying cost of the site until a repowering of Barrett is effected
- There are unresolved complexities regarding regulatory approval and RFP processes, including attempting to determine now the costs of constructing and operating generation that would not be required until the 2016-2023 timeframe
- The exercise of the option places LIPA at risk of becoming a long-term owner of the plant if the RFP process for a third party to purchase the site from LIPA, construct a new generation plant and enter into a long-term PPA with LIPA is unsuccessful
- While not considered likely, there exists some risk of rating agency concern over LIPA's entrance into the generation business, even if for a limited period of time and at this limited scale
- Potentially modestly increased cost of capital for LIPA resulting from a change in business mix

- NYPA rejected LIPA's request to act jointly in respect of the Barrett Purchase Option and become the developer, owner and operator of a new generation plant
- Other sites exist on Long Island for construction of new generation, and these sites would not have to be purchased now and then "banked" for 7-15 years
 - In addition, estimates to date by LIPA for the costs of a Barrett repowering are only modestly less than, or breakeven with, a comparable greenfield project development
- State regulatory approvals are required (PACB, Comptroller), and the level of State political support is unclear

4.5 MSA Renewal and/or Restructuring

SUMMARY OF MSA RENEWAL AND/OR RESTRUCTURING OPTIONS

Question 5

Q: How should LIPA approach renewal/restructuring of the MSA?

A: LIPA should continue to evaluate all available options in respect of the MSA to ensure proper negotiating leverage and maximum transparency, including the ability to single-source or competitively procure T&D services, and should simultaneously study the comparative benefits and issues of privatization or municipalization, in whole or in part.

However, as more fully discussed below, LIPA currently lacks the detailed information to properly evaluate the MSA as compared with other options it could pursue. Once the requisite detailed information is obtained and these options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

Because of the importance and complexity of this process, LIPA should not wait until 2013 to engage in this work and decide on a course of action. LIPA's evaluative process should be handled in a manner that is agnostic to outcome (other than in respect of ratepayer considerations), and in a way that does not create conflicts in respect of the evaluation of privatization or municipalization.

MSA Renewal and/or Restructuring Options – Key Elements

The MSA currently expires on December 31, 2013, with preparation for new arrangements to administer and operate the T&D system expected to be a complex multi-year process.

Currently National Grid operates the T&D system on an integrated basis with the gas distribution system, which is owned by National Grid. In exploring other options for administering and operating the T&D system, it must be kept in mind that the scope and complexity of the MSA may limit the universe of qualified and willing operators. Thus, in the context of determining its

options regarding the MSA, LIPA should study privatization of the T&D system, as well as full municipalization of the T&D system, as alternatives to an MSA re-bid.

A privatization would likely involve the following key elements:

- A pre-transaction separation of the T&D system from the Shoreham regulatory assets and debt obligations
- Sale of the T&D system to a third party
- Use of the transaction proceeds to pay down a portion of LIPA's debt, with an IRS letter ruling secured to assure continuing tax exemption of the remaining debt
- LIPA would continue to exist, with its role reduced to the servicing of its remaining debt and administration of any remaining asset interests (e.g., its interest in Nine Mile Point 2)

Full municipalization would likely involve the following key elements:

- LIPA would assume direct responsibility for the operation of the T&D system
- LIPA would assume direct responsibility for management of the T&D system
- LIPA would assume the existing T&D workforce (management and unionized labor)
- LIPA would change its organization to add the requisite management and other resources required to operate successfully the T&D system

MSA Renewal and/or Restructuring Options – Key Decisions Facing LIPA

- Whether LIPA should single-source or competitively procure all or a portion of the services provided under the MSA
- Whether there are alternatives LIPA should explore that might better address its goals than a re-bidding of the MSA
- Whether LIPA is in a position to make a determination at this time as to which such alternatives, if any, should be pursued in parallel with re-bidding the MSA

MSA Renewal and/or Restructuring Options – Current Conclusions

There is a clear urgency for LIPA to make a decision with respect to the long-term structure of the electric T&D system, given the identified complexities and inefficiencies of the current public/private partnership and the approaching expiration of the MSA in 2013.

Lazard studied various options related to the PSA and MSA, including, in the case of the MSA, single-sourcing or competitively procuring a revised contract, privatization and full municipalization. In that regard, LIPA currently lacks the detailed information to properly evaluate the financial and qualitative aspects of options involving the MSA as compared with other options it could pursue, and even once the requisite detailed information is obtained and the options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

The 2005 Strategic Organizational Review did not identify or consider the process to gather and evaluate the requisite detailed information.

Elements of the needed detailed information include, but are not limited to:

- Whether and how the T&D system's operations could be enhanced with integrated operations and ownership, in either private or municipal ownership scenarios
- How the costs of running a separated electric T&D system, either fully municipalized or privatized, would compare to a continuation of the current public/private partnership structure, taking into account the following elements, among others:
 - Operations and maintenance expenses
 - Functions currently provided through the MSA
 - LIPA's efficiency and renewables program
 - Storm restoration efforts
 - Account management
 - Billing

- Salaries and benefits
 - Pension and OPEB expenses and liabilities
 - Executive compensation expenses
- Professional services and general expenses
- Local taxes
- Capital expenditures
- What operational and financial resources and expertise would be required to separate operation of the electric T&D system from the gas LDC system on Long Island, including identification of the costs to LIPA (or another third party) to replicate critical assets currently shared with National Grid:
 - T&D control room
 - T&D telecommunications system
 - Outage management system
 - T&D system planning and design assets
 - T&D field support systems
 - General enterprise management systems
 - Customer care systems
 - Finance and accounting functions
 - Various other facilities and equipment
- Full accounting of the overhead and shared services costs allocated to the electric T&D system by National Grid in the MSA contract, including, but not limited to:
 - Client services
 - Information technology
 - Finance

- Human resources
- Other operations and maintenance functions
- Other common asset charges
- Estimates of the costs of separating the systems and shared assets described above
- Whether there are potential improvements to the MSA that are attractive to ratepayers, including adjusted terms or a new operator
- What potential enhancements to the T&D system’s operations and costs could result from private sector ownership
- What changes would be necessary to LIPA’s organization and governance as part of any municipalization
 - Management composition
 - Executive compensation
 - Decision-making processes
 - Operating expertise

LIPA has launched a Request For Information (“RFI”) in respect of a potential re-bid of the MSA in order to determine the universe of parties potentially interested in assuming the MSA contract after the term of the current provider concludes, the information required by such parties in order to bid on a new MSA, and whether LIPA has access to such information or must obtain it from National Grid.

Given the limitations of the status quo and the possibility of improving upon it, but also recognizing the complexity of evaluating the options in this regard as identified above, Lazard recommends that LIPA implement a process to obtain the requisite detailed information to properly evaluate the financial and qualitative aspects of these alternatives in respect of the MSA or other alternatives for ownership and operation of the T&D system. After such evaluative process is

concluded, and potentially viable options identified, LIPA should test the market to determine which alternative would best serve ratepayers.

The process of obtaining the requisite detailed information, evaluating the potential alternatives, and then testing the market to determine which alternative would best serve ratepayers would be one of the most complex decision-making processes faced by any utility in the United States, public or private, in many decades. LIPA, however, cannot reasonably make decisions on behalf of its ratepayers in respect of the long-term structure of the T&D systems without undertaking such a process.

POTENTIAL BENEFITS AND CONSIDERATIONS OF MSA RENEWAL AND/OR RESTRUCTURING OPTIONS

Benefits and considerations were evaluated for the following options:

- In respect of the MSA:
 - Single-sourcing vs. competitively procuring the MSA
 - Integrated vs. multi-party contract in respect of the functions provided under the MSA
 - National Grid vs. a third party as the MSA operator
- Privatization of the T&D system
- Full municipalization of the T&D system

Single-Source Option as a Complement to Competitively Procuring – Potential Benefits

- LIPA benefits from having widest possible range of decision-making power
- Single-sourcing could incent third parties to consider what is otherwise a complex and somewhat unique contractual relationship
- Single-sourcing could attract more interest from potential respondents, because the process would not involve an auction
- The potential that no single bidder could replace National Grid

Single-Source Option as a Complement to Competitively Procuring – Considerations

- If adequate information is available to bidders, a competitive process should theoretically produce the best pricing in most situations, albeit the ability to single-source could also enhance any competitive process
- Political perceptions regarding a single-sourced, or “no-bid”, significant government contract
 - However, the goal of the process should be the best outcome for ratepayers
- Customer perceptions if a single-source option is pursued with National Grid, particularly given National Grid’s previous “default” status under the MSA

Integrated vs. Multi-Party Contract – Potential Benefits

- An integrated contract provides administrative simplicity on an ongoing basis
- The MSA bidding process will be complex even if designed to obtain a single service provider for an integrated contract
- T&D operations are complex and are designed to operate on an integrated basis
- The scale of an integrated contract for any counterparty would provide LIPA with negotiating leverage

Integrated vs. Multi-Party Contract – Considerations

- A multi-party contract would only increase the complexity of an already complex public/private partnership
- A multi-party contract increases the complexity, costs and preparation needed for competitive procurement of the MSA
- The organizational strain on LIPA from increased administrative complexity in a multi-party contract
- The potential advantage of multiple parties competing to decrease costs may be potentially overshadowed by the costs created by multiple parties attempting to operate an integrated system
- The potential for increased complexity to affect service and reliability
- Maintaining the scale of the contract may be important to attracting high-quality vendors

National Grid vs. Third Party – Potential Benefits

- National Grid is an experienced T&D operator, with a high quality workforce and financial strength
- LIPA and National Grid both benefit from integrated operation of the T&D system and gas LDC system
- National Grid is a known entity and has intimate familiarity with the T&D system
- Potentially greater costs for a third-party operator of the system related to acquisition costs of shared assets, workforce, and otherwise

National Grid vs. Third Party – Considerations

- National Grid is a complex entity with which to interact because of its internal approval processes and non-local nature
- Other parties may prove to be more competitive than National Grid with respect to price and/or service levels
- Other parties may have greater operational synergies than National Grid with respect to operating the T&D system, and hence be able to reduce costs, particularly if they already own a nearby T&D system
- National Grid’s previous “default” status under the MSA

Privatization – Potential Benefits

- Improved system operation resulting from truly integrated operation and administration
- Simplified organizational structure
- Potential for enhanced long-range planning for the T&D system as a result of integrated ownership and operation
- Cost savings resulting from operational and capital investment efficiencies
- Efficiency benefits generally associated with private sector operations as compared with public sector operations
- Access to the management and workforce expertise available in the private sector, including because of the private sector's more flexible and conventional compensation structures
- The universe of interested and qualified buyers for the T&D system may be greater than the universe of potential MSA contract partners
- Removes the potential risk of being unable to find a capable and experienced operator for the system on a contracted basis
- Removes New York State from its role in State energy markets, and returns the State to its traditional role as a regulator
- Would bring LIPA under PSC regulation, which is not possible now because of the effect such regulation would have on LIPA's credit ratings under its current structure and the attendant costs to ratepayers
- Subject to maintaining ratepayer benefits, privatization could be a logical final conclusion to the original government intervention in 1998
- The structure and ownership of Long Island energy markets would be consistent with the rest of New York State

- The structure and ownership of the T&D system would be consistent with that which prevails in the U.S., which is private sector ownership, rather than public sector ownership
- Privatization would be consistent with a trend among State and local governments to reduce their involvement in activities conventionally handled by the private sector and otherwise
- Revised Board and management structures would be less complex
- Board and management recruiting would be less complex, more flexible, and more likely to attract individuals with direct utility experience
- Eliminates burden of complex, multi-level approval processes
- Privatization could reduce the significant debt burden of a political subdivision of New York State

Privatization – Considerations

- Cost of capital disadvantage for private sector ownership would need to be overcome by improved system operations, cost savings and investment efficiencies in order to benefit ratepayers on quantitative and qualitative basis
- National Grid may have advantages as a buyer given the synergies between the T&D system and the gas LDC system, and so it is unclear how competitive third parties could be
 - A similar dynamic already exists, however, for an MSA re-bid in any event
 - Other nearby parties with T&D assets should enjoy similar synergies
 - Third-party competition may be greater for asset ownership than for contract administration
- The potential breakage costs associated with an owner other than National Grid
 - Complexities of separating integrated electric/gas operations
 - Such breakage costs, however, affect National Grid, as well
- State-level political support is unclear

- The support of local and other constituencies is unclear
- A privatization transaction would involve multiple regulatory approvals (PACB, PSC, OSC, FERC, FTC), third-party consents (bondholder/bond insurer) and other clearances (IRS private letter ruling)

Full Municipalization – Potential Benefits

- The potential for cost savings resulting from full control and administration of the T&D system by LIPA, albeit LIPA does not currently possess the organizational capabilities to operate a T&D system; LIPA is organized to manage contracts
- The potential cost savings resulting from elimination of an MSA contractor's profit
- The potential ratepayer benefit resulting from the absence of a profit motive associated with private capital ownership
- Simplified organizational structure for the T&D system
- Potential to enhance customer service, resulting from direct control over O&M and capital investment decisions
- Integration of informational and operational control
- Potential for enhanced long-range planning for the T&D system as a result of integrated ownership and operation
- Reduces the risks associated with the potential transfer of the operations of the T&D system to a new third party operator, if the relationship with National Grid ends after expiration of the MSA
- May be a logical interim step in an ultimate privatization

Full Municipalization – Considerations

- LIPA does not currently possess the organizational capabilities to operate a T&D system; LIPA is organized to manage contracts
 - A significant enhancement and expansion of LIPA's management capabilities would be required
 - LIPA would continue to be burdened by complex governance and approvals structures and requirements, which could affect the operation of the T&D system
- Further study is required to quantify any potential ratepayer savings
- Loss of efficiency benefits generally associated with private sector operations as compared with public sector operations
- It may be difficult to improve customer service or reliability
- It is critical that LIPA attract and retain an experienced management team and workforce
- Municipalization would represent an expansion of the New York State workforce and New York State's role in Long Island energy markets
- Municipalization would run counter to the trend among State and local governments to reduce their involvement in activities conventionally handled by the private sector and otherwise
- Municipalization would run counter to the prevailing nature of U.S. businesses, which is private sector ownership, rather than public sector ownership
- The complexity of unwinding the current National Grid arrangements, including in respect of the shared assets serving the system
- Procurement restrictions may make day-to-day operation of the system complex
- Labor issues are complex and the regulatory construct for LIPA acquiring the union workforce is unclear and almost without precedent

- LIPA would assume responsibility for the issues of an aging workforce serving the T&D system, a problem prevalent throughout the Power & Utility Industry, and would need to believe that a public entity, with its complex approvals processes and compensation limitations, would be able to address this problem more adeptly than the private sector
- State regulatory approvals (PACB, OSC, Comptroller) necessitates State political support for full municipalization

5. Current Conclusions

CURRENT CONCLUSIONS

Status Quo

The current public/private partnership structure continues to largely meet its statutory goals of improved system reliability, reduced costs and economical energy supply, but it may be possible to address the issues and complexities of the status quo, as described in this report.

Enhancements to Status Quo

LIPA does not expect its current ELI Program to meet the 15x15 Goal; pursuit of the 15x15 Goal could therefore produce an improvement in the status quo and should be studied and implemented as merited, but only with ongoing cost/benefit analysis and with ongoing checks to ensure efficacy; these measures, if effective and targeted at peak demand reduction, could provide an alternative to developing new fossil fuel generation.

Purchase of Long Island Generating Assets

As there is no compelling economic rationale that has been identified, among other factors, LIPA should not proceed with the purchase of the Long Island Generating Assets, though it should consider what changes to the PSA it might seek if National Grid seeks to sell these assets; renegotiation of the MSA should be handled separately.

Barrett Purchase Option

As there is no compelling economic rationale that has been identified, among other factors, LIPA should allow the Barrett Purchase Option to expire on September 30, 2009.

MSA, Privatization, Full Municipalization

LIPA should continue to evaluate all available options to ensure proper negotiating leverage and maximum transparency, including the ability to single-source or competitively procure the

contract, and should simultaneously study the comparative benefits and issues of privatization or full municipalization.

However, LIPA currently lacks the detailed information to properly evaluate the MSA as compared with other options it could pursue. Once the requisite detailed information is obtained and these options are evaluated, LIPA should test the market to determine which alternative would best serve ratepayers.

Because of the importance and complexity of this process, LIPA should not wait until 2013 to engage in this work and decide on a course of action. LIPA's evaluative process should be handled in a manner that is agnostic to outcome (other than in respect of ratepayer considerations), and in a way that does not create conflicts in respect of the evaluation of privatization or municipalization.

6. Appendix

6.1 LIPA's Debt Schedule

LIPA DEBT SCHEDULE – 2010E COST OF DEBT

(\$ in millions)

Series	Type	Maturity	Year-End Principal Outstanding	Average Principal Outstanding	Effective Interest Rate	Interest Expense ^(a)
Senior Lien debt						
1998 A	Serial Bonds	2009-2016	\$81.8	\$152.9	4.976%	\$7.6
1998 A	Capital Appreciation Bonds ^(b)	2009-2028	135.8	132.7	5.173%	6.9
1998 B	Serial Bonds	2009-2016	3.7	23.3	4.639%	1.1
2000 A	Capital Appreciation Bonds ^(c)	2009-2028	414.5	411.7	5.543%	22.8
2001A	Serial Bonds	2013-2021	0.7	0.7	4.642%	0.0
2001 A	Term Bonds ^(d)	2025-2029	164.4	164.4	5.373%	8.8
2003 B	Serial Bonds	2009-2014	250.3	258.4	4.598%	11.9
2003 C	Serial Bonds ^(d)	2013-2033	70.5	70.5	5.011%	3.5
2003 C	Term Bonds ^(d)	2033	185.5	185.5	5.259%	9.8
2003 D-O	Variable Rate Debt ^{(e)(f)}	2029	187.2	337.2	4.408%	14.9
2004A	Serial Bonds ^(d)	2013-2025	33.9	33.9	4.272%	1.4
2004A	Term Bonds	2029-2034	166.1	166.1	5.084%	8.4
2006A	Serial Bonds ^(d)	2009-2026	839.2	839.2	4.609%	38.7
2006B	Serial Bonds	2035	4.2	4.2	4.500%	0.2
2006B	Term Bonds	2035	92.7	92.7	4.883%	4.5
2006C	Term Bonds ^(d)	2035	198.0	198.0	5.189%	10.3
2006D	Serial Bonds	2009-2025	215.5	216.0	4.453%	9.6
2006D	Serial Bonds - Variable Rate	2015	110.7	110.7	4.110%	4.6
2006E	Serial Bonds ^(d)	2009-2022	507.6	507.6	4.452%	22.6
2006F	Serial Bonds ^(d)	2009-2028	401.9	401.9	4.166%	16.7
2006F	Term Bonds	2033	112.6	112.6	4.250%	4.8
2008 A	Term Bonds	2034	605.1	605.1	5.931%	35.9
2008 B	Serial Bonds	2019-2025	96.5	96.5	5.770%	5.6
2008 B	Term Bonds	2033	52.8	52.8	5.750%	3.0
2009 A	Serial Bonds	2014-2039	363.4	363.4	5.153%	18.7
2009 A	Term Bonds	2033	72.5	72.5	6.250%	4.5
2010 A	--	--	210.0	192.5	5.250%	10.1
2010 B	--	--	210.0	192.5	5.377%	10.4
2010 C	--	--	210.0	70.0	5.000%	3.5
Total Senior Lien Debt			\$5,997.3	\$6,065.7	4.960%	\$300.8
Subordinate Debt						
Series 8	Mandatory Purchase	2010	\$26.5	\$32.8	3.787%	\$1.2
Series 2001 1A-3B	Variable Rate ^{(e)(f)}	2033	525.0	525.0	3.215%	16.9
Commercial Paper	Variable Rate ^(e)	Various	200.0	200.0	1.500%	3.0
Total Subordinated Debt			\$751.5	\$757.8	2.787%	\$21.1
Total Debt			\$6,748.8	\$6,823.5	4.719%	\$322.0
Other Debt-Related Interest Expense ^(g)						\$25.1
Total Average Debt Outstanding/Embedded Cost of Debt			\$6,748.8	\$6,823.5	5.086%	\$347.0

Source: LIPA and LIPA Five Year Financial Projections.

- (a) Net of amortizations for discounts and premiums, insurance costs and swaption proceeds, if applicable.
(b) Represents accreted value of original proceeds of \$145.793 million, adjusted for principal maturities and partial refinancing in 2003.
(c) Represents accreted value of original proceeds of \$325.165 million, adjusted for partial refinancing in 2003.
(d) Net of fixed-to-floating/basis swap arrangement.
(e) Projected variable rate of 1.50% for 2010
(f) Includes a Fixed Rate Swap arrangement.
(g) Excludes interest on customer deposits and other carrying charges.

6.2 Long Island Generating Assets Valuation Analysis

SUMMARY OBSERVATIONS: L.I. GENERATING ASSETS VALUATION

National Grid has offered to sell LIPA the Long Island Generating Assets in exchange for certain consideration, and, as requested by National Grid, a long-term extension and other material amendments to the MSA^(a).

A valuation analysis of the Long Island Generating Assets has been performed under two scenarios, using projections provided by LIPA and its consultants. These projections assume the following:

- These plants continue operating under the PSA and existing PPAs for Glenwood and Port Jefferson (the “PSA Extension Case”); or
- These plants operate under a merchant basis after expiration of the PSA (the Glenwood and Port Jefferson PPAs would continue) (the “Merchant Basis Case”)

Lazard has not interacted with National Grid or its representatives to perform due diligence on the plants, their financial profile or National Grid’s proposal, although it has discussed certain aspects of the proposed transaction with representatives of National Grid and has had access to an electronic data room containing information regarding the plants.

(a) The proposed consideration does not include the potential value impact of National Grid’s requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

The valuation of the Long Island Generating Assets under the two scenarios is: (i) approximately \$520 million to \$630 million in the PSA Extension Case and (ii) approximately (\$285) million to \$790 million in the Merchant Basis Case. It is possible, however, that a third party, using more aggressive assumptions, could arrive at a significantly higher valuation^(a) (or, conversely, could arrive at a more conservative valuation using less aggressive assumptions).

- (a) Among many factors where potential purchasers of the Long Island Generating Assets may have differing perspectives would be the appropriate rate of return to be used in valuing the assets under a discounted cash flow methodology. The Capital Asset Pricing Model is conventionally used to determine the appropriate rate of return of an asset, which is used as the discount rate in a discounted cash flow valuation. This rate of return, commonly referred to as the "Weighted Average Cost of Capital" (or "WACC"), reflects a number of factors, including the risk of the asset itself, and the appropriate balance of debt and equity that would be used to appropriately capitalize an asset of such risk profile. A key assumption of this model is that the discount rate used in valuing an asset should reflect the WACC of the asset itself, rather than the cost of funds of the acquiring entity, as the allocation of capital should be based on the risk and reward characteristics of a given investment as compared with all other potential investments available to the acquiring entity. Another key assumption (among others) is that as the amount of debt in a capital structure increases, the theoretical cost of debt should increase as a reflection of the increased risk resulting from high leverage. Given enough leverage, the probability of default becomes so high that the debt should reflect equity-like returns (equity, which has only a residual claim on the assets being financed, should have a higher rate of return than debt in a capital structure that is appropriate for a given asset). The distinction between the cost of funds for a given acquiring entity and the appropriate WACC for a given asset is particularly important for municipal entities. Municipal entities enjoy low nominal cost of funds only because (1) they employ capital structures that are essentially 100% debt financed; (2) the interest on their debt is tax exempt from federal, state and/or local taxes; and (3) they have autonomous taxing or rate-making power, which is judged by investors to reduce the probability of default to extremely low levels; the taxpayers or ratepayers of a municipal entity are implicitly insuring the municipal debt against default. Accordingly, LIPA would not use its own cost of funds in evaluating a purchase of the Long Island Generating Assets, as its cost of funds would not properly account for the WACC of the assets themselves. The analysis contained herein does show sensitivity analyses of the valuation at an illustrative cost of funds for LIPA, but only for illustrative purposes.

6.2.1. PSA Extension Valuation Analysis

SUMMARY OBSERVATIONS: PSA EXTENSION CASE VALUATION

The valuation of the Long Island Generating Assets in the PSA Extension Case is approximately \$520 million to \$630 million (before requested payment for previously funded Pension and OPEBs), which reflects:

- Approximately \$405 million to \$480 million value for the Genco generating assets and associated assets
- Approximately \$90 million to \$120 million for the Glenwood and Port Jefferson generating assets
- Approximately \$25 million for the Spagnoli Road asset

The PSA Extension Case valuation assumes that the useful lives of the Genco generating assets are coterminous with the end of the extended PSA and thus no “perpetuity” value is included in the valuation of these assets. If “perpetuity” value is assumed for the assets, the valuation range would rise to \$630 million to \$880 million.

The PSA Extension Case valuation is based on a discounted cash flow (“DCF”) valuation of the Genco generating assets and Glenwood and Port Jefferson generating assets. The Genco generating assets valuation reflects the assumption that the PSA would be extended in 2014 on substantially the same terms for an additional 15 years.

Under either approach, the valuation of the Long Island Generating Assets is less than the consideration proposed by National Grid^(a).

LIPA’s negotiating position in ongoing PSA settlement discussions formed the basis for the projections of future PSA-related cash flows; because critical factors impacting the long-term profitability of the PSA to National Grid or a third party are not specified in the PSA (e.g., capital

(a) The proposed consideration does not include the potential value impact of National Grid’s requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

expenditures), Lazard relied on LIPA's estimates and assumptions regarding long-term capital and cost items.

The Glenwood and Port Jefferson generating asset valuations reflect LIPA's long-term projections. A perpetuity value of the assets was included in the valuation of these assets.

SUMMARY L.I. GENERATION VALUATION ANALYSIS: PSA EXTENSION CASE

The valuation analysis implies a value of the Long Island Generating Assets that is approximately \$520 million to \$630 million in the PSA Extension Case. The valuation of the Long Island Generating Assets is less than the consideration proposed by National Grid^(a).

(\$ in millions)

		Valuation Analysis	
GENCO	PSA DCF Value @ 8.10% to 5.50%	\$311	– \$389
	Plus: Estimated Land Value	81	– 81
	Plus: Net Working Capital	12	– 12
	Total Genco	\$404	– \$482
GLENWOOD	PPA DCF Value @ 8.10% to 5.50%	\$47	– \$63
	Net Working Capital	(6)	– (6)
	Total Glenwood	\$41	– \$57
PORT JEFFERSON	PPA DCF Value @ 8.10% to 5.50%	\$52	– \$70
	Net Working Capital	(5)	– (5)
	Total Glenwood	\$47	– \$65
Sub-Total		\$492	– \$604
Plus: Estimated Value of Spagnoli Road		\$25	– \$25
Total Utility Plant Valuation^(a)		\$517	– \$629

Source: LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

(a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

KEY VALUATION ASSUMPTIONS

GENCO PSA EXTENSION CASE VALUATION ASSUMPTIONS	
PROJECTIONS:	<ul style="list-style-type: none"> 2010-2028 projected Genco cash flows based on LIPA estimated capitalization, returns and beginning PSA ratebase
CAPITALIZATION:	<ul style="list-style-type: none"> Capitalization and return assumptions reflect LIPA's current PSA settlement discussion positions: <ul style="list-style-type: none"> 45% equity; 10.75% ROE 55% debt; 5.56% cost of debt
TAX RATE:	<ul style="list-style-type: none"> Effective tax rate of 32.28% per LIPA's current PSA settlement discussion position
RATEBASE:	<ul style="list-style-type: none"> Beginning ratebase of \$517 million per LIPA's current PSA settlement discussion position Ratebase balance is calculated annually <ul style="list-style-type: none"> Increased by projected annual capital expenditures Decreased by projected annual utility plant depreciation Items such as accumulated deferred tax assets, working capital and other adjustments to ratebase held constant at 2009 amounts
CAPITAL EXPENDITURES:	<ul style="list-style-type: none"> 2010-2013 capital expenditures per LIPA's projections, post-2013 capital expenditures assumed to equal depreciation of gross utility plant
DEPRECIATION:	<ul style="list-style-type: none"> Straight-line annual depreciation at 3.5% of both existing and projected gross utility plant
1998 FIT^(a) CREDIT:	<ul style="list-style-type: none"> \$7.1 million annual credit extends to 2013; ending assumed in 2013
ENVIRONMENTAL/DECOMMISSIONING:	<ul style="list-style-type: none"> No explicit assumptions regarding environmental/decommissioning costs, which could be significant
MSA AMENDMENT/EXTENSION:	<ul style="list-style-type: none"> Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA
TERMINAL VALUE:	<ul style="list-style-type: none"> No value for the assets assumed post-2028
GLENWOOD AND PORT JEFFERSON VALUATION PPA ASSUMPTIONS	
PROJECTIONS:	<ul style="list-style-type: none"> 2010-2026 projected cash flows reflect LIPA's 20-year projected capacity and Summer Season Availability Factor ("SSAF") incentive payments
CAPITALIZATION:	<ul style="list-style-type: none"> Assumed capitalization per LIPA assumptions <ul style="list-style-type: none"> 30% equity; 10.75% ROE 70% debt; 8.50% cost of debt
TAX RATE:	<ul style="list-style-type: none"> Effective tax rate of 40.87% per LIPA assumptions
CAPITAL EXPENDITURES:	<ul style="list-style-type: none"> None assumed (assumed implicitly captured in fixed O&M costs)
DEPRECIATION:	<ul style="list-style-type: none"> None assumed (see capital expenditure assumptions)
ENVIRONMENTAL/DECOMMISSIONING:	<ul style="list-style-type: none"> No explicit assumptions regarding environmental/decommissioning costs, which could be significant
MSA AMENDMENT/EXTENSION:	<ul style="list-style-type: none"> Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA
TERMINAL VALUE:	<ul style="list-style-type: none"> Reflects assumed perpetuity value of 2026 unlevered free cash flows

Source: Navigant Consulting and LIPA.

(a) Represents the \$7.1 million annual reduction to the PSA capacity charge that LIPA negotiated for 15 years at the time of the Merger.

GENCO PSA EXTENSION CASE: DCF VALUATION^(a)

The DCF value of Genco in the PSA Extension Case is approximately \$310 million to \$390 million; \$93 million of other assets^(b) would be included in the acquisition, for a total implied Genco PSA value of \$405 million to \$480 million. This valuation does not include Glenwood or Port Jefferson, which have been valued separately.

(\$ in millions)

	For the Fiscal Year Ended December 31,											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	...	2028
EBIT	\$52.9	\$54.4	\$56.7	\$57.6	\$57.5	\$57.5	\$57.5	\$57.5	\$57.5	\$57.5	...	\$57.5
Less: 1998 FIT Credit	(7.1)	(7.1)	(7.1)	(7.1)	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
Net EBIT	45.8	47.3	49.6	50.5	57.5	57.5	57.5	57.5	57.5	57.5	...	57.5
Less: Taxes at 32.3%	(14.8)	(15.3)	(16.0)	(16.3)	(18.6)	(18.6)	(18.6)	(18.6)	(18.6)	(18.6)	...	(18.6)
EBIT (after tax)	\$31.0	\$32.0	\$33.6	\$34.2	\$39.0	\$39.0	\$39.0	\$39.0	\$39.0	\$39.0	...	\$39.0
Plus: Depreciation & Amortization	51.9	54.2	56.9	59.3	61.4	63.6	65.8	68.2	70.6	36.9	...	30.0
Less: Capital Expenditures	(55.1)	(79.8)	(76.5)	(57.7)	(61.4)	(63.6)	(65.8)	(68.2)	(70.6)	(36.9)	...	(30.0)
Unlevered Free Cash Flow	\$27.8	\$6.5	\$14.1	\$35.8	\$39.0	\$39.0	\$39.0	\$39.0	\$39.0	\$39.0	...	\$39.0
Average Rate Base	\$518.9	\$533.3	\$555.8	\$564.8	\$564.0	\$564.0	\$564.0	\$564.0	\$564.0	\$564.0	...	\$564.0
EBIT Buildup												
ROE	10.75%	10.75%	10.75%	10.75%	10.75%	10.75%	10.75%	10.75%	10.75%	10.75%	...	10.75%
% Equity (LIPA Current Position)	45.00%	45.00%	45.00%	45.00%	45.00%	45.00%	45.00%	45.00%	45.00%	45.00%	...	45.00%
Interest Rate	5.56%	5.56%	5.56%	5.56%	5.56%	5.56%	5.56%	5.56%	5.56%	5.56%	...	5.56%
% Debt (LIPA Current Position)	55.00%	55.00%	55.00%	55.00%	55.00%	55.00%	55.00%	55.00%	55.00%	55.00%	...	55.00%
Net Income	\$25.1	\$25.8	\$26.9	\$27.3	\$27.3	\$27.3	\$27.3	\$27.3	\$27.3	\$27.3	...	\$27.3
Interest	15.9	16.3	17.0	17.3	17.2	17.2	17.2	17.2	17.2	17.2	...	17.2
Effective Taxes at 32.3%	12.0	12.3	12.8	13.0	13.0	13.0	13.0	13.0	13.0	13.0	...	13.0
EBIT	\$52.9	\$54.4	\$56.7	\$57.6	\$57.5	\$57.5	\$57.5	\$57.5	\$57.5	\$57.5	...	\$57.5
<i>Memo: Implied WACC</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	<i>6.91%</i>	...	<i>6.91%</i>

SUMMARY DCF VALUATION OF GENCO					
	Discount Rate	PV of PSA Cash Flows		Other Genco Items ^(b)	Total Implied Genco Value ^(a)
LIPA Illustrative WACC	5.50%	\$389	+	\$93	= \$482
PSA WACC	6.91%	344	+	93	= 437
Merchant IPP WACC	8.10%	311	+	93	= 404

Source: LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

(a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

(b) Includes estimated land value of \$81 million, plus net working capital of \$12 million.

GENCO PSA EXTENSION CASE DCF VALUATION: SENSITIVITY ANALYSIS^(a)

Depending on the assumptions for capital expenditures and the 1998 FIT^(b) credit, the DCF value of Genco could range from \$325 million to \$450 million at a discount rate of 6.91% (the effective “WACC” implied by LIPA’s current settlement position), and from \$300 million to \$480 million at a range of illustrative discount rates.

(\$ in millions)

CASE 1 – BASE CASE				
Discount Rate	PV of PSA Cash Flows		Other Genco Items ^(c)	Total Genco Value
5.50%	\$389	+	\$93	= \$482
6.91%	344	+	93	= 437
8.10%	311	+	93	= 404

Assumptions:

Capital expenditures equal depreciation post-2013
1998 FIT^(b) Credit does not continue post-2013

CASE 2				
Discount Rate	PV of PSA Cash Flows		Other Genco Items ^(c)	Total Genco Value
5.50%	\$350	+	\$93	= \$443
6.91%	310	+	93	= 403
8.10%	281	+	93	= 374

Assumptions:

Capital expenditures equal depreciation post-2013
1998 FIT^(b) Credit continues post-2013

CASE 3				
Discount Rate	PV of PSA Cash Flows		Other Genco Items ^(c)	Total Genco Value
5.50%	\$296	+	\$93	= \$389
6.91%	267	+	93	= 360
8.10%	245	+	93	= 338

Assumptions:

Capital expenditures grow at 1.0% post-2013
1998 FIT^(b) Credit does not continue post-2013

CASE 4				
Discount Rate	PV of PSA Cash Flows		Other Genco Items ^(c)	Total Genco Value
5.50%	\$257	+	\$93	= \$350
6.91%	233	+	93	= 326
8.10%	215	+	93	= 308

Assumptions:

Capital expenditures grow at 1.0% post-2013
1998 FIT^(b) Credit continues post-2013

DISCOUNT RATES	
LIPA Illustrative WACC	5.50%
PSA WACC	6.91%
Merchant IPP WACC	8.10%

Source: LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

- (a) Analysis does not include the potential value impact of National Grid’s requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.
- (b) Represents the \$7 million annual reduction to the PSA capacity charge that LIPA negotiated for 15 years at the time of the Merger.
- (c) Includes estimated land value of \$81 million, plus net working capital of \$12 million.

GLENWOOD PPA DCF VALUATION^(a)

The estimated DCF value of the Glenwood PPA is approximately \$47 million to \$63 million.

(\$ in millions)

	For the Fiscal Year Ended December 31,											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	...	2026
Capacity Payments	\$9.5	\$9.1	\$8.7	\$8.3	\$7.9	\$7.4	\$7.0	\$6.6	\$6.3	\$6.0	...	\$4.1
SSAF Incentive Payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	...	0.1
EBIT	\$9.6	\$9.2	\$8.8	\$8.4	\$8.0	\$7.5	\$7.1	\$6.7	\$6.4	\$6.0	...	\$4.2
Less: Taxes at 40.9%	(3.9)	(3.8)	(3.6)	(3.4)	(3.3)	(3.1)	(2.9)	(2.7)	(2.6)	(2.5)	...	(1.7)
EBIT (after tax)	\$5.7	\$5.4	\$5.2	\$5.0	\$4.7	\$4.5	\$4.2	\$4.0	\$3.8	\$3.6	...	\$2.5
Plus: Depreciation & Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
Less: Capital Expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
Unlevered Free Cash Flow	\$5.7	\$5.4	\$5.2	\$5.0	\$4.7	\$4.5	\$4.2	\$4.0	\$3.8	\$3.6	...	\$2.5

SUMMARY DCF VALUATION OF GLENWOOD					
	Discount Rate	PV of Glenwood Cash Flows		PV of Perpetuity	Total PV
LIPA Illustrative WACC	5.50%	\$45	+	\$18	= \$63
PPA WACC	6.74%	42	+	12	= 54
Merchant IPP WACC	8.10%	39	+	8	= 47

PORT JEFFERSON PPA DCF VALUATION^(a)

The estimated DCF value of the Port Jefferson PPA is approximately \$52 million to \$70 million.

(\$ in millions)

	For the Fiscal Year Ended December 31,											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	...	2026
Capacity Payments	\$10.5	\$10.1	\$9.6	\$9.2	\$8.8	\$8.3	\$7.9	\$7.4	\$7.0	\$6.7	...	\$4.6
SSAF Incentive Payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	...	0.1
EBIT	\$10.7	\$10.2	\$9.8	\$9.3	\$8.9	\$8.4	\$8.0	\$7.5	\$7.1	\$6.7	...	\$4.6
Less: Taxes at 40.9%	(4.4)	(4.2)	(4.0)	(3.8)	(3.6)	(3.4)	(3.3)	(3.1)	(2.9)	(2.8)	...	(1.9)
EBIT (after tax)	\$6.3	\$6.0	\$5.8	\$5.5	\$5.2	\$5.0	\$4.7	\$4.5	\$4.2	\$4.0	...	\$2.7
Plus: Depreciation & Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
Less: Capital Expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0
Unlevered Free Cash Flow	\$6.3	\$6.0	\$5.8	\$5.5	\$5.2	\$5.0	\$4.7	\$4.5	\$4.2	\$4.0	...	\$2.7

SUMMARY DCF VALUATION OF PORT JEFFERSON					
	WACC	PV of Port Jefferson Cash Flows		PV of Perpetuity	Total PV
LIPA Illustrative WACC	5.50%	\$50	+	\$20	= \$70
PPA WACC	6.74%	47	+	13	= 60
Merchant IPP WACC	8.10%	43	+	9	= 52

Source: LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

Assumed WACC of 6.74% is based on 30.0% equity with a 10.75% ROE, 70.0% debt with a 8.50% interest rate and an assumed 40.87% tax rate.

- (a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

6.2.2. Merchant Basis Generation Valuation Analysis

SUMMARY OBSERVATIONS: MERCHANT BASIS CASE VALUATION ANALYSIS

The valuation of the Long Island Generating Assets in the Merchant Basis Case varies considerably depending on the operational enhancements assumed, ranging from (\$285) million if no operational enhancements are assumed and \$790 million with selected operational enhancements^(a). This valuation reflects the assumption that the PSA would not be extended in 2013 and that the Genco generating assets would be operated on a merchant basis from 2014 onward.

The Merchant Basis Case valuation is based on a discounted cash flow (“DCF”) valuation of the Genco generating assets using long-term revenue projections provided by Navigant Consulting and other cash flow-related assumptions provided by LIPA.

It is estimated that the Genco generating assets would be cash flow negative if they were operated at current revenue and cost levels (the “Base Case”) after the expiration of the PSA. The Base Case Value of the assets is negative under these conditions, approximately (\$220)^(b) million to (\$295) million^(b).

It can be reasonably assumed that a third-party buyer, absent the PSA, would take a variety of actions to improve the cash flow of the generating assets including by challenging current property tax assessments^(c), reducing O&M costs and retiring selected plants in order to increase realized capacity prices for the remaining portfolio.

Accounting for these operational enhancements, the implied value of the generating assets would rise to \$510 million to \$600 million from reducing property tax assessments by \$115 million annually and reducing O&M costs by 33%, and \$660 million to \$790 million from an illustrative 20% increase in capacity prices from retiring Genco generating units.

(a) Analysis does not include the potential value impact of National Grid’s requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

(b) Value includes Glenwood, Port Jefferson and Spagnoli Road assets.

(c) LIPA currently possesses the ability to challenge these property taxes through provisions in the PSA.

Further assuming that there is perpetuity value to the assets beyond the 20-year projection period, the value of Genco would rise to \$870 million to \$1,175 million depending on the operational enhancements assumed.

The Merchant Basis Case also reflects that the PSA would remain in effect until 2013 and that the Glenwood and Port Jefferson PPAs would continue.

SUMMARY L.I. GENERATION VALUATION ANALYSIS: MERCHANT BASIS CASE^(a)

The valuation analysis implies a value of the Long Island Generating Assets that is approximately \$660 million to \$790 million in the Merchant Basis Case^(b). The valuation of the Long Island Generating Assets is less than the consideration proposed by National Grid^(a).

This valuation reflects the illustrative successful achievement of significant operational enhancements by a new owner, including the reduction in property tax expenses of \$115 million annually, a 33% reduction in fixed O&M expense and a 20% increase in capacity prices.

(\$ in millions)

		Valuation Analysis	
GENCO	Genco DCF Value @ 9.10% to 7.10%	\$465	– \$575
	Plus: Estimated Land Value	81	– 81
	Plus: Net Working Capital	12	– 12
	Total Genco	\$558	– \$668
GLENWOOD	PPA DCF Value @ 9.10% to 7.10%	\$43	– \$52
	Net Working Capital	(6)	– (6)
	Total Glenwood	\$37	– \$46
PORT JEFFERSON	PPA DCF Value @ 9.10% to 7.10%	\$48	– \$58
	Net Working Capital	(5)	– (5)
	Total Glenwood	\$42	– \$52
Sub-Total		\$637	– \$766
Plus: Estimated Value of Spagnoli Road		\$25	– \$25
Total Utility Plant Valuation^(a)		\$662	– \$791

Sources: LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

- (a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.
- (b) Assumes fixed O&M reduction of 33%, 20% increase in capacity prices and property tax reduction of \$115 million in 2010, grown by 2.5% annually.

KEY VALUATION ASSUMPTIONS

GENCO MERCHANT BASIS VALUATION ASSUMPTIONS	
PSA:	<ul style="list-style-type: none"> PSA in effect through 2013
PROJECTIONS:	<ul style="list-style-type: none"> 2010-2013 projected Genco cash flows based on LIPA estimated PSA capitalization, returns and beginning ratebase (see PSA Extension Case analysis) Post-2013 projected Genco gross EBITDA based on Navigant projections of energy margins, capacity revenues and ancillary revenues
COMMODITY PRICES:	<ul style="list-style-type: none"> See attached charts for commodity price assumptions
FIXED O&M:	<ul style="list-style-type: none"> 2014-2029 fixed O&M based on 2010 fixed O&M grown at 2.5% annually 2010 fixed O&M of \$122 million, per LIPA's current PSA settlement discussion position
PROPERTY TAXES:	<ul style="list-style-type: none"> 2014-2029 property taxes based on 2010 property taxes grown at 2.5% annually 2010 property taxes of \$176 million, per LIPA's current PSA settlement discussion position
TAX RATE:	<ul style="list-style-type: none"> Effective tax rate of 37.5%
CAPITAL EXPENDITURES:	<ul style="list-style-type: none"> 2010-2013 capital expenditures per LIPA's projections, post-2013 capital expenditures assumed to equal depreciation of gross utility plant
DEPRECIATION:	<ul style="list-style-type: none"> Straight-line annual depreciation at 3.5% of both existing and projected gross utility plant
ENVIRONMENTAL/DECOMMISSIONING:	<ul style="list-style-type: none"> No explicit assumption regarding environmental/decommissioning costs, which could be significant
MSA AMENDMENT/EXTENSION:	<ul style="list-style-type: none"> Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA
TERMINAL VALUE:	<ul style="list-style-type: none"> No value for the assets assumed post-2029
GENCO MERCHANT BASIS VALUATION ASSUMPTIONS	
PPA:	<ul style="list-style-type: none"> Glenwood and Port Jefferson continue operating under their current PPAs
PROJECTIONS:	<ul style="list-style-type: none"> 2010-2026 projected cash flows reflect LIPA's 20-year projected capacity and SSAP incentive payments
CAPITALIZATION:	<ul style="list-style-type: none"> Assumed capitalization per LIPA assumptions 30% equity; 10.75% ROE 70% debt; 8.50% cost of debt
TAX RATE:	<ul style="list-style-type: none"> Effective tax rate of 40.87% per LIPA assumptions
CAPITAL EXPENDITURES:	<ul style="list-style-type: none"> None assumed (assumed implicitly captured in fixed O&M costs)
DEPRECIATION:	<ul style="list-style-type: none"> None assumed (see capital expenditure assumptions)
ENVIRONMENTAL/DECOMMISSIONING:	<ul style="list-style-type: none"> No explicit assumption regarding environmental/decommissioning costs, which could be significant
MSA AMENDMENT/EXTENSION:	<ul style="list-style-type: none"> Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA
TERMINAL VALUE:	<ul style="list-style-type: none"> Reflects perpetuity value of 2026 unlevered free cash flows

Source: Navigant Consulting and LIPA.

GENCO ASSETS MERCHANT BASIS VALUATION: “BASE CASE” FREE CASH FLOW (a)

Under illustrative “Base Case” assumptions, the Genco assets would be cash flow negative after expiration of the PSA. Accordingly, it can be reasonably assumed that a third-party buyer of the plants, absent the PSA, would take a variety of actions to improve their cash flows, including challenging property taxes, reducing O&M costs and retiring selected plants in order to increase realized capacity prices for the remaining portfolio.

(\$ in millions)

	PSA EFFECTIVE (a)				<i>For the Fiscal Year Ended December 31,</i>							
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	...	2029
Assumed Energy EBITDA	--	--	--	--	\$2.0	\$8.1	\$0.1	\$3.7	\$0.4	\$4.1	...	\$2.7
Plus: Capacity & Ancillary Revenue	--	--	--	--	214.2	225.1	247.1	264.7	293.8	318.8	...	378.1
Gross EBITDA	--	--	--	--	\$216.1	\$233.3	\$247.1	\$268.4	\$294.2	\$322.9	...	\$380.8
Less: Fixed O&M (Excl. Property Taxes)	--	--	--	--	(135.0)	(138.4)	(141.8)	(145.4)	(149.0)	(152.7)	...	(195.5)
Less: Property Taxes	--	--	--	--	(194.6)	(199.5)	(204.5)	(209.6)	(214.8)	(220.2)	...	(281.8)
Net EBITDA	\$97.7	\$101.5	\$106.5	\$109.8	(\$113.5)	(\$104.6)	(\$99.2)	(\$86.5)	(\$69.6)	(\$50.1)	...	(\$96.6)
Less: Depreciation & Amortization	(51.9)	(54.2)	(56.9)	(59.3)	(61.4)	(63.6)	(65.8)	(68.2)	(70.6)	(36.9)	...	(30.0)
EBIT	\$45.8	\$47.3	\$49.6	\$50.5	(\$174.9)	(\$168.1)	(\$165.0)	(\$154.7)	(\$140.2)	(\$86.9)	...	(\$126.6)
Less: Taxes at 37.5%	(17.2)	(17.7)	(18.6)	(18.9)	65.6	63.1	61.9	58.0	52.6	32.6	...	47.5
EBIT (after tax)	\$28.6	\$29.5	\$31.0	\$31.6	(\$109.3)	(\$105.1)	(\$103.1)	(\$96.7)	(\$87.7)	(\$54.3)	...	(\$79.1)
Plus: Depreciation & Amortization	51.9	54.2	56.9	59.3	61.4	63.6	65.8	68.2	70.6	36.9	...	30.0
Less: Capital Expenditures	(55.1)	(79.8)	(76.5)	(57.7)	(61.4)	(63.6)	(65.8)	(68.2)	(70.6)	(36.9)	...	(30.0)
Unlevered Free Cash Flow	\$25.4	\$4.0	\$11.5	\$33.1	(\$109.3)	(\$105.1)	(\$103.1)	(\$96.7)	(\$87.7)	(\$54.3)	...	(\$79.1)

Sources: Navigant Consulting and LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

(a) Assumes Genco continues under the PSA until the end of the current contract in 2013, and accordingly earns projected PSA returns from 2010-2013.

POTENTIAL ENHANCEMENTS TO GENCO GENERATING ASSETS^(a)

(\$ in millions, except KW/month amounts)

The chart below illustrates potential enhancements that could be made to the Genco Generating Assets, including reduction of costs and 500 MW of capacity retirement.

	PSA EFFECTIVE											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	...	2029
Base Case												
Fixed O&M	\$122	\$125	\$128	\$132	\$135	\$138	\$142	\$145	\$149	\$153	...	\$196
Implied \$/kW/Month	\$2.48	\$2.55	\$2.61	\$2.68	\$2.74	\$2.81	\$2.88	\$2.95	\$3.03	\$3.10	...	\$3.97
Property Taxes	\$176	\$181	\$185	\$190	\$195	\$199	\$204	\$210	\$215	\$220	...	\$282
Implied \$/kW/Month	\$3.58	\$3.67	\$3.76	\$3.86	\$3.95	\$4.05	\$4.15	\$4.26	\$4.36	\$4.47	...	\$5.72
Capital Expenditures	\$55	\$80	\$76	\$58	\$61	\$64	\$66	\$68	\$71	\$37	...	\$30
Implied \$/kW/Month	\$1.12	\$1.62	\$1.55	\$1.17	\$1.25	\$1.29	\$1.34	\$1.38	\$1.43	\$0.75	...	\$0.61
Total Fixed Costs	\$354	\$386	\$390	\$379	\$391	\$401	\$412	\$423	\$434	\$410	...	\$507
Pro Forma Enhancement Adjustments:												
Reduce Fixed O&M by 33.3%					\$45	\$46	\$47	\$48	\$50	\$51	...	\$65
Reduce Property Taxes by \$115 million (2.5% Growth)					127	130	133	137	140	144	...	184
Total Benefit/(Cost) of Enhancement Adjustments					\$172	\$176	\$181	\$185	\$190	\$195	...	\$249
Pro Forma Enhanced Total Fixed Costs					\$219	\$225	\$231	\$238	\$245	\$215	...	\$258
Memo: 500 MW Retirements (12.2% of Portfolio)												
Cost Adjustments												
Proportional Reduction in Pro Forma Fixed O&M					\$11	\$11	\$12	\$12	\$12	\$12	...	\$16
Proportional Reduction in Pro Forma Property Taxes					8	8	9	9	9	9	...	12
Proportional Reduction in Capital Expenditures					7	8	8	8	9	4	...	4
Benefit/(Cost) of "Retirement Case" Cost Adjustments					\$27	\$27	\$28	\$29	\$30	\$26	...	\$31
Earnings Adjustments												
Proportional Reduction in Genco Energy EBITDA					(\$0)	(\$1)	(\$0)	(\$0)	(\$0)	(\$1)	...	(\$0)
Proportional Reduction in Genco Capacity & Ancillary Revenues					(26)	(27)	(30)	(32)	(36)	(39)	...	(46)
Benefit/(Cost) of "Retirement Case" Earnings Adjustments					(\$26)	(\$28)	(\$30)	(\$33)	(\$36)	(\$39)	...	(\$46)
Net Benefit/(Cost) of "Retirement Case" Adjustments (Pre-Cap. Price Changes)					\$0	(\$1)	(\$2)	(\$4)	(\$6)	(\$13)	...	(\$15)
Capacity Pricing Adjustment												
Navigant Capacity Price Assumption (Average of Summer & Winter)					\$4.93	\$5.29	\$5.99	\$6.55	\$7.48	\$8.33	...	\$12.55
"Retirement Case" Genco Capacity Price Assumption ^(b)					5.91	6.35	7.19	7.86	8.98	10.00	...	15.06
Multiple of Original Capacity Price					1.20x	1.20x	1.20x	1.20x	1.20x	1.20x	...	1.20x
Base Case Genco Capacity Revenue (Navigant)					\$208	\$218	\$241	\$257	\$287	\$312	...	\$368
Less: Proportional Reduction in Genco Capacity Revenues					(25)	(27)	(29)	(31)	(35)	(38)	...	(45)
Pro Forma Genco "Retirement Case" Capacity Revenue					\$183	\$192	\$212	\$226	\$252	\$274	...	\$323
Multiple of Original Capacity Price					1.20x	1.20x	1.20x	1.20x	1.20x	1.20x	...	1.20x
Capacity Revenues Under New Assumed Price					\$219	\$230	\$254	\$271	\$302	\$329	...	\$388
Benefit/(Cost) of Cap. Pricing Adjustment					\$37	\$38	\$42	\$45	\$50	\$55	...	\$65
Total Net of Benefit/(Cost) of Retirement Adjustments					\$37	\$37	\$40	\$41	\$44	\$42	...	\$50
Total Potential Enhancements to Base Case					\$209	\$214	\$221	\$227	\$234	\$236	...	\$299

Sources: Navigant Consulting and LIPA.

Note: Analysis assumes 4,103 MW of Genco capacity, which is the average of summer and winter capacity amounts.

(a) Does not reflect environmental/decommissioning costs.

(b) Reflects a 20% increase in capacity prices from an illustrative retirement of 500 MW of Genco generating capacity.

LONG ISLAND GENERATING ASSETS: MERCHANT VALUATION^(a)

The valuation analysis implies that the value of the Long Island Generating Assets would be negative (approximately (\$220) million to (\$295) million) before accounting for changes that a new owner of the assets on a merchant basis would presumably make.

Accounting for these changes, the value of the generating assets rises to approximately \$510 million to \$790 million, assuming 20 years of remaining useful lives for the assets; if the estimated terminal year cash flows of the generating assets were valued in perpetuity, the implied value would rise to approximately \$650 million to \$1,175 million.

(\$ in millions)

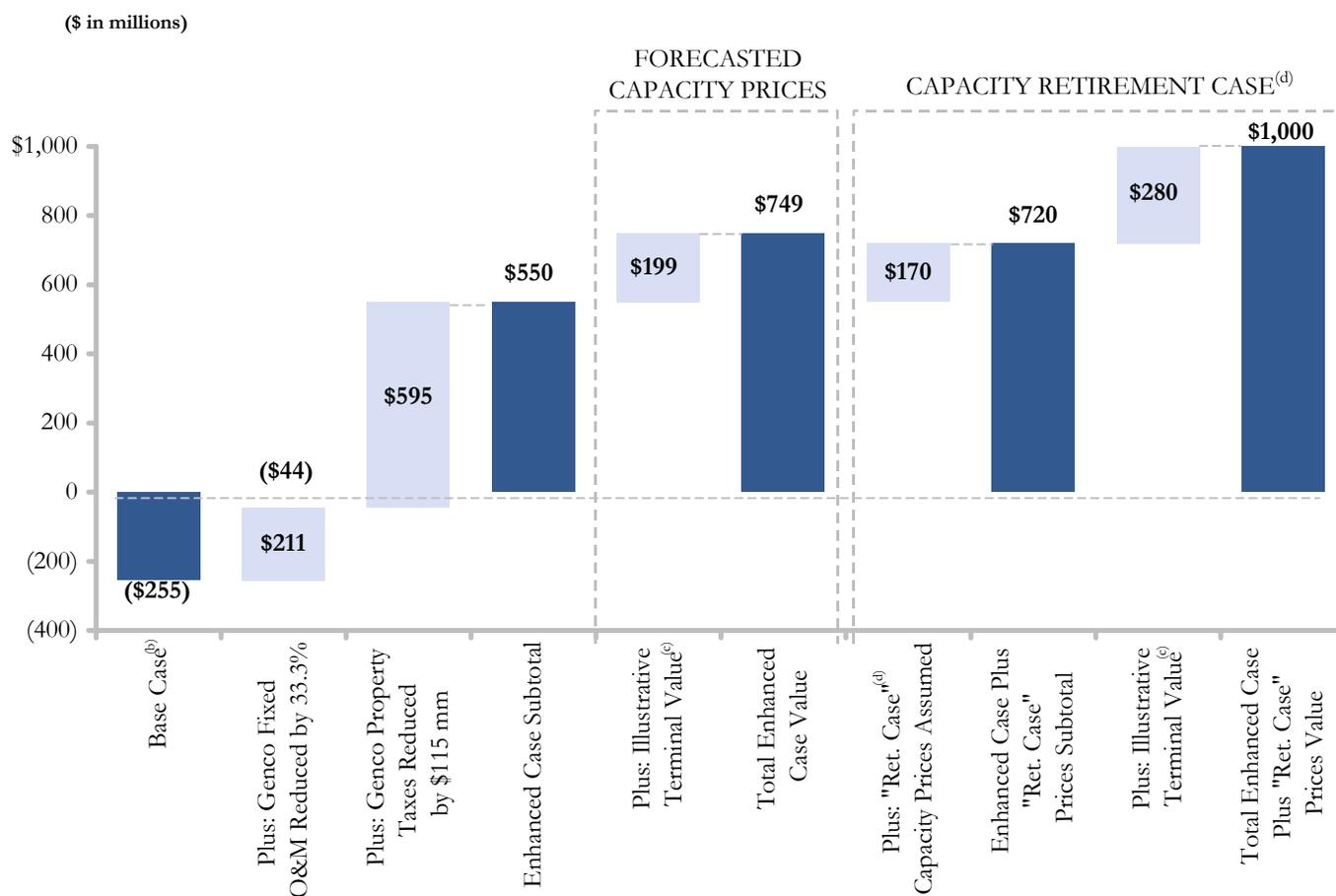
	Low (9.1% WACC)	High (7.1% WACC)	Reference (8.1% WACC)	
BASE CAPACITY PRICES	Base Case Value ^(b)	(\$219)	(\$295)	(\$255)
	Plus: Value of Reducing Genco Fixed O&M by 33.3%	190	234	211
	Plus: Value of Reducing Genco Property Taxes by \$115 mm	536	661	595
	Value Subtotal with Enhanced O&M and Property Taxes	\$507	\$601	\$550
	Plus: Illustrative Terminal Value with Enhanced O&M and Property Taxes ^(c)	147	273	199
Total Value with Enhanced O&M and Property Taxes	\$654	\$875	\$749	
CAPACITY RETIREMENT CASE	Value Subtotal with Enhanced O&M and Property Taxes	\$507	\$601	\$550
	Plus: Capacity Retirement Case ^(d)	153	189	170
	Value Subtotal with Enhanced O&M and Property Taxes and Capacity Retirement	\$660	\$790	\$720
	Plus: Perpetuity Value with Enhanced O&M and Property Taxes and Cap. Retire. ^(c)	207	384	280
Total Value with Enhanced O&M and Property Taxes and Capacity Retire.	\$868	\$1,174	\$1,000	

Source: Navigant Consulting and LIPA.

- (a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.
- (b) Comprised of the present value of Genco cash flows; other Genco items of \$93 million (estimated land value of \$81 million, plus net working capital of \$12 million); the present value of Glenwood and Port Jefferson cash flows under their current PPAs (\$90 at 9.10% discount rate, \$99 at 8.10% discount rate and \$110 at 7.10% discount rate) plus various related items including working capital of (\$11) million; and the estimated value of Spagnoli Road (\$25 million).
- (c) Present value of perpetuity of Genco 2029 cash flows.
- (d) Reflects a 20% increase in capacity prices from an illustrative retirement of 500 MW of Genco generating capacity.

VALUATION BRIDGE ANALYSIS^(a)

Based on the midpoints of indicated valuation ranges, the valuation analysis implies a valuation of approximately (\$255) million; however, applying different assumptions regarding expenses and capacity revenues could result in a value of approximately \$750 million to \$1,000 million (\$210 million of value from a reduction in fixed O&M, \$600 million in value from the reduction of property taxes, \$170 million from capacity retirement and \$280 million from terminal value).



Source: Navigant Consulting and LIPA.

- (a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.
- (b) Comprised of the present value of Genco cash flows; other Genco items of \$93 million (estimated land value of \$81 million, plus net working capital of \$12 million); the present value of Glenwood and Port Jefferson cash flows under their current PPAs (\$90 at 9.10% discount rate, \$99 at 8.10% discount rate and \$110 at 7.10% discount rate) plus various related items including working capital of (\$11) million; and the estimated value of Spagnoli Road (\$25 million).
- (c) Present value of perpetuity of Genco 2029 cash flows.
- (d) Reflects a 20% increase in capacity prices from an illustrative retirement of 500 MW of Genco generating capacity.

L.I. GENERATING ASSETS SENSITIVITY ANALYSIS ^(a)

Depending on the assumptions for Genco fixed O&M, Genco property taxes, Genco terminal value and Genco capacity prices, the midpoint value of the L.I. Generating Assets can range from (\$255) million to \$1,000 million at a discount rate of 8.10%.

(\$ in millions)

CASE 1 - BASE CASE						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	(\$414)	+	\$93	+	\$103	= (\$219)
8.60%	(436)	+	93	+	107	= (236)
8.10%	(459)	+	93	+	111	= (255)
7.60%	(484)	+	93	+	116	= (274)
7.10%	(510)	+	93	+	122	= (295)

Variation from Base Case:

--

CASE 2						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	(\$224)	+	\$93	+	\$103	= (\$29)
8.60%	(236)	+	93	+	107	= (36)
8.10%	(248)	+	93	+	111	= (44)
7.60%	(261)	+	93	+	116	= (52)
7.10%	(275)	+	93	+	122	= (60)

Variation from Base Case:

Genco fixed O&M reduced by 33.3%

CASE 3						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	\$121	+	\$93	+	\$103	= \$317
8.60%	128	+	93	+	107	= 328
8.10%	136	+	93	+	111	= 340
7.60%	143	+	93	+	116	= 353
7.10%	152	+	93	+	122	= 367

Variation from Base Case:

Genco property taxes reduced by \$115 million per year in 2010, reduction grown at 2.5% annually

Source: Navigant Consulting and LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

- (a) Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.
- (b) Includes estimated land value of \$81 million, plus net working capital of \$12 million.
- (c) Assumes Glenwood and Port Jefferson continue operating under their current PPAs.

CASE 4						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	\$311	+	\$93	+	\$103	= \$507
8.60%	328	+	93	+	107	= 528
8.10%	346	+	93	+	111	= 550
7.60%	366	+	93	+	116	= 575
7.10%	386	+	93	+	122	= 601

Variation from Base Case:

Genco fixed O&M reduced by 33.3%

Genco property taxes reduced by \$115 million per year in 2010, reduction grown at 2.5% annually

CASE 5						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	\$459	+	\$93	+	\$103	= \$654
8.60%	499	+	93	+	107	= 699
8.10%	545	+	93	+	111	= 749
7.60%	598	+	93	+	116	= 808
7.10%	660	+	93	+	122	= 875

Variation from Base Case:

Genco fixed O&M reduced by 33.3%

Genco property taxes reduced by \$115 million per year in 2010, reduction grown at 2.5% annually

Assumes perpetuity of Genco 2029 free cash flows

CASE 6						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	\$465	+	\$93	+	\$103	= \$660
8.60%	490	+	93	+	107	= 689
8.10%	516	+	93	+	111	= 720
7.60%	544	+	93	+	116	= 754
7.10%	575	+	93	+	122	= 790

Variation from Base Case:

Genco fixed O&M reduced by 33.3%

Genco property taxes reduced by \$115 million per year in 2010, reduction grown at 2.5% annually

Assumes 20% increase in capacity prices from an illustrative 500 MW retirement

CASE 7						
Discount Rate	PV of Genco Cash Flows		Other Genco Items ^(b)		PV of G.W. & P.J. Cash Flows & SR ^(c)	Total Implied L.I. Gen. Assets Value
9.10%	\$672	+	\$93	+	\$103	= \$868
8.60%	730	+	93	+	107	= 930
8.10%	796	+	93	+	111	= 1,000
7.60%	872	+	93	+	116	= 1,081
7.10%	959	+	93	+	122	= 1,174

Variation from Base Case:

Genco fixed O&M reduced by 33.3%

Genco property taxes reduced by \$115 million per year in 2010, reduction grown at 2.5% annually

Assumes 20% increase in capacity prices from an illustrative 500 MW retirement

Assumes perpetuity of Genco 2029 free cash flows

Source: Navigant Consulting and LIPA.

Note: Discounted cash flow valuation to December 31, 2009.

Analysis does not include the potential value impact of National Grid's requested long-term extension and other material amendments to the MSA or the retirement, decommissioning and environmental costs of the Long Island Generating Assets.

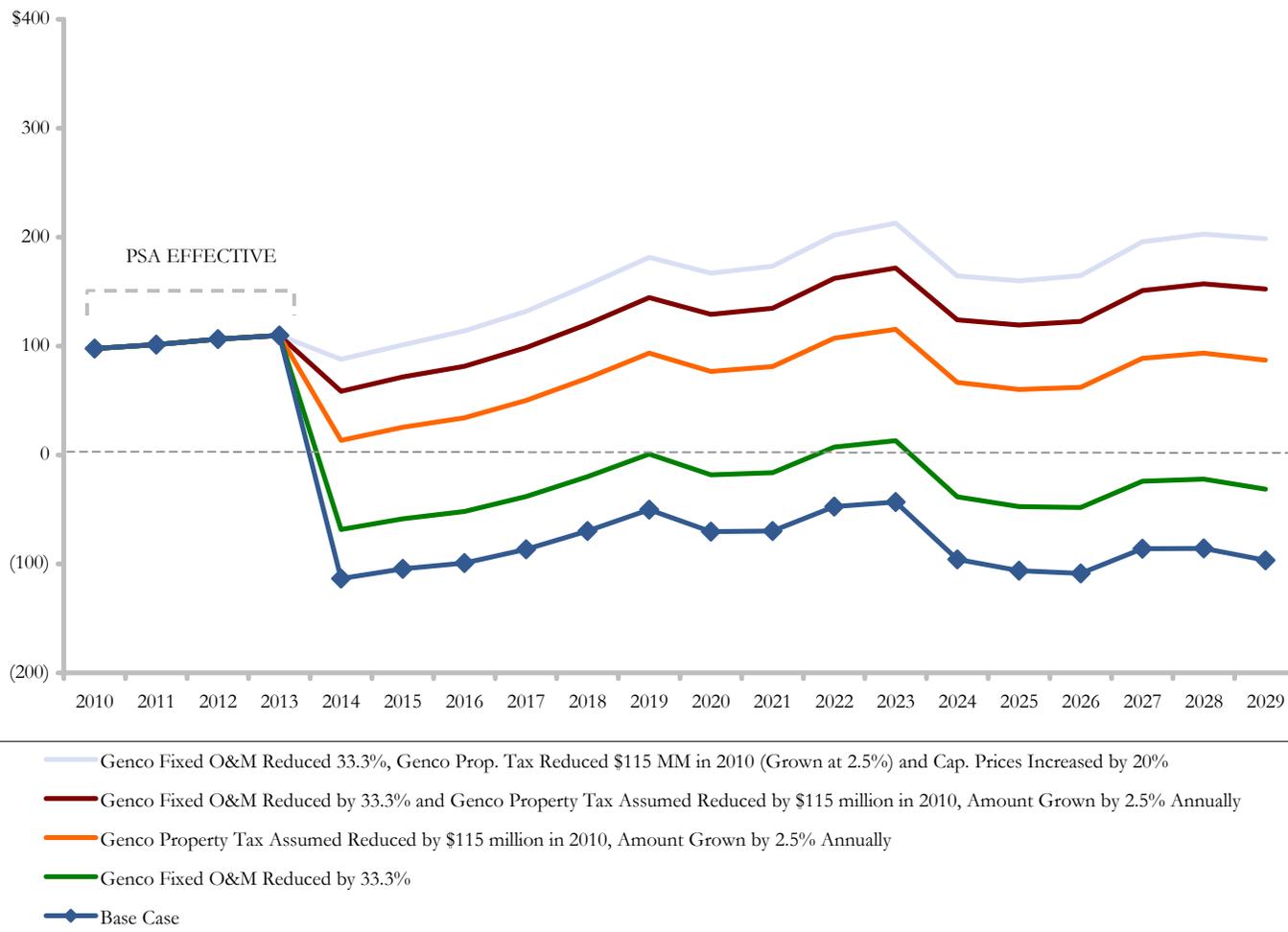
(b) Includes estimated land value of \$81 million, plus net working capital of \$12 million.

(c) Assumes Glenwood and Port Jefferson continue operating under their current PPAs.

GENCO FLEET EBITDA^(a)

(\$ in millions)

The chart below illustrates the range of potential EBITDA results for Genco under various sensitivity assumptions, which were used in selected valuation sensitivity cases:



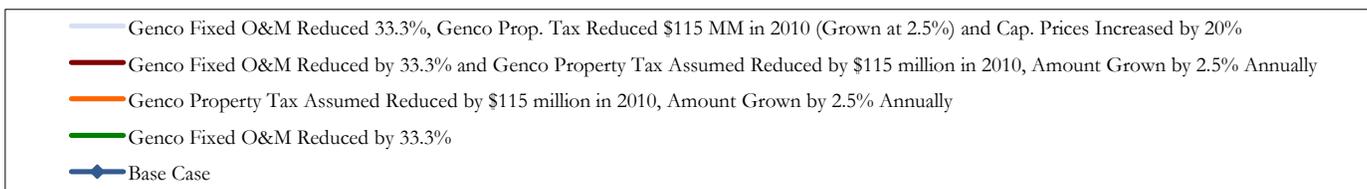
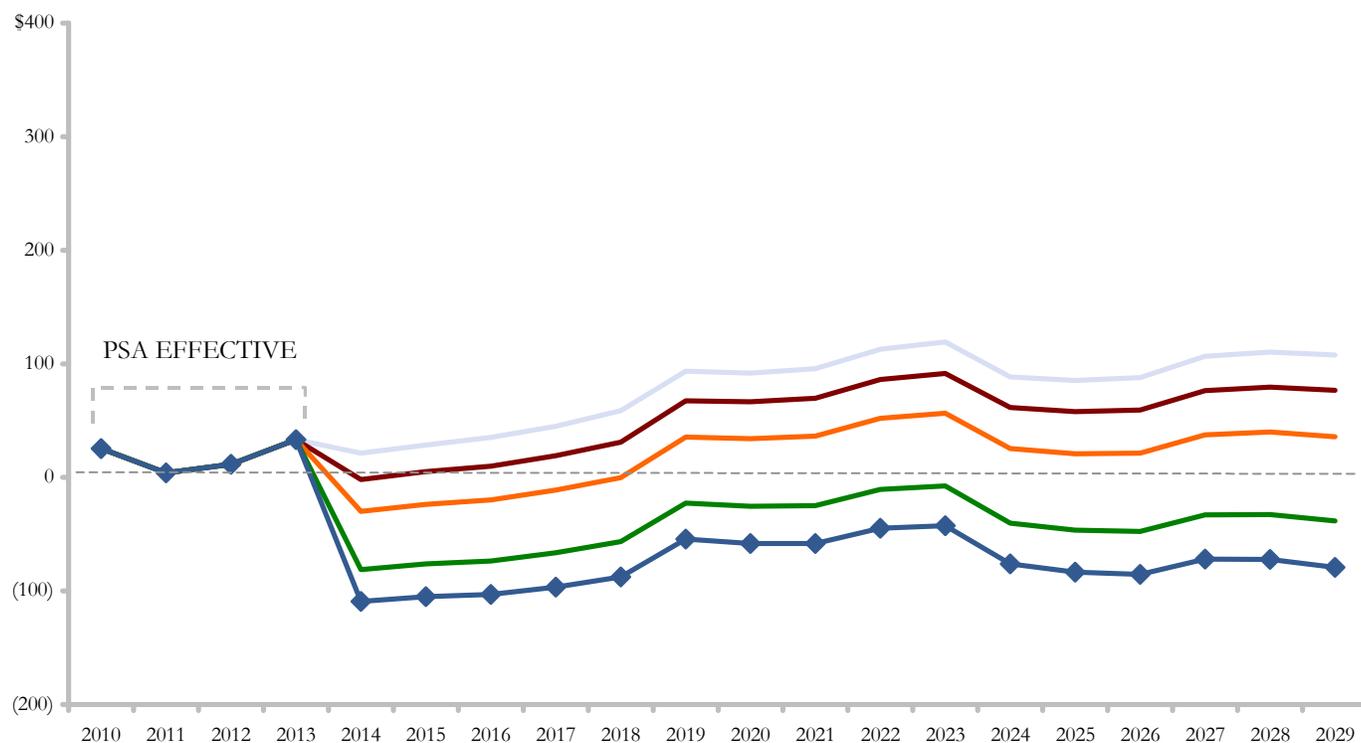
Source: Navigant Consulting and LIPA.

(a) Comprised of energy margins plus capacity and ancillary revenues, less fixed O&M and property taxes.

GENCO FLEET FREE CASH FLOWS ^(a)

(\$ in millions)

The chart below illustrates the range of potential free cash flow results for Genco under various sensitivity assumptions, which were used in selected valuation sensitivity cases:



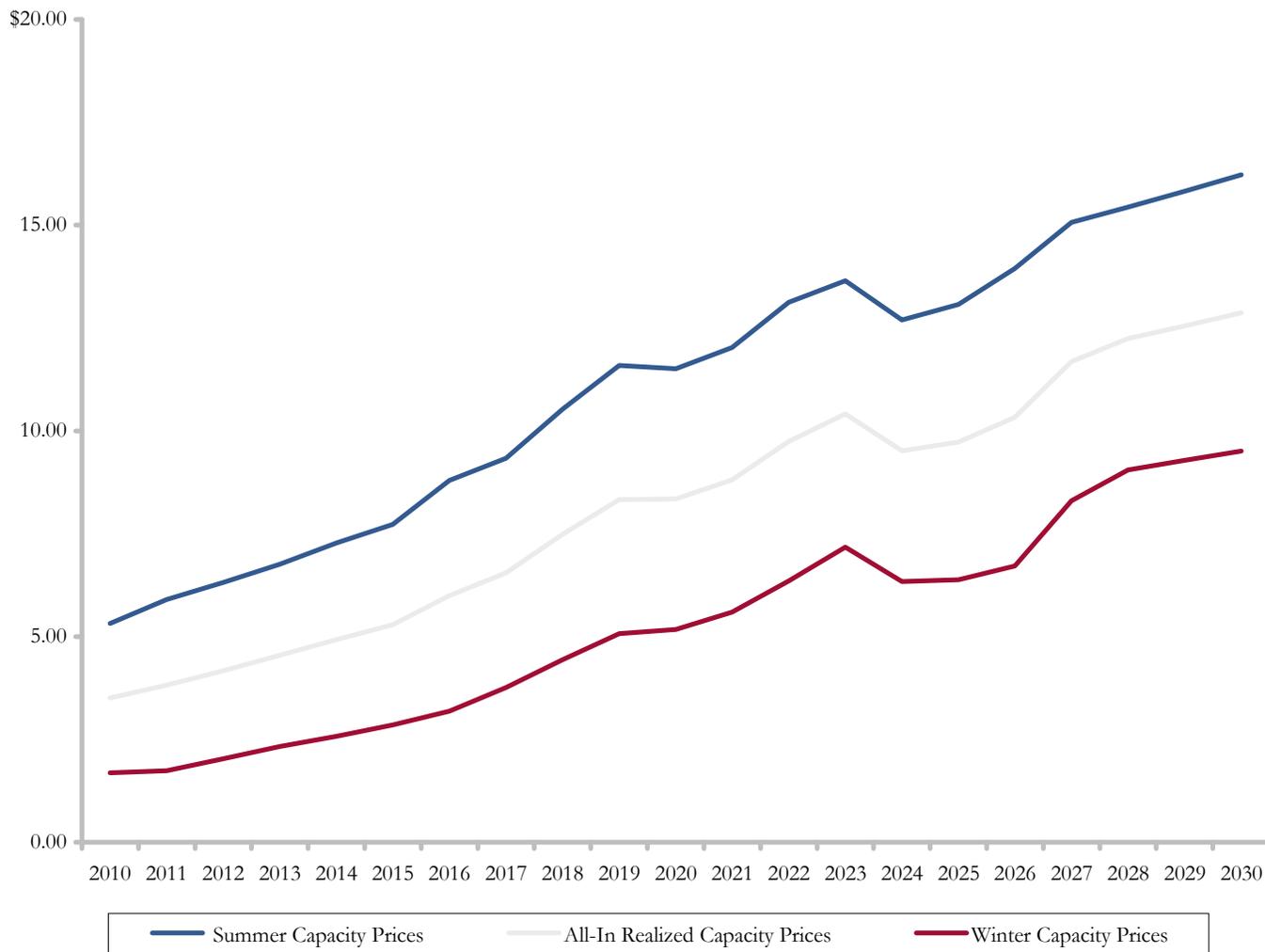
Source: Navigant Consulting and LIPA.

(a) Comprised of tax-effected EBIT plus D&A, less capital expenditures.

EMBEDDED CAPACITY PRICE ASSUMPTIONS

(\$/kW Month)

The chart below illustrates embedded capacity price assumptions from 2010 through 2030.

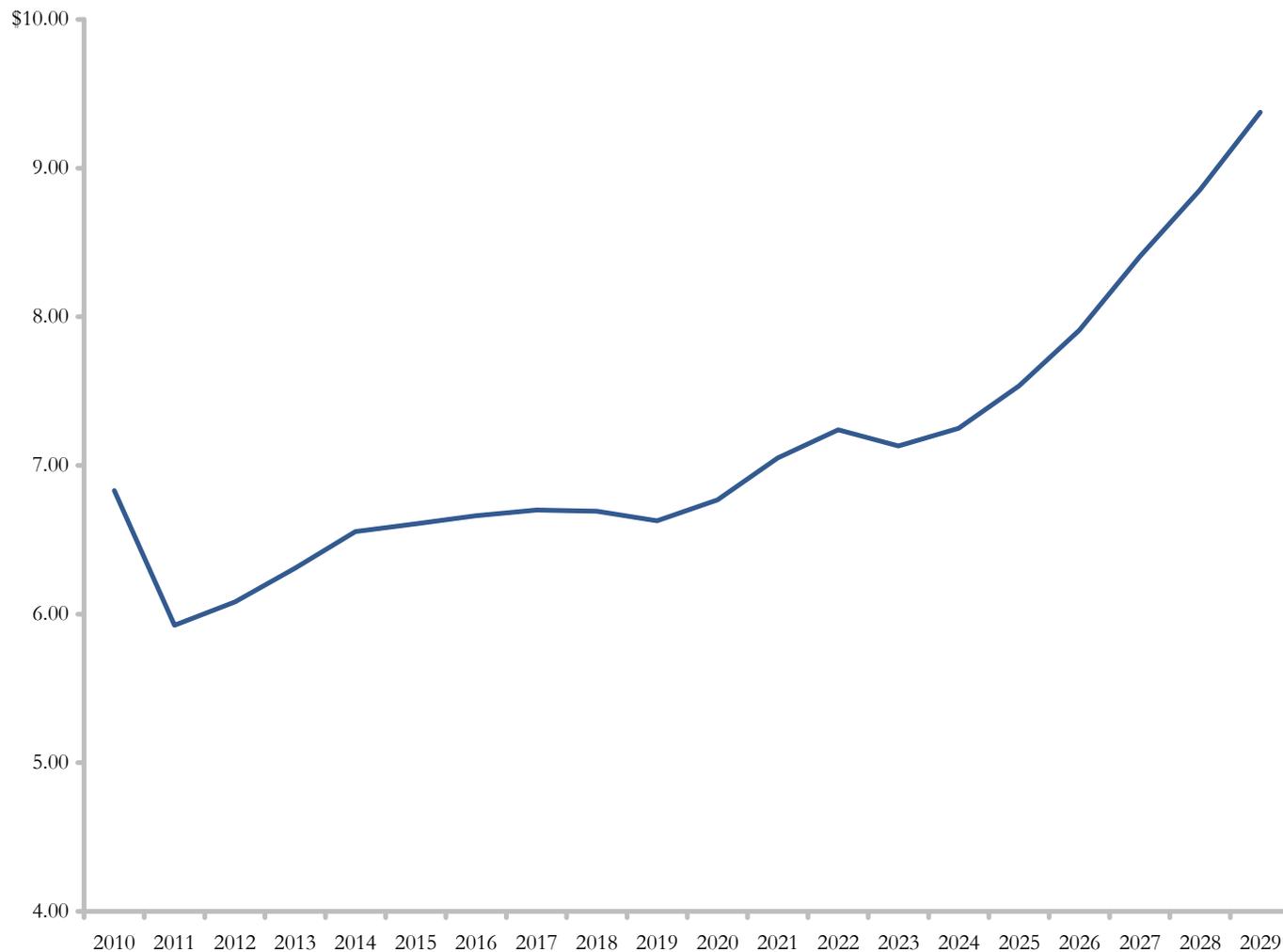


Source: Navigant Consulting.

EMBEDDED GAS COST ASSUMPTIONS

(\$/MMBtu)

The chart below illustrates embedded gas cost assumptions from 2010 through 2029.



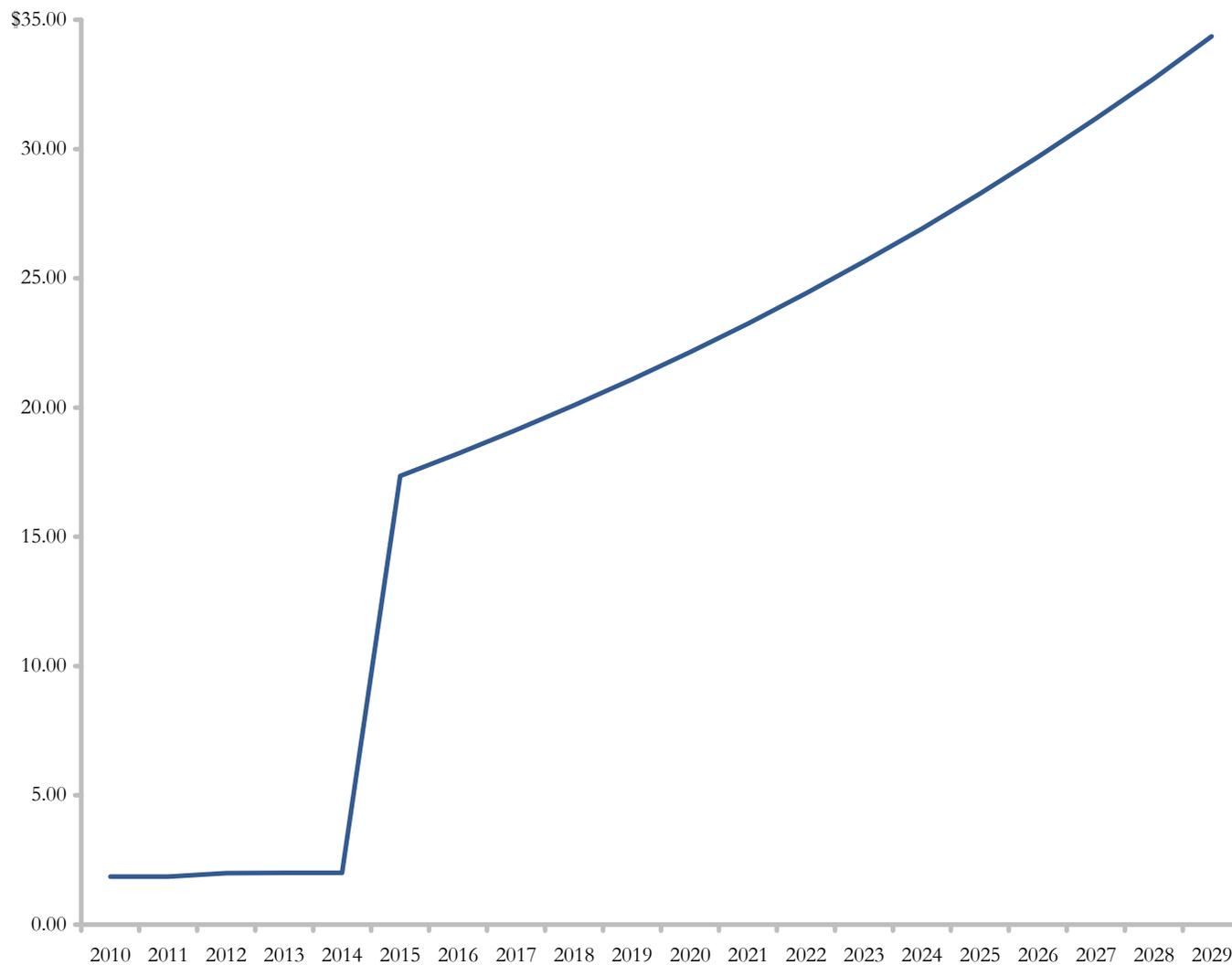
Source: Navigant Consulting.

Note: Amounts represent annual averages.

EMBEDDED CARBON EMISSION COST ASSUMPTIONS

(\$/ton)

The chart below illustrates embedded carbon emission cost assumptions from 2010 through 2029.



Source: Navigant Consulting.

Note: Amounts represent annual averages.

EMBEDDED CAPACITY FACTOR ASSUMPTIONS

The chart below illustrates embedded unit-specific capacity factor assumptions from 2010 through 2029.

Genco	Maximum Capacity (MW)	Winter Capacity (MW)	Summer Capacity (MW)	Capacity Factor (%)										
				2010	2011	2012	2013	2014	...	2019	...	2024	...	2029
Barret Units CT 1-8	156.7	151.8	136.8	0.0%	0.1%	0.4%	0.1%	0.5%	...	1.4%	...	1.4%	...	1.6%
Barrett Units JE 9-12	198.8	198.8	166.2	0.0%	0.0%	0.1%	0.0%	0.1%	...	0.0%	...	0.1%	...	0.2%
Barret ST 1 & 2	381.2	381.2	382.0	7.8%	6.8%	8.7%	6.7%	8.6%	...	9.5%	...	10.8%	...	10.7%
East Hampton CT 1	24.2	22.4	18.6	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.0%
Far Rockaway ST 4	111.1	111.1	105.6	5.5%	7.2%	7.0%	7.4%	8.4%	...	8.7%	...	9.0%	...	10.1%
Glenwood ST 4-5	220.7	220.7	238.7	3.5%	3.9%	4.4%	4.1%	5.0%	...	5.3%	...	5.0%	...	5.5%
Glenwood CT 1-3	149.2	149.2	115.2	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.0%
Holtsville JE 1-10	648.5	653.9	534.6	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.0%
NCI Aggregate ^(a)	12.0	12.0	12.0	4.4%	2.0%	2.3%	2.2%	2.7%	...	2.5%	...	2.8%	...	5.0%
Northport ST 1-4	1,510.3	1,509.3	1,569.9	7.7%	8.1%	8.0%	7.9%	8.4%	...	10.1%	...	10.0%	...	11.7%
Northport CT 1	18.0	18.0	12.5	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.0%
Port Jefferson ST 3-4	379.2	379.2	379.2	2.3%	1.5%	1.3%	1.3%	1.8%	...	1.5%	...	1.2%	...	4.9%
Port Jefferson CT 1	17.3	17.3	13.4	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.1%
South Hampton CT 1	8.9	8.9	9.7	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.1%
Southhold CT 1	16.2	16.2	10.9	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.1%
Wading River CT 1-3	306.5	306.5	233.8	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.1%
West Babylon CT 4	60.5	60.5	49.0	0.0%	0.0%	0.0%	0.0%	0.0%	...	0.0%	...	0.0%	...	0.0%
Total Genco Capacity Factor %	4,219.3	4,217.0	3,988.1	4.4%	4.4%	4.6%	4.3%	4.9%	...	5.6%	...	5.7%	...	6.8%
Other Long Island Generating Assets														
Glenwood CT 4-5	96.5	96.5	80.0	16.8%	15.3%	18.0%	18.3%	20.7%	...	26.7%	...	28.1%	...	33.7%
Port Jefferson CT 2-3	89.5	89.5	79.0	8.4%	8.2%	10.2%	9.7%	10.6%	...	12.8%	...	16.4%	...	21.8%
GW and PJ Capacity Factor %	186.0	186.0	159.0	12.6%	11.8%	14.2%	14.0%	15.7%	...	19.8%	...	22.3%	...	27.8%

Source: Navigant Consulting and NY ISO Gold Book.

(a) Represents National Grid owned generation in East Hampton IC 2-4 and Montauk IC 2-4.

MERCHANT GENERATING COMPANY WACC ANALYSIS

The chart below illustrates the assumed weighted average cost of capital based on a variety of merchant generating companies.

(\$ in millions)

Merchant Companies	Stock Price	Equity Value	Net Debt	Debt/Book Cap.	Net Debt/Ent. Value	Net Debt/Equity Value	Levered Beta	Unlevered Beta ^(a)	
AES	AES	\$13.25	\$8,838	\$20,172	70.0%	69.5%	228.2%	1.33	0.55
Calpine	CPN	\$11.22	\$5,442	\$9,107	70.2%	62.6%	167.4%	1.40	0.69
Covanta	CVA	\$17.50	\$2,711	\$1,726	64.4%	38.9%	63.7%	1.09	0.78
Dynegy	DYN	\$1.82	\$1,538	\$5,644	61.2%	78.6%	367.0%	1.74	0.53
Mirant	MIR	\$16.34	\$2,371	\$1,773	45.7%	42.8%	74.8%	1.44	0.98
NRG	NRG	\$26.65	\$7,647	\$7,130	51.9%	48.3%	93.2%	1.32	0.84
Ormat	ORA	\$35.87	\$1,629	\$463	37.9%	22.1%	28.4%	0.84	0.72
RRI Energy	RRI	\$5.71	\$2,007	\$1,527	40.4%	43.2%	76.1%	1.60	1.08
TransAlta	TAC	\$18.93	\$2,943	\$2,538	44.8%	46.3%	86.2%	0.80	0.52
<i>Median</i>					51.9%	46.3%	86.2%	1.33	0.72

Assumptions

Marginal Tax Rate	38.0%
Risk Free Rate of Return ^(b)	3.38%
Equity Risk/Market Premium ^(c)	7.10%

Debt/Cap	Debt/Equity	Median		Levered Beta	Cost of Equity ^(e)
		Unlevered Beta	Levering Factor ^(d)		
0.00%	0.00%	0.72	1.00	0.72	8.45%
10.00%	11.11%	0.72	1.07	0.76	8.80%
20.00%	25.00%	0.72	1.16	0.83	9.24%
30.00%	42.86%	0.72	1.27	0.90	9.80%
40.00%	66.67%	0.72	1.41	1.01	10.55%
50.00%	100.00%	0.72	1.62	1.16	11.60%
60.00%	150.00%	0.72	1.93	1.38	13.17%
70.00%	233.33%	0.72	2.45	1.75	15.80%
80.00%	400.00%	0.72	3.48	2.49	21.04%

Pre-Tax/After-Tax Cost of Debt			
6.50%	7.00%	7.50%	8.00%
4.03%	4.34%	4.65%	4.96%

Weighted Average Cost of Capital ^(f)				
8.45%	8.45%	8.45%	8.45%	8.45%
8.33%	8.36%	8.39%	8.42%	8.45%
8.20%	8.26%	8.32%	8.38%	8.45%
8.07%	8.16%	8.26%	8.35%	8.44%
7.94%	8.07%	8.19%	8.32%	8.44%
7.82%	7.97%	8.13%	8.28%	8.44%
7.69%	7.87%	8.06%	8.25%	8.43%
7.56%	7.78%	7.99%	8.21%	8.43%
7.43%	7.68%	7.93%	8.18%	8.42%

Notes:

- Unlevered Beta = Levered Beta/[1+(1-Tax Rate)(Debt/Equity)].
- Risk Free Rate is 10-Year Treasury Bond Yield.
- Source: Represents the long-horizon expected equity risk premium based on differences of historical arithmetic mean returns on the S&P 500 from 1926-2006 (Ibbotson Associates' 2008 Yearbook)
- Levering Factor = [1 + (1-Tax Rate)(Debt/Equity)].
- Cost of Equity = (Risk Free Rate of Return)+(Levered Beta)(Equity Risk Premium)+ Equity Size Premium.
- Weighted Average Cost of Capital = (After-Tax Cost of Debt)(Debt/Cap.)+(Cost of Equity)(Equity/Cap.).

6.2.3. Barrett Valuation Analysis

SUMMARY OBSERVATIONS: BARRETT VALUATION ANALYSIS

Valuation of the Barrett Generating Station varies considerably depending on the operational enhancements assumed by the new owner, ranging from (\$105) million if no operational enhancements are assumed to \$70 million with selected operational enhancements. This valuation reflects the assumption that the PSA would not be extended in 2014 and that Barrett would be operated on a merchant basis from 2014 onward

The valuation is based on a discounted cash flow (“DCF”) valuation of Barrett using long-term revenue projections provided by Navigant Consulting and other cash flow-related assumptions provided by LIPA. Barrett would be cash flow negative if it is operated at current revenue and cost levels after the expiration of the PSA.

It can be reasonably assumed that a third-party buyer of Barrett, absent the PSA, would take a variety of actions to improve its cash flow including by challenging current property tax assessments^(a) and reducing O&M costs.

Accounting for these operational enhancements, the implied value of Barrett would rise to \$60 million to \$70 million. Further assuming that there is perpetuity value to the assets beyond the 20-year projection period, the implied value of Barrett would rise to \$75 million to \$105 million depending on the operational enhancements assumed.

(a) LIPA currently possess the ability to challenge property taxes through provisions in the PSA.

KEY VALUATION ASSUMPTIONS

BARRETT MERCHANT VALUATION ASSUMPTIONS	
PSA:	<ul style="list-style-type: none"> ■ PSA in effect through 2013
CAPACITY:	<ul style="list-style-type: none"> ■ Barrett capacity of 708 MW (average of summer and winter capacity) <ul style="list-style-type: none"> ■ Represents 17.3% of total average Genco capacity (4,103 MW)
PROJECTIONS:	<ul style="list-style-type: none"> ■ 2010-2013 projected cash flows based on LIPA estimated PSA capitalization, returns and beginning ratebase (see PSA analysis) <ul style="list-style-type: none"> ■ Cash flows calculated for total Genco, then prorated based on Barrett capacity ■ Post-2013 projected gross EBITDA based on Navigant projections of energy margins, capacity revenues and ancillary revenues
COMMODITY PRICES:	<ul style="list-style-type: none"> ■ See attached charts for commodity price assumptions
FIXED O&M:	<ul style="list-style-type: none"> ■ 2014-2029 fixed O&M based on 2010 fixed O&M grown at 2.5% annually <ul style="list-style-type: none"> ■ 2010 fixed O&M of \$21 million, equal to LIPA's current PSA settlement discussion position prorated based on Barrett capacity ■ 33% reduction of fixed O&M analyzed as valuation sensitivity
PROPERTY TAXES:	<ul style="list-style-type: none"> ■ 2014-2029 property taxes based on 2008 property taxes grown at 2.5% annually <ul style="list-style-type: none"> ■ 2008 property taxes of \$33.7 million, per LIPA's Barrett Purchase Option Study ■ 65% reduction of property taxes analyzed as valuation sensitivity
TAX RATE:	<ul style="list-style-type: none"> ■ Effective tax rate of 37.5%
CAPITAL EXPENDITURES:	<ul style="list-style-type: none"> ■ 2010-2013 capital expenditures per LIPA's projections, post-2013 capital expenditures assumed to equal the average of 2010-2013 capital expenditures grown at 2.5% annually
DEPRECIATION:	<ul style="list-style-type: none"> ■ Annual depreciation equal to annual capital expenditures
ENVIRONMENTAL/DECOMMISSIONING:	<ul style="list-style-type: none"> ■ No explicit assumption regarding environmental/decommissioning costs, which could be significant
TERMINAL VALUE:	<ul style="list-style-type: none"> ■ No value for the assets assumed post-2029 in Base Case; analyzed as valuation sensitivity

Source: Navigant Consulting and LIPA.

POTENTIAL ENHANCEMENTS TO BARRETT^(a)

(\$ in millions, except kW/month amounts)

The chart below illustrates potential enhancements that could be made to Barret, including reduction of O&M costs and property taxes.

	PSA EFFECTIVE				2014	2015	2016	2017	2018	2019	...	2029
	2010	2011	2012	2013								
Base Case												
Fixed O&M	\$21	\$22	\$22	\$23	\$23	\$24	\$24	\$25	\$26	\$26	...	\$34
<i>Implied \$/kW/Month</i>	\$2.48	\$2.55	\$2.61	\$2.68	\$2.74	\$2.81	\$2.88	\$2.95	\$3.03	\$3.10	...	\$3.97
Property Taxes	\$35	\$36	\$37	\$38	\$39	\$40	\$41	\$42	\$43	\$44	...	\$57
<i>Implied \$/kW/Month</i>	\$4.17	\$4.27	\$4.38	\$4.49	\$4.60	\$4.71	\$4.83	\$4.95	\$5.07	\$5.20	...	\$6.66
Capital Expenditures	\$5	\$8	\$7	\$5	\$6	\$7	\$7	\$7	\$7	\$7	...	\$9
<i>Implied \$/kW/Month</i>	\$0.53	\$0.94	\$0.84	\$0.60	\$0.75	\$0.77	\$0.78	\$0.80	\$0.82	\$0.84	...	\$1.08
Total Fixed Costs	\$61	\$66	\$67	\$66	\$69	\$70	\$72	\$74	\$76	\$78	...	\$100
Pro Forma Enhancement Adjustments:												
Reduce Fixed O&M by 33.3%					\$8	\$8	\$8	\$8	\$9	\$9	...	\$11
Reduce Property Taxes by 65% ^(b)					25	26	27	27	28	29	...	37
Total Benefit/(Cost) of Enhancement Adjustments					\$33	\$34	\$35	\$36	\$37	\$38	...	\$48
<i>Memo:</i>												
<i>Pro Forma Enhanced Total Fixed Costs</i>					\$36	\$36	\$37	\$38	\$39	\$40	...	\$52

Source: Navigant Consulting and LIPA.

Note: Analysis assumes 4,103 MW of Genco capacity and 708 MW of Barrett capacity, which are the averages of summer and winter capacity amounts.

(a) Does not reflect environmental/decommissioning costs.

(b) 65% is equivalent to the percentage reduction in total Genco taxes assuming a \$115 Genco tax reduction.

DCF VALUATION

As compared with the option exercise price of \$90 million, valuation analysis implies that the value of Barrett would be negative (approximately (\$80) million to (\$100) million) before accounting for changes that a new owner of the assets on a merchant basis would presumably make.

Accounting for these changes, the implied value of Barrett rises to approximately \$60 million to \$70 million, assuming 20 years of remaining useful lives for the assets; if the estimated terminal year cash flows of the generating assets were valued in perpetuity, the implied value would rise to approximately \$80 million to \$100 million.

(\$ in millions)

	Low (9.1% WACC)	High (7.1% WACC)	Reference (8.1% WACC)
Base Case Value ^(a)	(\$82)	(\$104)	(\$92)
Plus: Value of Reducing Genco Fixed O&M by 33.3%	33	40	36
Plus: Value of Reducing Genco Property Taxes by 65%	107	132	119
Value Subtotal with Enhanced O&M and Property Taxes	\$58	\$69	\$63
Plus: Illustrative Terminal Value with Enhanced O&M and Property Taxes ^(b)	19	35	26
Total Value with Enhanced O&M and Property Taxes	\$77	\$104	\$88

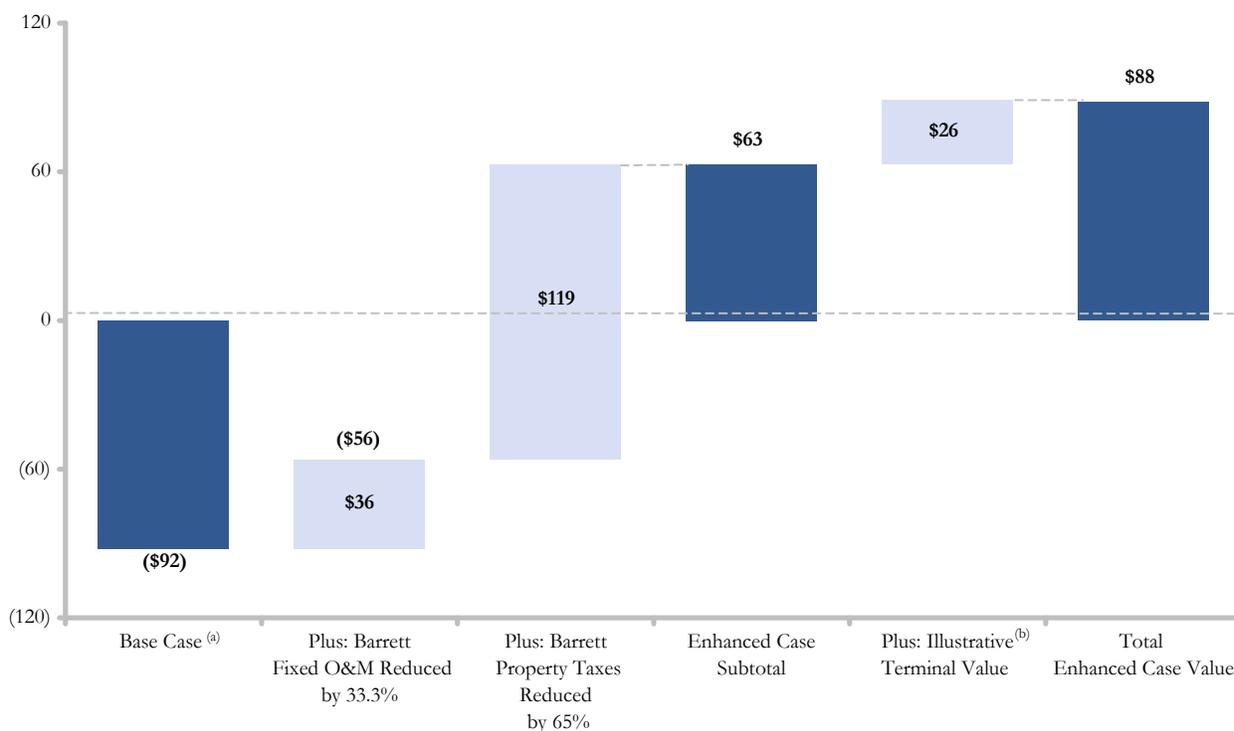
(a) Comprised of the present value of Barrett cash flows, does not assume any additional value from land or other items.

(b) Present value of perpetuity of Barrett 2029 cash flows.

PRELIMINARY VALUATION BRIDGE ANALYSIS^(a)

(\$ in millions)

This chart illustrates the contribution analysis of the potential enhancements to Barret.



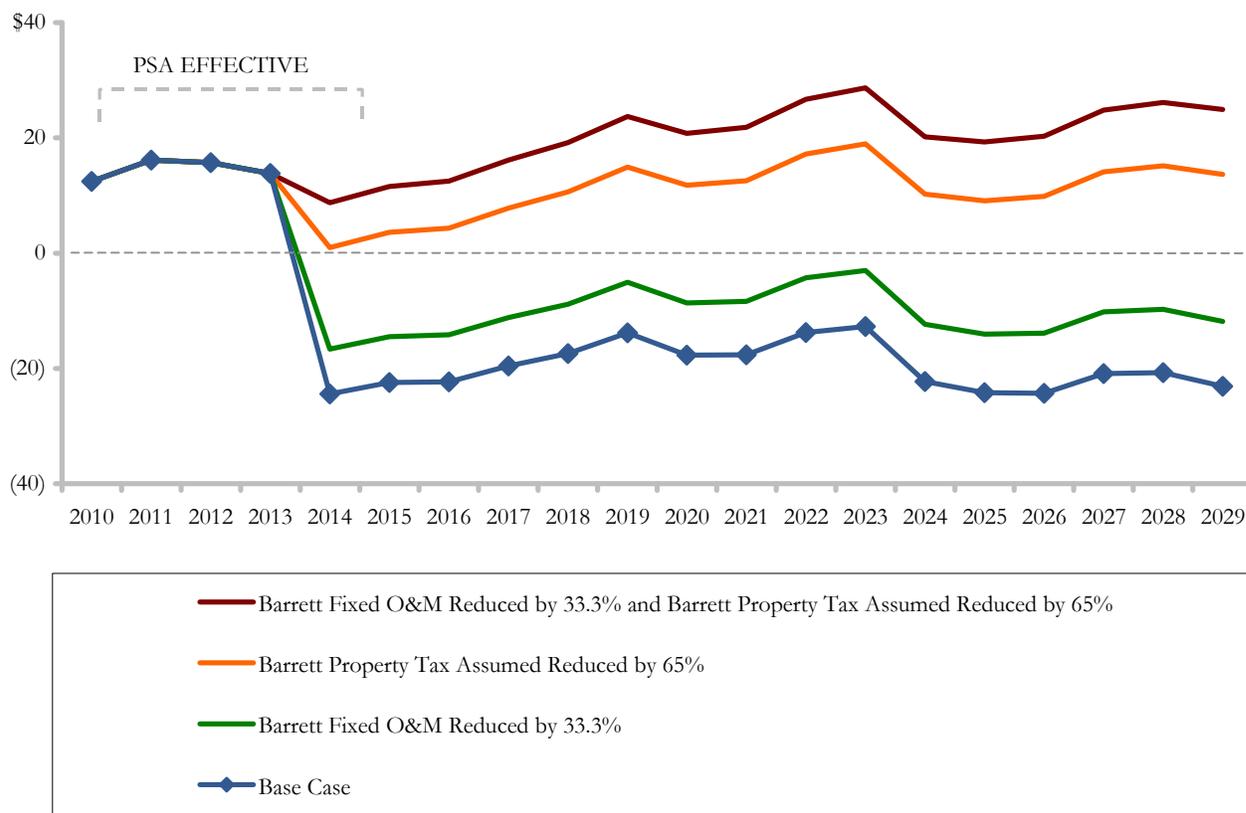
(a) Comprised of the present value of Barrett cash flows, does not assume any additional value from land or other items.

(b) Present value of perpetuity of Barrett 2029 cash flows.

BARRETT EBITDA^(a)

(\$ in millions)

The chart below illustrates the range of potential EBITDA results for Barret under various sensitivity assumptions, which were used in selected valuation sensitivity cases:



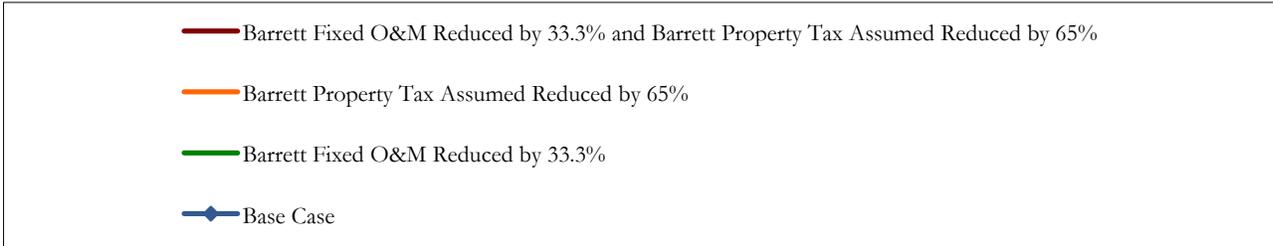
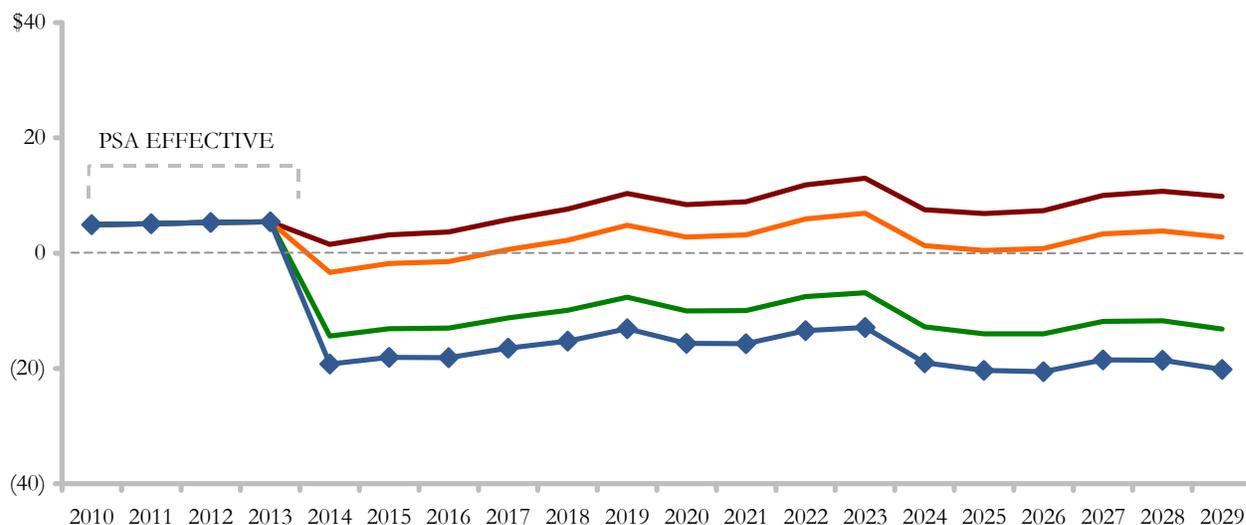
Source: Navigant Consulting and LIPA.

(a) Comprised of energy margins plus capacity and ancillary revenues, less fixed O&M and property taxes.

BARRETT FREE CASH FLOWS^(a)

(\$ in millions)

The chart below illustrates the range of potential free cash flow results for Barret under various sensitivity assumptions, which were used in selected valuation sensitivity cases:



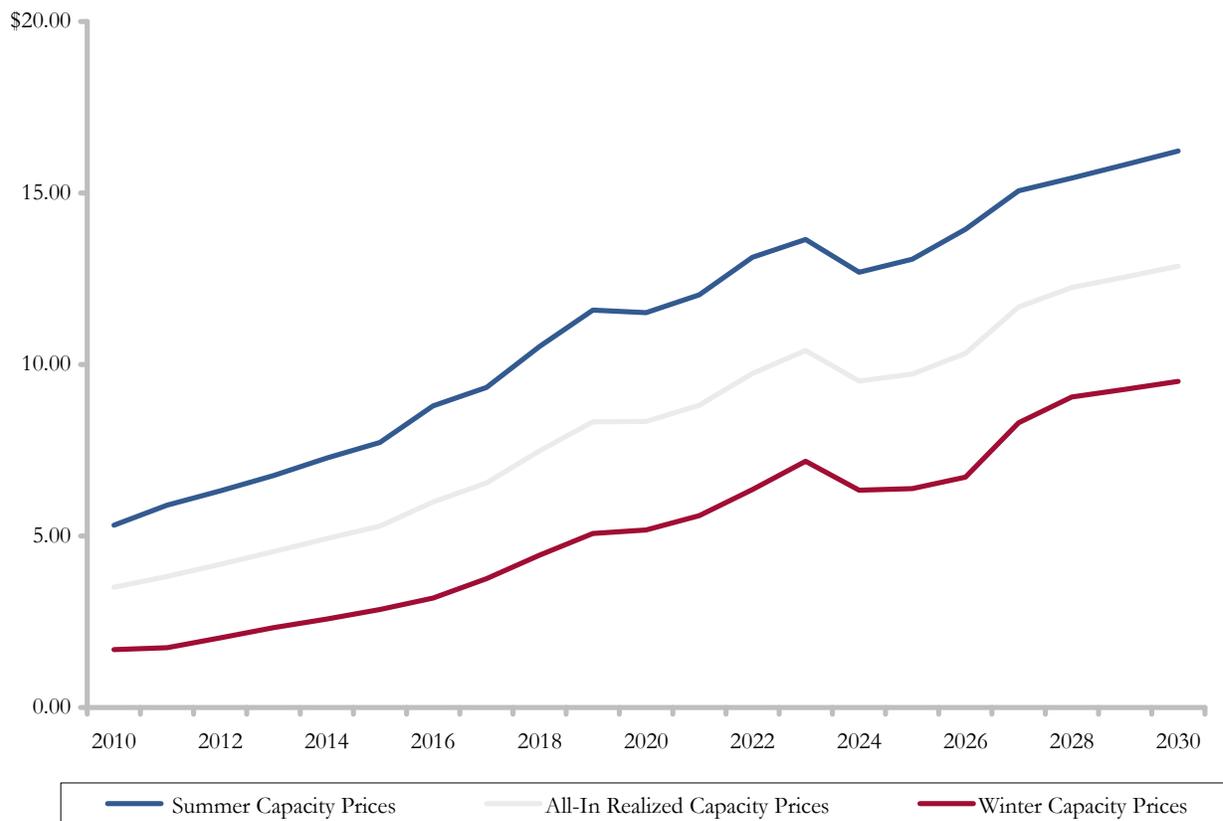
Source: Navigant Consulting and LIPA.

(a) Comprised of tax-effected EBIT plus D&A, less capital expenditures.

EMBEDDED CAPACITY PRICE ASSUMPTIONS

(\$/kW Month)

The chart below illustrates embedded capacity price assumptions from 2010 through 2030.

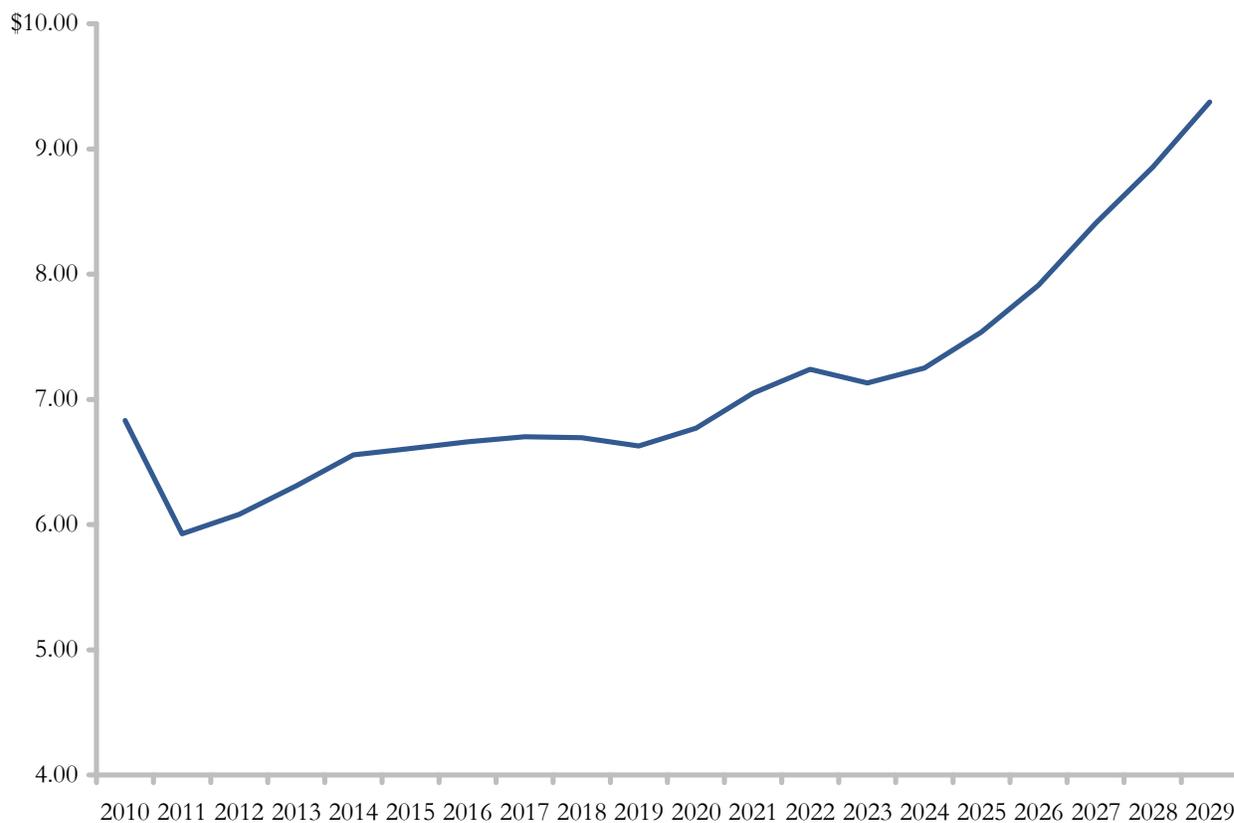


Source: Navigant Consulting.

EMBEDDED GAS COST ASSUMPTIONS

(\$/MMBtu)

The chart below illustrates embedded gas cost assumptions from 2010 through 2029.



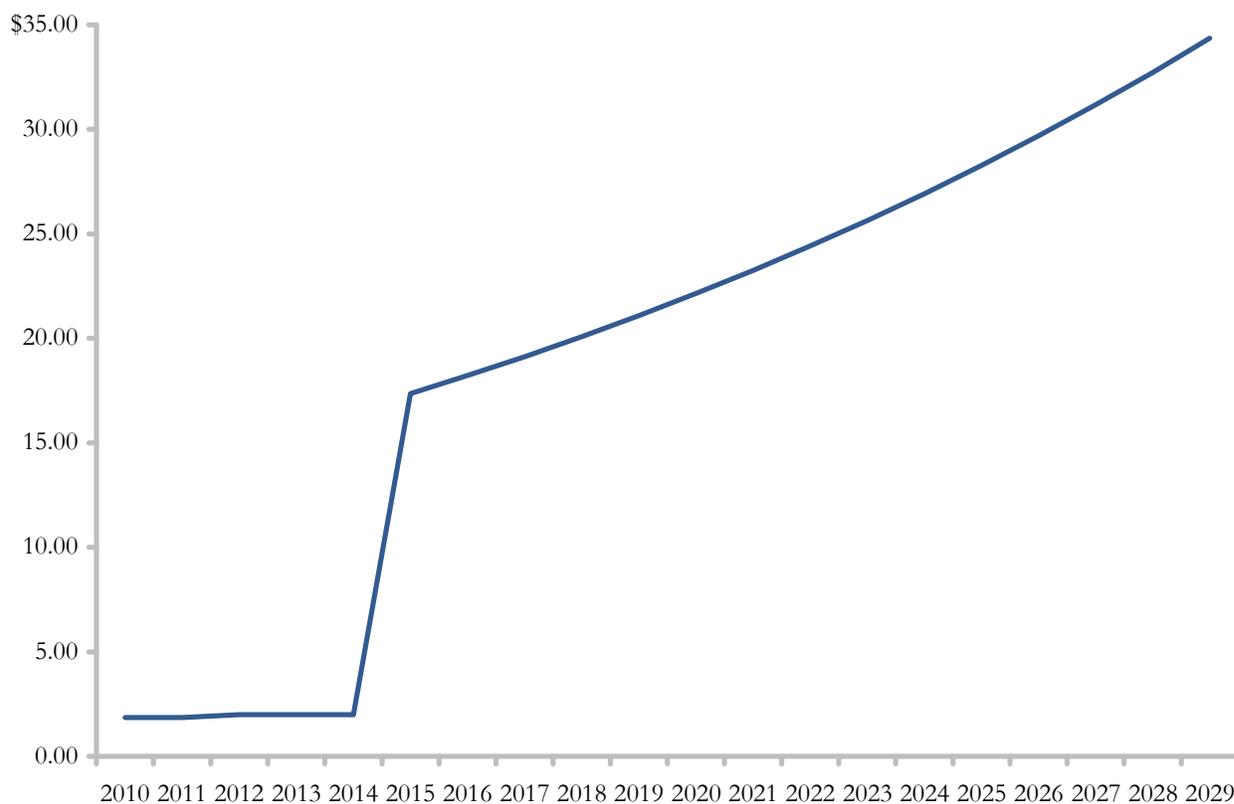
Source: Navigant Consulting.

Note: Amounts represent annual averages.

EMBEDDED CARBON EMISSION COST ASSUMPTIONS

(\$/ton)

The chart below illustrates embedded carbon emission cost assumptions from 2010 through 2029.



Source: Navigant Consulting.

Note: Amounts represent annual averages.

MERCHANT GENERATING COMPANY WACC ANALYSIS

(\$ in millions)

The chart below illustrates the assumed weighted average cost of capital based on a variety of merchant generating companies.

Merchant Companies	Stock Price	Equity Value	Net Debt	Debt/Book Cap.	Net Debt/Ent. Value	Net Debt/Equity Value	Levered Beta	Unlevered Beta ^(a)	
AES	AES	\$13.25	\$8,838	\$20,172	70.0%	69.5%	228.2%	1.33	0.55
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Dynegy	DYN	\$1.82	\$1,538	\$5,644	61.2%	78.6%	367.0%	1.74	0.53
Mirant	MIR	\$16.34	\$2,371	\$1,773	45.7%	42.8%	74.8%	1.44	0.98
NRG	NRG	\$26.65	\$7,647	\$7,130	51.9%	48.3%	93.2%	1.32	0.84
Ormat	ORA	\$35.87	\$1,629	\$463	37.9%	22.1%	28.4%	0.84	0.72
RRI Energy	RRI	\$5.71	\$2,007	\$1,527	40.4%	43.2%	76.1%	1.60	1.08
TransAlta	TAC	\$18.93	\$2,943	\$2,538	44.8%	46.3%	86.2%	0.80	0.52
<i>Median</i>					51.9%	46.3%	86.2%	1.33	0.72

Assumptions

Marginal Tax Rate	38.0%
Risk Free Rate of Return ^(b)	3.38%
Equity Risk/Market Premium ^(c)	7.10%

Debt/Cap	Debt/Equity	Median		Levered Beta	Cost of Equity ^(e)
		Unlevered Beta	Levering Factor ^(d)		
0.00%	0.00%	0.72	1.00	0.72	8.45%
10.00%	11.11%	0.72	1.07	0.76	8.80%
20.00%	25.00%	0.72	1.16	0.83	9.24%
30.00%	42.86%	0.72	1.27	0.90	9.80%
40.00%	66.67%	0.72	1.41	1.01	10.55%
50.00%	100.00%	0.72	1.62	1.16	11.60%
60.00%	150.00%	0.72	1.93	1.38	13.17%
70.00%	233.33%	0.72	2.45	1.75	15.80%
80.00%	400.00%	0.72	3.48	2.49	21.04%

Pre-Tax/After-Tax Cost of Debt				
6.50%	7.00%	7.50%	8.00%	8.50%
4.03%	4.34%	4.65%	4.96%	5.27%

Weighted Average Cost of Capital ^(f)				
8.45%	8.45%	8.45%	8.45%	8.45%
8.33%	8.36%	8.39%	8.42%	8.45%
8.20%	8.26%	8.32%	8.38%	8.45%
8.07%	8.16%	8.26%	8.35%	8.44%
7.94%	8.07%	8.19%	8.32%	8.44%
7.82%	7.97%	8.13%	8.28%	8.44%
7.69%	7.87%	8.06%	8.25%	8.43%
7.56%	7.78%	7.99%	8.21%	8.43%
7.43%	7.68%	7.93%	8.18%	8.42%

Note:

- Unlevered Beta = Levered Beta / [1 + (1 - Tax Rate)(Debt/Equity)].
- Risk Free Rate is 10-Year Treasury Bond Yield.
- Source: Represents the long-horizon expected equity risk premium based on differences of historical arithmetic mean returns on the S&P 500 from 1926-2006 (Ibbotson Associates' 2008 Yearbook)
- Levering Factor = [1 + (1 - Tax Rate)(Debt/Equity)].
- Cost of Equity = (Risk Free Rate of Return) + (Levered Beta)(Equity Risk Premium) + Equity Size Premium.
- Weighted Average Cost of Capital = (After-Tax Cost of Debt)(Debt/Cap.) + (Cost of Equity)(Equity/Cap.).