BROOKLYN UNION GAS COMPANY AND SUBSIDIARIES d/b/a KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS FOR THE PERIOD JANUARY 1, 2007 THROUGH MARCH 31, 2008 AND INDEPENDENT AUDITORS' REPORT

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

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KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME

(In Thousands of Dollars)	**Successor For the Period August 25, 2007 - March 31, 2008**	**Predecessor For the Period January 1, 2007 - August 24, 2007**	**Predecessor For the Twelve Months Ended December 31, 2006**
Operating Revenues	$ 1,835,908	$ 1,556,894	$ 2,119,323
Operating Expenses			
Purchased gas for resale	1,211,425	1,001,604	1,358,514
Operations and maintenance	204,996	212,273	304,102
Depreciation and amortization	49,027	55,153	75,508
Operating taxes	110,003	104,798	116,459
Total Operating Expenses	1,575,451	1,373,828	1,854,583
Income from equity investments	7,183	6,112	9,796
Operating Income	267,640	189,178	274,536
Interest Charges	(41,438)	(56,268)	(59,241)
Other Income and (Deductions)	7,133	8,596	1,281
Earnings Before Income Taxes	233,335	141,506	216,576
Income Taxes			
Current	70,397	28,057	29,048
Deferred	21,648	26,705	49,091
Total Income Tax Expense	92,045	54,762	78,139
Net Income	$ 141,290	$ 86,744	$ 138,437

The accompanying notes are an integral part of these consolidated financial statements.

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(In Thousands of Dollars)	**Successor** **March 31, 2008**	**Predecessor** **December 31, 2006**
ASSETS		
Current Assets		
Cash and temporary cash investments	$ 221,437	$ 8,312
Restricted cash, margin accounts	-	3
Accounts receivable	445,896	221,920
Unbilled revenue	214,164	175,634
Allowance for uncollectible accounts	(42,788)	(17,574)
Gas in storage, at average cost	168,909	376,169
Materials and supplies, at average cost	8,253	8,821
Prepayments	29,516	61,129
Regulatory assets	27,952	-
Derivative contracts	41,768	1,441
Other	-	4,525
	1,115,107	840,380
Equity Investments	73,002	70,288
Property, Plant and Equipment		
Gas	2,986,515	2,809,550
Accumulated depreciation	(873,413)	(807,916)
	2,113,102	2,001,634
Deferred Charges		
Regulatory assets-miscellaneous	616,110	296,943
Regulatory assets-derivative contracts	25,643	68,172
Goodwill, net of amortization	1,456,336	1,264
Derivative contracts	11,899	50,945
Other	27,449	29,897
	2,137,437	447,221
Total Assets	$ 5,438,648	$ 3,359,523

The accompanying notes are an integral part of these consolidated financial statements.

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	Successor	Predecessor
(In Thousands of Dollars)	**March 31, 2008**	**December 31, 2006**
LIABILITIES AND CAPITALIZATION		
Current Liabilities		
Accounts payable and other	$ 87,549	$ 96,758
Taxes accrued	23,954	3,153
Customer deposits	30,268	22,670
Interest accrued	33,542	10,746
Regulatory liabilities	66,226	-
Other current liability, derivative contracts	1,861	57,291
Accounts payable affiliates, net	418,687	307,932
	662,087	498,550
Deferred Credits and Other Liabilities		
Regulatory liabilities:		
Miscellaneous liabilities	136,592	30,447
Derivative contracts	11,753	52,417
Removal costs recovered	125,000	112,500
Asset retirement obligations	8,604	7,892
Deferred income tax	369,701	312,444
Environmental and other reserves	312,775	175,420
Derivative contracts	25,868	11,134
Other	79	1,510
	990,372	703,764
Capitalization		
Common stock - $0.01 per share 100 shares issued stated at	-	-
Additional paid in capital	2,605,830	472,627
Retained earnings	141,290	705,410
Accumulated other comprehensive loss	78	(59,731)
Total common shareholders' equity	2,747,198	1,118,306
Long-term debt	1,038,991	1,038,903
Total Capitalization	3,786,189	2,157,209
Total Liabilities and Capitalization	$ 5,438,648	$ 3,359,523

The accompanying notes are an integral part of these consolidated financial statements.

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Successor	Predecessor	Predecessor
	For the Period	For the Period	For the Twelve
	August 25, 2007 -	January 1, 2007 -	Months Ended
(In Thousands of Dollars)	March 31, 2008	August 24, 2007	December 31, 2006
Operating Activities			
Net Income	$ 141,290	$ 86,744	$ 138,437
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	49,027	55,153	75,508
Deferred income tax	21,648	26,705	49,091
Income from equity investments	(7,183)	(6,112)	(9,796)
Dividends from equity investments	6,790	3,880	7,954
Amortization of financing fees	1,090	1,204	1,668
Amortization of property taxes	64,981	41,426	63,721
Non cash charges	-	33,511	-
Changes in assets and liabilities			
Accounts receivable	(377,392)	83,669	116,705
Materials and supplies, and gas in storage	183,136	25,558	3,939
Accounts payable and accrued expenses	40,726	16,688	(194,328)
Prepaid property taxes	(62,184)	(57,658)	(109,372)
Reserve payments	(27,644)	(11,559)	(19,166)
Insurance recovery and regulatory settlements, net	-	-	2,270
Other	17,461	5,497	(16,732)
Net Cash Provided by Operating Activities	51,746	304,706	109,899
Investing Activities			
Capital expenditures	(103,291)	(101,743)	(163,124)
Cost of removal	(3,163)	(256)	(289)
Derivative margin calls	-	23,700	(23,700)
Net Cash Used in Investing Activities	(106,454)	(78,299)	(187,113)
Financing Activities			
Issuance of long term debt	-	-	400,000
Other	-	-	(1,956)
Dividends paid to Parent	-	(3,880)	(7,954)
Accounts payable affiliates, net	84,986	(39,680)	(325,976)
Net Cash Provided by Financing Activities	84,986	(43,560)	64,114
Net Increase (Decrease) in Cash and Cash equivalents	30,278	182,847	(13,100)
Cash and Cash equivalents at Beginning of period	191,159	8,312	21,412
Cash and Cash equivalents at End of period	$ 221,437	$ 191,159	$ 8,312
Interest paid	$ 30,559	$ 37,127	$ 33,708
Taxes paid	$ 23,648	$ 8,433	$ 16,243

The accompanying notes are an integral part of these consolidated financial statements.

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

(In Thousands of Dollars)	**Successor For the Period August 25, 2007 - March 31, 2008**	**Predecessor For the Period January 1, 2007 - August 24, 2007**	**Predecessor For the Twelve Months Ended December 31, 2006**
Balance at beginning of period	$ 788,274	$ 705,410	$ 574,927
Net income	141,290	86,744	138,437
Dividends paid to Parent	-	(3,880)	(7,954)
Purchase accounting adjustment	(788,274)	-	-
Balance at end of period	$ 141,290	$ 788,274	$ 705,410

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(In Thoudsands of Dollars)	**Successor For the Period August 25, 2007 - March 31, 2008**	**Predecessor For the Period January 1, 2007 - August 24, 2007**	**Predecessor For the Twelve Months Ended December 31, 2006**
Net income	$ 141,290	$ 86,744	$ 138,437
Other comprehensive income, net of tax			
Pension amortization	-	4,775	-
Unrealized losses on derivative financial instruments	-	461	(390)
Unrealized gains (losses) on marketable securities	(9)	16	-
Reduction of accrued unfunded pension obligation	-	-	12,450
Other comprehensive income, net of tax	(9)	5,252	12,060
Comprehensive Income	$ 141,281	$ 91,996	$ 150,497
Related tax expense			
Pension amortization	-	3,300	-
Unrealized losses on derivative financial instruments	-	248	(210)
Unrealized gains (losses) on marketable securities	(5)	9	-
Reduction of accrued unfunded pension obligation	-	-	6,704
Total Tax Expense	$ (5)	$ 3,557	$ 6,494

The accompanying notes are an integral part of these consolidated financial statements.

KEYSPAN ENERGY DELIVERY NEW YORK AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CAPITALIZATION

	Successor	Predecessor
(In Thousands of Dollars)	**March 31, 2008**	**December 31, 2006**
Common Shareholder's Equity		
Common stock, $0.01 per share		
100 shares issued stated at	$ -	$ -
Additional paid in capital	2,605,830	472,627
Retained earnings	141,290	705,410
Accumulated other comprehensive loss	78	(59,731)
Total Common Shareholder's Equity	2,747,198	1,118,306
Long-Term Debt		
Gas Facilities Revenue Bonds		
6.368% Series 1993A and 1993B due April 1, 2020	75,000	75,000
Variable Rate Series 1997 due December 1, 2020	125,000	125,000
5.5% Series 1996 due January 1, 2021	153,500	153,500
4.7% Series 2005A due February 1, 2024	82,000	82,000
Variable Rate Series 2005B due June 1, 2025	55,000	55,000
6.95% Series 1991A and 1991B due July 1, 2026	100,000	100,000
Variable Rate Series 1991D due July 1, 2026	50,000	50,000
Notes Payable		
5.6% Senior Unsecured Note 2016	400,000	400,000
	1,040,500	1,040,500
Less: derivative impact on long term debt	1,509	1,597
Total Long-Term Debt	1,038,991	1,038,903
Total Capitalization	$ 3,786,189	$ 2,157,209

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

A. Organization of the Company

The Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York ("KEDNY"), was incorporated in the State of New York in 1895 as a combination of existing companies, the first of which was granted a franchise in 1849. KEDNY distributes natural gas at retail in the Boroughs of Brooklyn and Staten Island and two-thirds of the Borough of Queens, all in New York City. KEDNY is subject to the regulatory jurisdiction of the New York State Public Service Commission ("NYPSC"). The Brooklyn Union Gas Company will be referred to in these notes to the Consolidated Financial Statements as "KEDNY", "we", "us", "our" or "the Company".

In 1997, KEDNY and its subsidiaries were reorganized into a holding company structure with KeySpan Corporation d/b/a/ KeySpan Energy ("KeySpan") becoming the parent company.

On August 24, 2007, KeySpan completed its merger (the "Merger") with National Grid plc, a public limited company incorporated under the laws of England and Wales as contemplated by the Agreement and Plan of Merger dated February 25, 2006 (the "Merger Agreement"). The aggregate consideration paid by National Grid plc was approximately $7.6 billion. Pursuant to the Merger Agreement, each outstanding share of common stock of KeySpan was converted into the right to receive $42.00 per share in cash, without interest. As a result of the Merger, KeySpan ceased to be publicly traded and accordingly is no longer listed on the New York Stock Exchange ("NYSE"). Additionally, KeySpan and KEDNY have changed their fiscal years from a fiscal year ending December to a fiscal year ending March.

KEDNY continues to operate its utility business as a wholly-owned subsidiary of KeySpan and as an indirectly-owned subsidiary of National Grid plc. Through its wholly-owned subsidiary, North East Transmission Co., Inc. ("NETCO"), KEDNY owns a 19.4% interest in the Iroquois Gas Transmission System L.P. ("Iroquois"), a 375-mile pipeline that currently transports Canadian gas supply daily to markets in the northeastern United States.

B. Basis of Presentation

The Consolidated Financial Statements reflect the accounts of KEDNY and its subsidiary. All significant inter-company transactions have been eliminated. Due to the acquisition of KeySpan by National Grid plc and the change in KeySpan's fiscal year, KEDNY's Consolidated Statement of Income and its Consolidated Statement of Cash Flows are presented for the following periods: (i) the successor period August 25, 2007 – March 31, 2008; (ii) the predecessor period January 1, 2007 – August 24, 2007; and (iii) the predecessor period twelve months ended December 31, 2006. The Consolidated Balance Sheet is presented at March 31, 2008 as the successor company and December 31, 2006 as the predecessor company.

The preparation of financial statements in conformity with Generally Accepted Accounting Principles in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

C. Seasonal Aspect

The gas distribution business is influenced by seasonal weather conditions. Annual revenues are principally realized during the heating season (November through April) as a result of the large proportion of heating sales in these months. Accordingly, results of operations are most favorable in the first calendar quarter of the Company's fiscal year, followed by the fourth calendar quarter. Losses are generally incurred in the second and third calendar quarters.

D. Accounting for the Effects of Rate Regulation

The accounting records of KEDNY are maintained in accordance with the Uniform System of Accounts prescribed by the NYPSC. KEDNY's financial statements reflect the ratemaking policies and actions of NYPSC in conformity with GAAP.

KEDNY is subject to the provisions of Statement of Financial Accounting Standards 71, "Accounting for Certain Types of Regulation" ("SFAS 71"). This Statement recognizes the ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, KEDNY records these future benefits and obligations as regulatory assets or regulatory liabilities on the Consolidated Balance Sheet. In the event that the Company no longer meets the criteria for following SFAS 71, the accounting impact would be an extraordinary, non-cash charge to operations. Criteria that gives rise to the discontinuance of SFAS 71 include (1) increasing competition that restricts our ability to establish prices to recover specific costs or (2) a significant change in the manner in which rates are set by regulators. We have reviewed these criteria and believe that the continued application of SFAS 71 is appropriate.

The following table presents KEDNY's regulatory assets and liabilities as of March 31, 2008 and December 31, 2006:

(In Thousands of Dollars)	**March 31, 2008**		**December 31, 2006**
	Current	**Non-Current**	**Non-Current**
Regulatory Assets			
Regulatory tax asset	$ -	$ 21,532	$ 22,846
Property taxes	-	50,218	35,346
Environmental costs	2,787	395,089	222,922
Postretirement benefits	11,832	129,264	-
Derivative contracts	1,862	25,643	68,172
Other	11,471	20,007	15,829
Total Regulatory Assets	$ 27,952	$ 641,753	$ 365,115
Regulatory Liabilities			
Miscellaneous liabilities	(24,457)	(136,592)	(30,447)
Derivative liabilities	(41,769)	(11,753)	(52,417)
Total Regulatory Liabilities	$ (66,226)	$ (148,345)	$ (82,864)
Net Regulatory Assets	(38,274)	493,408	282,251
Removal Costs Recovered	-	(125,000)	(112,500)
	(38,274)	368,408	169,751

The regulatory assets above are not included in rate base. As of March 31, 2008, all of our regulatory assets and liabilities for which cash expenditures have been made or cash has been received are reflected in rates charged or credited to customers or are receiving the appropriate carrying charges. Deferred gas costs of approximately $15.5 million are reflected in accounts receivable on the Consolidated Balance Sheet.

E. Property and Depreciation

Utility gas property is stated at original cost of construction, which includes allocations of overheads, taxes, asset retirement costs and an allowance for funds used during construction. The rate at which the Company capitalized interest at March 31, 2008 was 2.5%. Capitalized interest for the period January 1, 2007 through March 31, 2008 and for the year ended December 31, 2006 was $1.2 million and $0.6 million respectively and is reflected as a reduction to interest expense. At March 31, 2008, we had $2.9 billion of utility plant and $65.8 million of construction work in progress.

Depreciation is provided on a straight-line basis in amounts equivalent to composite rates on average depreciable property of 2.70% at March 31, 2008. The cost of property retired, and the cost of removal less salvage, is charged to accumulated depreciation. KEDNY recovers asset retirement costs through rates charged to customers as a portion of depreciation expense. For the period January 1, 2007 through March 31, 2008 and for the year ended December 31, 2006, KEDNY had costs recovered in excess of costs incurred totaling $125.0 million and $112.5 million. These amounts are reflected as a regulatory liability. The cost of repair and minor replacement and renewal of property is charged to maintenance expense.

Provisions for depreciation of all non-utility property are computed on a straight-line basis over their respective lives.

F. Equity Investments

As previously stated, NETCO, which owns a 19.4% interest in Iroquois, is accounted for under the equity method. Operating income for this investment for the period January 1, 2007 through March 31, 2008 and for the year ended December 31, 2006 was $13.3 million and $9.8 million respectively.

G. Revenues

Utility gas customers generally are billed bimonthly. Revenues include unbilled amounts related to the estimated gas usage that occurred from the last meter reading to the end of each month.

The cost of gas sold is recovered when billed to firm customers through the operation of a tariff provision, the Gas Adjustment Clause ("GAC"). The GAC provision requires an annual reconciliation of recoverable gas costs and GAC revenues. Any difference is deferred pending recovery from or refund to firm customers during a subsequent twelve-month period.

KEDNY's tariff contains a weather normalization adjustment that provides for recovery from or refund to firm customers of material shortfalls or excesses of firm net revenues (revenues less applicable gas costs and revenue taxes) during a heating season due to variations from normal weather.

H. Hedging and Derivative Financial Instruments

We employ derivative instruments to hedge a portion of our exposure to commodity price risk and interest rate risk. Whenever hedge positions are in effect, we are exposed to credit risk in the event of nonperformance by counter-parties to derivative contracts, as well as nonperformance by the counter-parties of the transactions against which they are hedged. We believe that the credit risk related to futures, options and swaps instruments is no greater than that associated with the primary commodity contracts which they hedge. KEDNY's derivatives instruments do not qualify as energy trading contracts as defined by current accounting literature.

Firm Gas Sales Derivatives Instruments: We use derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of our future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales prices to our regulated firm gas sales customers in our New York service territory. Since these derivative instruments are being employed to support our gas sales prices to regulated firm gas sales customers, the accounting for these derivative instruments is subject to SFAS 71. Therefore, changes in the market value of these derivatives are recorded as regulatory assets or regulatory liabilities on our Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers during the appropriate winter heating season consistent with regulatory requirements.

Physically-Settled Commodity Derivative Instruments: Certain of our contracts for the physical purchase of natural gas were assessed as no longer being exempt from the requirements of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 149, "Amendment of Statement 133 Derivative Instruments and Hedging Activities" (collectively, "SFAS 133") as normal purchases. As such, these contracts are recorded on the Consolidated Balance Sheet at fair market value. However, since such contracts were executed for the purchases of natural gas that is sold to regulated firm gas sales customers, and pursuant to the requirements of SFAS 71, changes in the fair market value of these contracts are recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet.

Other Financially-Settled Commodity Derivative Instruments: From time to time, we also employ a limited number of derivative financial instruments that are accounted for pursuant to the requirements of SFAS 133. With respect to those commodity derivative instruments that are designated and accounted for as cash flow hedges, the effective portion of periodic changes in the fair market value of cash flow hedges is recorded as accumulated other comprehensive income (loss) on the Consolidated Balance Sheet, while the ineffective portion of such changes in fair value is recognized in earnings. Unrealized gains and losses (on such cash flow hedges) that are recorded as accumulated other comprehensive income (loss) are subsequently reclassified into earnings concurrent when hedged transactions impact earnings. With respect to those commodity derivative instruments that are not designated as hedging instruments, such derivatives are accounted for on the Consolidated Balance Sheet at fair value, with all changes in fair value reported in earnings.

Interest Rate Derivative Instruments. We continually assess the cost relationship between fixed and variable rate debt. Consistent with our objective to minimize our cost of capital, we periodically enter into hedging transactions that effectively convert the terms of underlying debt obligations from fixed to variable or variable to fixed. Payments made or received on these derivative contracts are recognized as an adjustment to interest expense as incurred. Hedging transactions that effectively convert the terms of underlying debt obligations from fixed to variable are designated and accounted for as fair-value hedges pursuant to the requirements of SFAS 133. Hedging transactions that effectively convert the terms of underlying debt obligations from variable to fixed are considered cash flow hedges. Currently, there are no interest rate derivative instruments outstanding.

I. Income and Excise Taxes

Upon implementation of SFAS 109, "Accounting for Income Taxes", the Company recorded a regulatory asset and a net deferred tax liability for the cumulative effect of providing deferred income taxes on certain differences between the financial statement carrying amounts of assets and liabilities, and their respective tax bases. This regulatory asset continues to be amortized over the lives of the individual assets and liabilities to which it relates. Additionally, investment tax credits which were available prior to the Tax Reform Act of 1986, were deferred and generally amortized as a reduction of income tax over the estimated lives of the related property.

We report our collections and payments of excise taxes on a gross basis. Gas distribution revenues include the collection of excise taxes, while operating taxes include the related expense. Excise taxes collected and paid for the period ended January 1, 2007 through March 31, 2008 and for the year ended December 31, 2006 were $82.3 million and $ 50.4 million respectively.

J. Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS 161 "Disclosures about Derivative Instruments and Hedging Activities." This Statement amends and expands the disclosure requirements of SFAS 133 with the intent to provide users of financial statements with an enhanced understanding of (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses of derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. This Statement shall be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. This Statement will have no impact on results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS 160 "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin 51 "Consolidated Financial Statements." The objective of SFAS 160 is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 shall be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. KEDNY is currently reviewing the requirements of SFAS 160, and at this point in time cannot determine what impact, if any, SFAS 160 will have on its results of operations, cash flows or financial position.

In February 2007, the FASB issued SFAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement requires a business entity to report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. An entity may decide whether to elect the fair value option for each eligible item on its election date, subject to certain requirements described in the statement. This statement shall be effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. KEDNY has not elected the fair value method.

In September 2006, the FASB issued SFAS 157 "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value. SFAS 157 expands the disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value, the recurring fair value measurements using significant unobservable inputs and the effect of the measurement on earnings (or changes in net assets) for the period. The guidance in SFAS 157 also applies for derivatives and other financial instruments measured at fair value under Statement 133 "Accounting for Derivative

Instruments and Hedging Activities" at initial recognition and in all subsequent periods. This Statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. KEDNY has not elected the fair value method.

In July 2006, the FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes" and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. KeySpan adopted the provisions of FIN 48 on January 1, 2007 and there were was no impact to KEDNY's results of operations, financial position or cash flows.

K. Accumulated Other Comprehensive Income

The table below indicates the components of comprehensive income:

(In Thousdands of Dollars)	**March 31, 2008**	**December 31, 2006**
Accrued unfunded pension obligation	-	$ (7,666)
SFAS 158 transition	-	(51,675)
Unrealized losses on derivative financial instruments	(78)	(390)
Accumulated other comprehensive loss	$ (78)	$ (59,731)

L. Cash and Temporary Cash Investments

Temporary cash investments are short-term marketable securities with maturities of generally three months or less.

Note 2. Income Taxes

KEDNY and its subsidiaries file a consolidated income tax return with KeySpan Corporation. A tax sharing agreement between the Company and KeySpan provides for the allocation of a realized tax liability or asset based upon the separate return contributions of each company in the consolidated group to the total taxable income of KeySpan Corporation's income tax returns.

Income tax expense is reflected as follows in the Consolidated Statement of Income:

(In Thousands of Dollars)	For the Period August 25, 2007 - March 31, 2008	For the Period January 1, 2007 - August 24, 2007	For the Twelve Months Ended December 31, 2006
Current income tax:			
State and local tax	$ 14,417	$ 17,388	$ 2,391
Federal income tax	55,980	10,669	26,657
	70,397	28,057	29,048
Deferred income tax			
State and local tax	3,438	(4,048)	15,118
Federal income tax	18,210	30,753	33,973
	21,648	26,705	49,091
Total income tax	$ 92,045	$ 54,762	$ 78,139

The income tax amounts included in the Statement of Income differ from the amounts that result from applying the statutory federal income tax rate to income before income tax.

The following is a reconciliation between reported income tax and tax computed at the statutory rate of 35%:

(In Thousands of Dollars)	For the Period August 25, 2007 - March 31, 2008	For the Period January 1, 2007 - August 24, 2007	For the Twelve Months Ended December 31, 2006
Book Income	$ 233,335	$ 141,506	$ 216,576
Computed at the statutory rate	81,667	49,527	75,802
Adjustments related to:			
State income tax, net of federal benefit	10,709	9,155	11,381
Amortization of investment tax credits	(531)	(683)	(911)
FAS 109 regulatory liabilty adjustment	(825)	(2,200)	(8,437)
Medicare income	(247)	(582)	(629)
Depreciation in excess of tax	655	748	1,122
Other items - net	617	(1,203)	(189)
Total income tax	$ 92,045	$ 54,762	$ 78,139
Effective income tax	39.4%	38.7%	36.1%

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

For income tax purposes, we use accelerated depreciation and shorter depreciation lives, as permitted by the Internal Revenue Code. Deferred federal and state taxes are provided for the tax effects of all temporary differences between financial reporting and tax bases. Significant items making up deferred tax assets and liabilities at March 31, 2008 and December 31, 2006 are as follows:

(In Thousands of Dollars)	March 31, 2008	December 31, 2006
Reserves not currently deductible	$ (19,971)	$ (8,354)
State income taxes	(8,066)	13,960
Property related differences	396,891	382,863
Regulatory tax asset	(6,342)	32,048
Property taxes	206	(57,161)
Employee benefits and compensation	(30,596)	(12,009)
Other items - net	37,579	(38,903)
Net deferred tax liability	$ 369,701	$ 312,444

In 2008 the Company performed a comprehensive analysis and reconciliation of its income tax accounts which included a reconciliation of its book account to tax returns. The reconciliation resulted in a $7.6 million adjustment to income tax expense related to 2006 and prior periods which is recorded in the period January 1, 2007 to August 24, 2007 and offsetting adjustments to deferred income tax and accrued expenses.

In July 2006, the Financial Accounting Standards Board (“FASB”) issued Financial Interpretation (“FIN”) 48, “Accounting for Uncertainty in Income Taxes,” which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) 109, “Accounting for Income Taxes.” FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, assuming the taxing authority has full knowledge of all relevant information and that any dispute with a taxing authority is resolved by the court of last resort. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. Recognized tax benefits are measured as the largest amount of tax benefit that is more likely than not to be realized upon settlement with the taxing authority, assuming the taxing authority has full knowledge of all relevant information. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN 48 on January 1, 2007. The Company recorded no change to the liability for unrecognized tax benefits or retained earnings as a result of the implementation of FIN 48.

The following is a tabular reconciliation of the total amounts of unrecognized tax benefits for the period:

(In Thousands of Dollars)		
Unrecognized Tax Benefit - January 1, 2007	$	69,590
Gross increases - tax positions in prior period		0
Gross decreases - tax positions in prior period		0
Gross increases - tax positions in current period		2,992
Gross decreases - tax positions in current period		0
Settlements		0
Lapse of statute of limitations		0
Unrecognized Tax Benefit - March 31, 2008	$	72,582

Included in the balance of unrecognized tax benefits at March 31, 2008 are tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred income tax accounting, other than for interest and penalties, the disallowance of the shorter deductibility period would not affect the effective income tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. Included in the balance of unrecognized tax benefits at March 31, 2008, are $8.8 million of tax benefits that, if recognized, would affect the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits within the interest expense line and other expense line, respectively, in the accompanying consolidated statement of operations for the periods ended August 24, 2007 and March 31, 2008. Accrued interest and penalties are included within the related liability lines in the consolidated balance sheet as of March 31, 2008. The Company has accrued no penalties related to the unrecognized tax benefits noted above. The Company accrued interest of $3.9 million and $4.4 million during the periods ended August 24, 2007 and March 31, 2008, respectively. In total, the Company has recognized a liability for interest of $21.1 million as of March 31, 2008.

The Company believes that it is not reasonably possible that the tax liability for unrecognized tax benefits will significantly increase or decrease by March 31, 2009.

The Company is subject to taxation in the US and New York. The Company's federal tax returns for tax years 2000 forward and New York tax returns for tax years 2003 forward are subject to examination by the federal and state tax authorities.

Note 3. Postretirement Benefits

Pension Plans**:** The employees of KEDNY are members of a consolidated defined benefit pension plan under KeySpan. Benefits are based on years of service and compensation. Pension costs are allocated to KEDNY; related pension obligations and assets are commingled and are not allocated to individual sponsors. At March 31, 2008 the KeySpan defined benefit pension plan has a net underfunded obligation of $288.4 million. Certain current year changes in the funded status of the KeySpan plan are allocated to KEDNY through an intercompany payable amount. KEDNY is subject to certain deferral accounting requirements mandated by the NYPSC for pension and other postretirement benefit costs. Pension expense allocated to KEDNY for the period January 1, 2007 through March 31, 2008 was approximately $9.5 million, and is included in operations and maintenance expense on the Consolidated Statement of Income. Funding for pensions is in accordance with requirements of federal law and regulations.

Pension benefits for salaried employees are based on salary and years of service, while pension benefits for union employees are based on negotiated benefits and years of service. Employees hired before 1993 who are participants in the pension benefit plans become eligible for post-retirement health care benefits if they reach retirement age while working for KEDNY.

Other Postretirement Benefits: KEDNY employees are members of a noncontributory defined benefit plan under which is provided certain health care and life insurance benefits for all former retired employees. KeySpan and KEDNY have been funding a portion of future benefits over employees' active service lives through Voluntary Employee Beneficiary Association ("VEBA") trusts. Contributions to VEBA trusts are tax deductible, subject to limitations contained in the Internal Revenue Code.

Other postretirement costs are allocated to us; related other postretirement obligations and assets are commingled and are not allocated to individual sponsors. At March 31, 2008 the KeySpan defined benefit plan has a net underfunded obligation of $878.4 million. Certain current year changes in the funded status of the KeySpan plan are allocated to KEDNY through an intercompany payable amount. Other postretirement expense allocated to KEDNY for the period January 1, 2007 through March 31, 2008 was $16.3 million, and was included in operations and maintenance expense on the Consolidated Statement of Income.

Note 4. Long-term Debt

Gas Facilities Revenue Bonds: KEDNY can issue tax-exempt bonds through the New York State Energy Research and Development Authority. Whenever bonds are issued for new gas facilities projects, proceeds are deposited in trust and subsequently withdrawn by KEDNY to finance qualified expenditures. There are no sinking fund requirements for any of KEDNY's Gas Facilities Revenue Bonds ("GFRB"). At March 31, 2008, $640.5 million of GFRBs were outstanding; $230 million of which are variable-rate, auction rate bonds. The interest rate on the various variable rate series due through July 1, 2026 is reset weekly and ranged from 3.00% to 6.27% during the period January 1, 2007 through March 31, 2008. The bonds are currently in the auction rate mode and are backed by bond insurance. Credit rating agencies have recently downgraded the ratings of the bond insurers. The resulting interest rate on the bonds revert to the maximum rate which depends on the current commercial paper rates and the senior unsecured rating of KEDNY or the bond insurer, whichever is greater. The effect on the interest expense has not been material at this time.

Notes Payable: During 2006, KEDNY issued $400 million of Senior Unsecured Notes at 5.60% due November 29, 2016. Interest is payable on a semi-annual basis on May and November.

Debt Maturity Schedule: There is no long-term debt maturing in the next five years.

Note 5. Commitments and Contingencies

Lease Obligations: Substantially all leases are the obligations of KeySpan. KEDNY records as intercompany expenses, costs incurred for the use of leased equipment such as buildings, office equipment, vehicles, and powered operated equipment. These intercompany expenses are reflected in operations and maintenance expense on the Consolidated Statement of Income.

Fixed Charges Under Firm Contracts: KEDNY has entered into various contracts for gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges in the aggregate amount of approximately $256.7 million. KEDNY is liable for these payments regardless of the level of service it requires from third parties. Such charges are currently recovered from utility customers as gas costs.

Asset Retirement Obligations: KEDNY has various asset retirement obligations primarily associated with its gas distribution activities. These obligations have remained substantially unchanged from December 31, 2006, except for accretion adjustments.

At March 31, 2008 and December 31, 2006 the following asset retirement obligations were recorded on the Consolidated Balance Sheet at their estimated present values:

(In Thousands of Dollars)					
			2008		**2006**
Asset Retirement Obligations					
Asbestos removal	(i)	$	313	$	331
Tanks removal and cleaning	(ii)		14		78
Main - cutting, purging and capping	(iii)		8,277		7,483
Total Asset Retirement Obligations		$	8,604	$	7,892

(i) Asbestos-containing materials exist in roof flashing, floor tiles, pipe insulation and mechanical room insulation within our common facilities. The Company has a legal obligation to remove asbestos upon either a major renovation or demolition.

(ii) The Company has numerous storage tanks that contain among other things waste oil, #2 and #6 fuel oil, diesel fuel, multi chemicals, lube oil, kerosene, ammonia, and other waste contaminants. All of these tanks are subject to cleaning and removal requirements prior to demolition and retirement if so specified by law or regulation.

(iii) The Company has a legal requirement to cut (disconnect from the gas distribution system), purge (clean of natural gas and PCB contaminants) and cap gas mains within its gas distribution and transmission system when mains are retired in place. Gas mains are generally abandoned in place when retired, unless the main and other equipment needs to be removed due to sewer or water system rerouting or other roadblock work. When such a main and equipment are removed certain PCB test procedures must be employed.

KEDNY recorded $0.8 million of asset retirement obligation accretion expense for the year ended

March 31, 2008 and $ 0.5 million for the year ended December 31, 2006.

Legal Matters: From time to time, KEDNY is subject to various legal proceedings arising out of the ordinary course of its business. KEDNY does not consider any of such proceedings to be material to its business or likely to result in a material adverse effect on its results of operations or financial condition.

On February 8, 2007, we received a Notice of Intent to File Suit from the Office of the Attorney General for the State of New York ("AG") against KeySpan and four other companies in connection with the cleanup of historical contamination found in certain lands located in Greenpoint, Brooklyn and in an adjoining waterway. KeySpan has previously agreed to remediate portions of the properties referenced in this notice and will work cooperatively with the Department of Environmental Conservation ("DEC") and AG to address environmental conditions associated with the remainder of the properties. KeySpan has entered into an Administrative Orders on Consent ("ACO") for one of the land-based sites and is currently negotiating the terms of another ACO for the remaining land-based sites. To resolve issues associated with the waterway, KeySpan and the other four companies are currently negotiating the terms of a Consent Decree. At this time, we are unable to predict what effect, if any, the outcome of these proceedings will have on our financial condition, results of operation and cash flows.

Environmental Matters - Manufactured Gas Plant Sites**:** As part of KeySpan's merger with National Grid plc and the associated purchase accounting fair value measurement of assets and liabilities, KeySpan undertook an extensive review of all current and former properties that are subject to environmental remediation. Also, in order to align the accounting policies of KeySpan with those of National Grid plc, KeySpan adjusted the approach used to measure these environmental liabilities. KeySpan's former policy was to use the "75th Probable" method. The 75th Probable method results in the recognition of 100% of expenditures that are considered more than 75% probable of being incurred, with no recognition of potential expenditures below this probability. Consistent with the methodology employed by National Grid plc, KeySpan used the "Expected Value" method for the recent environmental review. The Expected Value method applies a weighting to potential future expenditures based on the probability of these costs being incurred. A liability is recognized for all potential costs based on this probability. Costs considered to be 100% probable of being incurred are recognized in full, with costs below a 100% probability recognized in proportion to their probability.

As a result of this study KEDNY increased the reserve for estimated manufactured gas plant ("MGP") related environmental activities by $165.1 million. As allowed for under SFAS 141 "Business Combinations" fair value measurement of assets, liabilities and intangible assets can be adjusted during the allocation period. Such period can not exceed on year. Accordingly, this estimate is subject to change. Through various rate orders issued by the NYPSC costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers. As a result, this reserve adjustment is reflected as a component of regulatory assets on the Consolidated Balance Sheet.

We have identified 27 MGP sites which were historically owned or operated by Brooklyn Union or its predecessors. These former sites, some of which are no longer owned by us, have been identified to the NYPSC and the DEC for inclusion on appropriate site inventories. Administrative Orders on Consent ("ACO") or Voluntary Cleanup Agreements ("VCA") have been executed with the DEC to address the investigation and remediation activities associated with certain sites

One of the sites noted above has been fully remediated. Subject to the issues described in the preceding paragraph, the remaining 26 sites either are in the process of being investigated and remediated or will be investigated and, if necessary, remediated under the terms and conditions of ACO's, VCA's or Brownfield Cleanup Agreements ("BCA"). Expenditures incurred to date by us with respect to these KEDNY MGP-related activities total $119.3 million.

We presently estimate the remaining cost of our environmental remediation activities will be $312.7 million, which amount has been accrued by us as a reasonable estimate of probable cost for known sites however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered.

The KEDNY rate plan generally provides for the recovery of MGP-related investigation and remediation costs as costs are incurred. A regulatory asset of $397.9 million for MGP sites is reflected at March 31, 2008.

Insurance Reimbursement of MGP Response Costs: KeySpan and KEDNY instituted lawsuits in New York against numerous insurance carriers for reimbursement of costs incurred for the investigation and remediation of these MGP sites. In July 2001, KEDNY filed complaints for the recovery of its remediation costs in the New York State Supreme Court against the various insurance companies that issued general comprehensive liability policies to the Company. The outcome of these proceedings cannot yet be determined.

Note 6. Hedging, Derivative Financial Instruments and Fair Value

Firm Gas Sales Derivative Instruments*:* KEDNY uses derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales prices to regulated firm gas sales customers in our New York service territory. The accounting for these derivative instruments is subject to SFAS 71. Therefore, changes in the fair value of these derivatives have been recorded as regulatory asset or regulatory liability on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. At March 31, 2008, the fair value of these derivatives was $35.2 million.

Physically-Settled Commodity Derivative Instruments: Certain of our contracts for the physical purchase of natural gas are considered derivatives as defined by current accounting literature. As such, these contracts are recorded on the Consolidated Balance Sheet at fair market value. However, since such contracts were executed for the purchases of natural gas that is sold to regulated firm gas sales customers, and pursuant to the requirements of SFAS 71, changes in the fair market value of these contracts are recorded as a regulatory asset or regulatory liability on the Consolidated Balance

Sheet. At March 31, 2008, the fair value of these contracts was a liability of $9.2 million.

Other Financially-Settled Commodity Derivative Instruments*:* Certain derivative instruments employed by our gas operations are not subject to SFAS 71 and thus are not subject to deferral accounting treatment. KEDNY uses OTC natural gas swaps to hedge the cash-flow variability of gas purchases associated with certain large-volume gas sales customers. These gas swaps are accounted for as cash-flow hedges. KEDNY uses market quoted forward prices to value these swap positions. The maximum length of time over which we have hedged such cash flow variability is through December 2008. The fair value of these derivative instruments at March 31, 2008 was immaterial. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial in 2007.

Interest Rate Derivative Instruments: In the fourth quarter of 2006, KeySpan issued $400 million Senior Unsecured Notes for KEDNY. KeySpan utilized a $125 million treasury lock, at 4.77%, to hedge the 5-year US Treasury component of the underlying notes and a $125 million treasury lock, at 4.82%, to hedge the 10-year US Treasury component of the underlying notes. These derivative instruments settled in the fourth quarter of 2006 at which time KEDNY paid $0.2 million to the counterparty to the contracts. The loss on the settlement of these contracts has been deferred for future collection from firm gas sales customers consistent with regulatory requirements.

Credit and Collateral: Derivative contracts are primarily used to manage exposure to market risk arising from changes in commodity prices and interest rates. In the event of non-performance by a counterparty to a derivative contract, the desired impact may not be achieved. The risk of counterparty non-performance is generally considered a credit risk and is actively managed by assessing each counterparty credit profile and negotiating appropriate levels of collateral and credit support. In instances where the counterparties' credit quality has declined, or credit exposure exceeds certain levels, we may limit our credit exposure by restricting new transactions with counterparties, requiring additional collateral or credit support and negotiating the early termination of certain agreements. At March 31, 2008, KEDNY has no outstanding margin calls.

Fair Value of Financial Instruments: KEDNY's long-term debt consists of publicly traded Gas Facilities Revenue Bonds, the fair value of which is estimated on quoted market prices for the same or similar issues. As previously indicated, there is no maturing long-term within the next five years. The carrying value and fair value of KEDNY's long-term debt at March 31, 2008 was $1,040.5 million and $ 1,040.6 million, respectively.

(In Thousands of Dollars) **Long-Term Debt**	**Carrying Value**	**Fair Value**
Gas Facilities Revenue Bonds		
6.368% Series 1993A and 1993B due April 1, 2020	$ 75,000	$ 76,500
Variable Rate Series 1997 due December 1, 2020	125,000	125,000
5.5% Series 1996 due January 1, 2021	153,500	154,268
4.7% Series 2005A due February 1, 2024	82,000	75,171
Variable Rate Series 2005B due June 1, 2025	55,000	55,000
6.95% Series 1991A and 1991B due July 1, 2026	100,000	100,071
Variable Rate Series 1991D due July 1, 2026	50,000	50,000
5.6% Senior Unsecured Note 2016	400,000	404,614
	$ 1,040,500	$ 1,040,624

All other financial instruments on the Consolidated Balance Sheet such as cash, accounts receivable and accounts payable are stated at amounts that approximate fair value.

Note 7. Rate Matters

On August 22, 2007, the New York State Public Service Commission ("NYPSC") unanimously voted to approve the Merger of KeySpan and National Grid plc. The NYPSC issued an abbreviated order and a long-form order on August 23, 2007 and September 17, 2007, respectively, authorizing the Merger subject to conditions and setting partial revenue requirements for KEDNY ("the Order"). In addition, KEDNY reached an agreement in principle with the Staff of the NYPSC and other parties related to gas rates for KEDNY and on October 10, 2007 the Gas Rates Joint Proposal ("the Rates JP") was filed with the NYPSC for approval. The Rates JP was approved at the NYPSC session on December 21, 2007. Below is a discussion of the more significant aspects of the Order and the Rates JP.

The Order

The Order sets out conditions for the Merger, upon which the NYPSC's approval is based. These conditions, relate to, among other things, financial protections for customers and potential revenue adjustments that are based on safety, reliability and customer service performance measures.

The Order includes the following restrictions and/or requirements that KEDNY must adhere to.

1. Goodwill, or the amount National Grid plc pays for KeySpan Corporation (together with transaction costs) in excess of the book value of the assets and liabilities of the latter and its subsidiaries, will not be reflected on the regulatory books of or in the determination of KEDNY's rates and the calculation of their earned returns.

2. KEDNY will be able to pay dividends in any year, provided at least two nationally and internationally recognized rating agencies give it an investment grade credit rating. The maximum dividend in any year would be (a) income available for dividends in that year, plus (b) cumulative retained earnings, plus (c) certain paid in capital.

3. KEDNY will be barred from paying dividends when (a) its least secure form of debt is at the lowest investment grade and one or more rating agencies have outstanding negative watch or review downgrade notices, or (b) National Grid plc's least secure form of debt is rated below investment grade by one or more rating agencies.

4. If KEDNY's bond rating falls below A- or A3, as determined by two nationally recognized credit rating agencies, then any long-term debt issued by the relevant company during the period of such reduced credit rating will be priced as if it had been issued by an A-/A3 utility at the same issue date, and any difference will be credited to KEDNY's customers. KEDNY"s earnings sharing calculations will then reflect the actual debt rates outstanding for the companies.

5. KEDNY's debt ratio for any 12-month period ending at the end of a fiscal quarter will not exceed 56%. If this limit is exceeded, KEDNY would have a nine month period to reduce the debt limit accordingly, during which the dividends paid out as a percentage of total equity may not be increased. If the stated debt ratio is not met by the end of the nine month cure period, KEDNY may not pay any dividends until the debt limit is met.

6. No debt associated with the Merger will be reflected as an obligation of KEDNY.

7. There will be a regulated money pool in which KEDNY may participate as borrowers and lenders. The regulated money pool will prohibit its utility participants from directly or indirectly loaning or transferring funds borrowed from the regulated money pool to any unregulated affiliate.

8. There will be no cross-default provisions for any affiliate of National Grid plc that affect KEDNY.

9. KEDNY will establish "golden shares" to prevent a bankruptcy of any National Grid plc affiliate from triggering a bankruptcy of KEDNY. The holder(s) of the golden shares will be determined by the NYPSC.

In addition to the above, KEDNY is subject to maintaining certain service quality and reliability performance standards. These standards focus on safety, reliability and customer service. KEDNY's failure to meet the stated performance targets for calendar years 2008 through 2012 may result in downward revenue adjustments. The safety and reliability performance measures focus primarily on (i) minimum requirements for main and service replacement; (ii) response time for gas leak investigations; and (iii) reduction in the number of hazardous gas leaks. Failure to meet the safety and reliability performance measures can result in downward revenue adjustments of up to $7.0 million. The customer services performance measures focus primarily on (i) reducing the number of customer complaints and customer bill adjustments; (ii) customer survey satisfaction ratings; and (iii) response time associated with customer telephone inquires. Failure to meet the customer service performance measures can result in downward revenue adjustments of up to $11.7 million.

The Gas Rates Joint Proposal

As noted, KEDNY reached an agreement with the Staff of the NYPSC and other parties related to gas rates for KEDNY. The discussion that follows summarizes some of the more significant aspects to the Rate JP.

Under the Rates JP, KEDNY's base delivery rates will be increased $5 million annually in rate years one (beginning January 1, 2008) through rate year five. However, the increase in base delivery rates will be deferred and used to offset future increases in special franchise taxes and environmental investigation and remediation costs. In addition, certain gas related costs currently being recovered in base delivery rates will be transferred out of base delivery rates on January 1, 2008 and recovered through the gas adjustment clause thereafter. The calculation of the revenue requirement reflects a 50% - 50% sharing of net synergy savings (synergy savings less costs to achieve those synergy savings) that are estimated to be generated as a result of the merger.

As part of the Rates JP, KEDNY returned to the New York Public Service Commission's Statement of Policy for Pensions and Other Postretirement Employee Benefits ("OPEB") issued in September 1993. As a result, KEDNY will now reconcile its actual pension and OPEB expense to the estimated pension and OPEB expense established in the Rates JP and defer or "true-up" the difference for future recovery from or refund to its gas sales customers. KEDNY recorded a regulatory liability of approximately $128 million to return to the Statement of Policy for Pension and OPEB's along with a direct charge to equity. The regulatory liability will be amortized over five years.

The Rates JP also allows KEDNY to true-up 90% of the difference between actual property and special franchise taxes to the estimated amounts established in the Rates JP. However, recovery of $22.5 million of previously deferred special franchise taxes was disallowed and expensed. Additionally, KEDNY is permitted to continue to true-up 100% of the difference between actual environmental site and investigation costs to the estimated amounts established in the Rates JP.

The revenue requirement provides for sharing of earnings above 10.5% calculated using an equity component of 45% with gas sales customers in the following manner. Earnings between 10.5% - 12.5% are shared 50% - 50% between gas sales customers and KEDNY. Earnings between 12.5% - 13.5% are shared 65% to gas sales customers and the remaining 35% to KEDNY. Earnings in excess of 13.5% are refunded to gas sales customers.

Additionally, certain "exogenous costs" that are outside the control of KEDNY, may be deferred for future recovery from or refund to gas sales customers. Exogenous costs are incremental effects on KEDNY's revenue requirements due to any of the following: (i) externally imposed accounting changes; (ii) any change in Federal, state or local taxes; and (iii) any legislative, court or regulatory change

Note 8. Related Party Transactions

We engage in various transactions with KeySpan and its affiliates. For the most part, the various subsidiaries of KeySpan do not maintain large separate cash balances. Financing for KEDNY's working capital and gas inventory needs is obtained through KEDNY's participation in a money pool. In addition, all cash generated from billings is collected and held by KeySpan's corporate and administrative subsidiary KeySpan Corporate Services LLC ("KCS"). Further, all payments to third parties for KEDNY's payables, including labor, are made by KCS on its behalf. The money pool is funded by commercial paper issuances by KeySpan and operating funds of KeySpan affiliates. The various KeySpan subsidiaries can either borrow from or lend to the money pool. Interest expense is charged to "borrowers", while interest income is earned by "lenders". At March 31, 2008, KEDNY had an $ 8.7 million money pool receivable.

KeySpan and its affiliates also provide the Company with various services, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax, treasury/finance), human resources (including pension funding), information technology, legal, and strategic planning. The costs of these services are charged to the Company via inter-company billings and generally settled through the money pool on a monthly basis. At March 31, 2008, KEDNY had a $274.1 million liability for these services. In addition KEDNY had an inter-company income tax payable of $118.0 million and an inter-company postretirement benefit payable of $35.3 million reflecting the accrued liability for pension and other post-employment benefit cost. Therefore at March 31, 2008 KEDNY had a net accounts payable, affiliate position of $418.7 million.

Note 9. Acquisition of Keyspan

On August 24, 2007 National Grid plc purchased all the outstanding stock of KeySpan Corporation for $42.00 per share in cash. The transaction has been accounted for using the purchase method of accounting for business combinations in accordance with SFAS 141 "Business Combination." As a result of the acquisition, KeySpan ceased to be publicly traded. The purchase price of $7.6 billion was allocated to KeySpan's net assets based upon their fair value. The historical cost basis of KeySpan's assets and liabilities associated with its gas distribution businesses, including property, plant and equipment and debt with minor exceptions, was determined to represent fair value due to the existence of regulatory-approved rate plans based upon the recovery of historical costs and a fair return thereon.

Upon acquisition, KeySpan adjusted certain assumptions underlying the calculations for its environmental reserve to align those assumptions with National Grid plc's environmental reserve assumptions where appropriate. This alignment increased KeySpan's environmental reserve approximately $343 million - of this amount $165.1 million relates to KEDNY. Since KEDNY is subject to certain deferral accounting requirements mandated by the NYPSC the entire amount of the increase was recorded as a regulatory asset as well. See Note 4 "Commitments and Contingencies – Environmental Matters" for additional information on KEDNY's environmental reserve balances.

Additionally, KeySpan made certain adjustments to its pension and other postretirement reserve balances. KeySpan adjusted certain assumptions underlying the calculations for its pension and other postretirement reserves to align those assumptions with National Grid plc's pension and postretirement reserve assumptions where appropriate. This alignment reduced KeySpan's pension and other postretirement reserves approximately $180 million. KEDNY's applicable share of this reduction was $41.8 million and was recorded to its intercompany accounts payable. Since KEDNY is subject to certain deferral accounting requirements mandated by the NYPSC for pension costs and other postretirement benefit costs all of this decrease was recorded as an "offset" to regulatory assets.

As required by SFAS 141, KeySpan "pushed-down" goodwill associated with the acquisition of KeySpan by National Grid plc to all of its subsidiaries and "realigned" the equity of each subsidiary. As a result of the push-down of goodwill and the resulting realignment of its equity, KEDNY's goodwill is now $1.5 billion. In addition, NETCO's goodwill balance was eliminated.

SFAS 141 requires that pre-acquisition accumulated other comprehensive income balances be "charged" to accumulated paid-in-capital or some other appropriate equity account at the time of acquisition. Upon implementation of SFAS 158 "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans," in December 2006, KEDNY recorded a charge to accumulated other comprehensive income of $52 million and a debit to deferred income taxes of $36 million. Since KEDNY is now subject to the New York Public Service Commission's Statement of Policy for Pensions and Other Postretirement Employee Benefits, KEDNY eliminated the outstanding balances in other comprehensive income and deferred income taxes associated with SFAS 158 and re-established those balances in regulatory assets.

As allowed for under SFAS 141, the fair value measurement of assets, liabilities and intangible assets, and the resulting impact on goodwill, can be adjusted during the allocation period. However such period is not to exceed one year. The fair value measurements discussed above are subject to change as a result of the following:(i) finalization and measurement of the financial implications associated with the more significant aspects of the Gas Rates Joint Proposal as discussed in Note 7, "Rate Matters;" (ii) continued measurement and identification of intangible assets; (iii) continued assessment of the deferred tax implications associated with the above adjustments and (iv) continued review of contingent liabilities. The preceding list is not intended to be all inclusive and the final determination of goodwill and intangible assets may be impacted by other fair value measurement adjustments.

Workforce Reduction Program

In connection with the acquisition of KeySpan, National Grid plc and KeySpan offered 673 non-union employees a voluntary early retirement offer ("VERO") in an effort to reduce the workforce. Eligible employees must have been working in a targeted area as of April 13, 2007 and be at least 52 years of age with seven or more years of service as of September 30, 2007. For eligible employees who have elected to accept the VERO offer, National Grid plc and KeySpan have the right to retain that employee for up to three years before VERO payments are made. An employee who accepts the VERO offer but elects to terminate employment with National Grid plc or KeySpan prior to the three year period, without consent of National Grid plc or KeySpan, forfeits all rights to VERO payments. The cost of the VERO offer to KEDNY is estimated to be approximately $20 million, which will be deferred for recovery from gas sales customers as part of the synergy savings and cost to achieve calculations. This amount will be accrued over a three year period or over the remaining service period which ever is shorter. Through March 31, 2008, KEDNY has accrued approximately $6.6 million of VERO costs.