KEYSPAN CORPORATION AND SUBSIDIARIES

FINANCIAL STATEMENTS FOR THE PERIOD JANUARY 1, 2007 THROUGH MARCH 31, 2008

KEYSPAN CORPORATION AND SUBSIDIARIES

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KEYSPAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(In Millions of Dollars)	Successor March 31, 2008	Predecessor December 31, 2006
ASSETS		
Current Assets		
Cash and temporary cash investments	$ 588.0	$ 210.7
Restricted cash	0.1	0.9
Accounts receivable	1,235.5	868.1
Unbilled revenue	579.2	515.1
Allowance for uncollectible accounts	(108.9)	(53.8)
Gas in storage, at average cost	311.7	646.0
Material and supplies, at average cost	327.3	84.2
Derivative contracts	119.0	30.6
Regulatory assets	108.2	-
Prepayments	117.3	228.1
Other	70.4	60.9
Discontinued current assets held for sale	167.1	196.1
	3,514.9	2,786.9
Equity Investments and Other	232.7	269.7
Property		
Gas	8,113.0	7,639.4
Electric	1,829.5	1,734.9
Other	563.9	373.9
Accumulated depreciation	(3,200.8)	(2,948.3)
Gas production and development	156.4	186.9
Accumulated depletion	(119.3)	(113.6)
Discontinued property held for sale	2,792.7	705.1
	10,135.4	7,578.3
Deferred Charges		
Regulatory assets:		
Miscellaneous assets	1,404.5	1,054.2
Derivative contracts	72.6	206.5
Goodwill, net of amortization	3,938.3	1,615.8
Intangibles, net of amortization	230.9	-
Derivative contracts	114.6	116.7
Other	229.5	847.0
Discontinued deferred assets held for sale	65.6	78.7
	6,056.0	3,918.9
Total Assets	$ 19,939.0	$ 14,553.8

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(In Millions of Dollars)	Successor March 31, 2008	Predecessor December 31, 2006
LIABILITIES AND CAPITALIZATION		
Current Liabilities		
Accounts payable and other liabilities	$ 1,067.5	$ 947.6
Commercial paper	286.8	85.0
Current maturities of long-term debt & capital leases	171.3	1.2
Taxes accrued	259.3	154.3
Dividends payable	-	83.3
Customer deposits	58.7	33.5
Interest accrued	131.0	58.5
Other current liabilities, derivative contracts	11.4	195.9
Regulatory liabilities	182.6	-
Accounts payable - affiliates	453.6	-
Discontinued current liabilities held for sale	608.1	561.0
	3,230.3	2,120.3
Deferred Credits and Other Liabilities		
Regulatory liabilities:		
Miscellaneous liabilities	284.9	111.6
Removal costs recovered	627.9	556.2
Derivative accounts	113.3	132.2
Asset retirement obligations	48.7	45.4
Deferred income tax	484.4	1,028.3
Postretirement benefits and other reserves	1,888.3	1,648.8
Derivative contracts	75.7	27.7
Other	414.7	104.5
Discontinued deferred liabilities held for sale	1,252.7	219.3
	5,190.6	3,874.0
Commitments and Contingencies (See Note 5)	-	-
Capitalization		
Common stock and accumulated paid-in-capital	7,574.3	3,994.0
Retained earnings	291.7	973.7
Accumulated other comprehensive loss	(101.8)	(144.4)
Treasury stock	-	(273.6)
Total common shareholders' equity	7,764.2	4,549.7
Long-term debt and capital leases	3,750.3	4,006.8
Total Capitalization	11,514.5	8,556.5
Minority Interest in Consolidated Companies	3.6	3.0
Total Liabilities and Capitalization	$ 19,939.0	$ 14,553.8

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME

(In Millions of Dollars)	Successor - Period August 25, 2007 - March 31, 2008	Predecessor - Period January 1, 2007 - August 24, 2007	Predecessor - Twelve Months Ended December 2006
Revenues			
Gas Distribution	$ 4,355.1	$ 3,805.4	$ 5,062.6
Electric Services	588.2	663.3	1,035.4
Energy Services	72.4	79.5	118.5
Energy Investments	22.8	26.5	35.0
Total Revenues	5,038.5	4,574.7	6,251.5
Operating Expenses			
Purchased gas for resale	2,909.1	2,541.7	3,331.5
Fuel and purchased power	11.1	30.1	26.0
Operations and maintenance	990.8	1,264.8	1,523.0
Depreciation, depletion and amortization	239.5	254.1	362.8
Operating taxes	280.5	276.9	367.5
Total Operating Expenses	4,431.0	4,367.6	5,610.8
Income from equity investments	8.6	10.3	13.1
Sale of assets	0.3	0.4	1.3
Operating Income	616.4	217.8	655.1
Other Income and (Deductions)			
Interest charges	(205.0)	(204.1)	(256.1)
Other	9.7	34.1	35.7
Total Other Income and (Deductions)	(195.3)	(170.0)	(220.4)
Income Taxes (Benefit)			
Current tax expense (benefit)	144.8	503.9	6.9
Deferred tax expense (benefit)	15.5	(408.0)	106.1
Total Income Taxes	160.3	95.9	113.0
Net Income (Loss) from Continuing Operations	260.8	(48.1)	321.7
Net Income from Discontinued Operations, net of tax	30.9	46.2	112.5
Extraordinary charge, net of tax of $83.2 million	-	(113.9)	-
Net Income (Loss)	$ 291.7	$ (115.8)	$ 434.2

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

(In Millions of Dollars)	Successor - Period August 25, 2007 - March 31, 2008	Predecessor - Period January 1, 2007 -August 24, 2007	Predecessor - Twelve Months Ended December 31, 2006
Operating Activities			
Net income (Loss)	$ 291.7	$ (115.8)	$ 434.2
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Depreciation, depletion and amortization	239.5	254.1	362.8
Deferred income tax	15.5	(408.0)	106.1
Income from equity investments	(8.6)	(10.3)	(13.1)
Dividends from equity investments	7.5	4.6	8.9
Loss on impairment	-	32.8	-
Amortization of property taxes and demand charges	84.3	41.4	70.3
Merger related and other non-cash charges	(47.5)	226.4	-
Income from discontinued operations	(30.9)	(46.2)	(112.5)
Non-cash extraodinary charge	-	113.9	-
Pension and other postretirement costs	40.0	(50.3)	
Changes in assets and liabilities			
Accounts receivable	(847.0)	342.0	234.6
Materials and supplies, fuel oil and gas in storage	363.9	41.5	(11.3)
Accounts payable and accrued expenses	68.3	285.6	(137.9)
Prepaid property taxes	(62.2)	(57.7)	(109.4)
Reserve payments	(64.9)	(33.4)	(51.0)
Insurance settlements	-	-	16.6
Other	50.6	4.5	55.6
Net Cash Provided by Continuing Operating Activities	100.2	625.1	853.9
Investing Activities			
Construction expenditures	(310.2)	(308.8)	(485.1)
Cost of removal	(24.1)	(19.0)	(32.6)
Net proceeds from sale of property and investments	23.8	8.0	1.3
Derivative margin call	-	42.9	(33.9)
Net Cash (Used in) Continuing Investing Activities	(310.5)	(276.9)	(550.3)
Financing Activities			
Treasury stock issued	-	12.8	30.1
Issuance of long-term debt	-	-	500.0
Payment of long-term debt	(135.3)	(1.5)	(13.0)
Issuance / (payment) of commercial paper	4.4	197.5	(572.6)
Common and preferred stock dividends paid	(41.7)	(250.4)	(325.3)
Accounts payable - affiliates	453.6	-	-
Other	-	-	(2.5)
Net Cash Provided by (Used in) Continuing Financing Activities	281.0	(41.6)	(383.3)
Net Increase (Decrease) in Cash and Cash Equivalents	$ 70.7	$ 306.6	$ (79.7)
Cash Flow from Discontinued Operations - Operating Activities	(20.5)	61.4	204.8
Cash Flow from Discontinued Operations - Investing Activities	(17.6)	(23.3)	(38.7)
Cash and Cash Equivalents at Beginning of Period	555.4	210.7	124.3
Cash and Cash Equivalents at End of Period	$ 588.0	$ 555.4	$ 210.7
Interest Paid	$ 160.5	$ 181.8	$ 256.9
Income Tax Paid	$ 179.6	$ 131.5	$ 175.7

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

(In Millions of Dollars)	Sucessor - Period August 25, 2007 - March 31, 2008	Predecessor - Period January 1, 2007 - August 24, 2007	Predecessor - Twelve Months Ended December 2006
Balance at Beginning of Period	$ 643.6	$ 973.7	$ 866.9
Net Income (Loss) for Period	291.7	(115.8)	434.2
	935.3	857.9	1,301.1
Deductions:			
Cumulative effect of FIN 48 implementation	-	5.2	-
Purchase accounting adjustment	643.6	-	-
Cash dividends declared on common stock	-	209.1	327.4
Balance at End of Period	$ 291.7	$ 643.6	$ 973.7

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(In Millions of Dollars)	Successor - Period August 25, 2007 - March 31, 2008	Predecessor - Period January 1, 2007 - August 24, 2007	Predecessor - Twelve Months Ended December 31, 2006
Net Income (Loss)	$ 291.7	$ (115.8)	$ 434.2
Other comprehensive income, net of tax			
Reclassification of (gains) losses included in net income	0.9	26.5	(47.8)
Unrealized (losses) gains on derivative financial instruments	(4.8)	0.3	55.4
Unrealized gains (losses) on marketable securities	(1.3)	-	2.0
Accrued unfunded postretirement obligations	(96.6)	(124.8)	37.9
FIN 48 Adjustment	-	17.4	-
Other comprehensive income (loss), net of tax	(101.8)	(80.6)	47.5
Comprehensive Income (Loss)	$ 189.9	$ (196.4)	$ 481.7
Related tax (benefit) expense			
Reclassification of (gains) losses included in net income	0.5	17.7	(25.8)
Unrealized (losses) gains on derivative financial instruments	(3.1)	0.2	31.5
Unrealized gains (losses) on marketable securities	(0.9)	-	1.1
Accrued unfunded postretirement obligations	(62.3)	(92.0)	20.4
Total Tax (Benefit) Expense	$ (65.8)	$ (74.1)	$ 27.2

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CAPITALIZATION

(In Millions of Dollars)	March 2008	December 2006	Successor March 2008	Predecessor December 2006
Common Shareholders' Equity	**Shares Issued**			
Common stock, $0.01 par value	100	184,864,124	$ -	$ 1.8
Premium on capital stock			7,574.3	3,992.2
Retained earnings			291.7	973.7
Accumulated other comprehensive loss			(101.8)	(144.4)
Treasury stock	-	(9,451,408)	-	(273.6)
Total Common Shareholders' Equity	100	175,412,716	7,764.2	4,549.7
Long - Term Debt	**Interest Rate**	**Interest Rate**		
Medium and Long Term Notes	4.65% - 9.75%	4.65% - 9.75%	2,800.2	2,925.4
Gas Facilities Revenue Bonds	Variable	Variable	230.0	230.0
	3.00% - 6.27%	4.70% - 6.95%	410.5	410.5
Total Gas Facilities Revenue Bonds			640.5	640.5
Promissory Notes to LIPA				
Pollution Control Revenue Bonds	5.15%	5.15%	108.0	108.0
Electric Facilities Revenue Bonds	5.30%	5.30%	47.4	47.4
Total Promissory Notes to LIPA			155.4	155.4
Industrial Development Bonds	5.25%	5.25%	128.3	128.3
First Mortgage Bonds	6.34% - 8.80%	6.34% - 8.80%	85.0	95.0
Authority Financing Notes	Variable	Variable	66.0	66.0
Capital Leases			8.1	9.8
Subtotal			3,883.5	4,020.4
Fair value adjustment and unamortized interest rate hedge			38.1	(29.2)
Derivative impact on debt			-	16.8
Less: current maturities			171.3	1.2
Total Long-Term Debt			3,750.3	4,006.8
Total Capitalization			$ 11,514.5	$ 8,556.5

See accompanying Notes to the Consolidated Financial Statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

A. Organization of the Company

KeySpan Corporation, a New York corporation, (referred to in the Notes to the Consolidated Financial Statements as “KeySpan,” “we,” “us” and “our”) is a holding company under the Public Utility Holding Company Act of 2005 (“PUHCA 2005”). KeySpan was formed in May 1998, as a result of the business combination of KeySpan Energy Corporation, the parent of The Brooklyn Union Gas Company, and certain businesses of the Long Island Lighting Company (“LILCO”). On November 8, 2000, KeySpan acquired Eastern Enterprises (“Eastern”), a Massachusetts business trust, and the parent of several gas utilities operating in Massachusetts. Also on November 8, 2000, Eastern acquired EnergyNorth, Inc. (“ENI”), the parent of a gas utility operating in central New Hampshire.

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 (“Parent”), as contemplated by the Agreement and Plan of Merger dated February 25, 2006 (the “Merger Agreement”). The aggregate consideration paid by the Parent 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 has changed its fiscal year from a fiscal year ending December to a fiscal year ending March. (See Note 10, “Acquisition of KeySpan” for additional information on this transaction.)

KeySpan operates six regulated utilities that distribute natural gas to approximately 2.6 million customers in New York City, Long Island, Massachusetts and New Hampshire, making KeySpan the fifth largest gas distribution company in the United States and the largest in the Northeast. We also own and operate electric generating plants in Nassau and Suffolk Counties on Long Island. Under contractual arrangements, we provide power, electric transmission and distribution services, billing and other customer services for approximately 1.1 million electric customers of the Long Island Power Authority (“LIPA”). Additionally, KeySpan owns and leases an electric generating facility in New York City that is classified as a discontinued operation. KeySpan’s other operating subsidiaries are primarily involved in gas production and development; underground gas storage; liquefied natural gas storage; retail electric marketing; large energy-system ownership, installation and management; and service and maintenance of energy systems. KeySpan subsidiaries that are engaged in engineering and consulting services are classified as discontinued operations. We also invest and participate in the development of natural gas pipelines, electric generation and other energy-related projects.

KeySpan has four reportable segments: Gas Distribution, Electric Services, Energy Services and Energy Investments.

The Gas Distribution segment consists of six gas distribution subsidiaries. KeySpan Energy Delivery New York ("KEDNY") provides gas distribution services to customers in the New York City Boroughs of Brooklyn, Queens and Staten Island. KeySpan Energy Delivery Long Island ("KEDLI") provides gas distribution services to customers in the Long Island Counties of Nassau and Suffolk and the Rockaway Peninsula of Queens County (See Note 11, "Rate Matters" for a further discussion of the impact of the Merger on KEDNY and KEDLI regulated operations). The remaining gas distribution subsidiaries, Boston Gas Company, Colonial Gas Company, Essex Gas Company and EnergyNorth Natural Gas, Inc., collectively referred to as KeySpan Energy Delivery New England ("KEDNE"), provide gas distribution service to customers in Massachusetts and New Hampshire.

The Electric Services segment consists of subsidiaries that operate the electric transmission and distribution system owned by LIPA; own and provide capacity to and produce energy for LIPA from our generating facilities located on Long Island; and manage fuel supplies for LIPA to fuel our Long Island generating facilities. These services are provided in accordance with existing long-term service contracts having remaining terms that range from one to six years and power purchase agreements having remaining terms that range from six to 20 years. On February 1, 2006, KeySpan and LIPA agreed to extend, amend and restate these contractual arrangements. (See Note 9, "2006 LIPA Settlement" for a further discussion of these agreements.) The Electric Services segment also conducts retail marketing of electricity to commercial customers.

The Electric Services segment formerly included subsidiaries that own or lease and operate the 2,200 MW Ravenswood Facility located in Queens, New York, and the 250 MW combined-cycle Ravenswood Expansion. Collectively the Ravenswood Facility and Ravenswood Expansion are referred to as the "Ravenswood Generating Station." To finance the purchase and/or construction of the Ravenswood Generating Station, KeySpan entered into a leasing arrangement for each facility. (See Note 5, "Contractual Obligations, Financial Guarantees and Contingencies" for further details on the leasing arrangements.)

Until January 1, 2008, all of the energy, capacity and ancillary services related to the Ravenswood Generating Station were sold to the New York Independent Systems Operator ("NYISO") energy markets. As a condition of the New York State Public Service Commission ("NYPSC") approval of the Merger, KeySpan is required to sell its energy output. On January 1, 2008, an agreement became effective whereby all of the energy and certain ancillary services from the Ravenswood Generating Station were sold to a third party. KeySpan remains responsible for the marketing and sale of capacity and certain fixed price ancillary services.

Further, the NYPSC also required KeySpan to divest of the Ravenswood Generating Station. Accordingly, the Ravenswood Generating Station is reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows. (See Note 12 "Ravenswood Sale Transaction" for additional details on the sale.)

The Energy Services segment includes companies that provide energy-related services to customers located primarily within the northeastern United States, as well as certain telecommunications services. Subsidiaries in this segment provide residential and small commercial customers with service and maintenance of energy systems and appliances, as well as operation and maintenance, design, engineering and consulting services to commercial, institutional and industrial customers. Upon the acquisition of KeySpan, National Grid plc proposed to sell KeySpan's telecommunications subsidiary. Subsequently, management also decided to sell KeySpan's subsidiaries engaged in engineering and consulting services. As a result of these decisions, the activities of these subsidiaries are reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

The Energy Investments segment consists of our gas production and development investments, as well as certain other domestic energy-related investments. KeySpan's gas production and development activities include its wholly-owned subsidiaries Seneca Upshur Petroleum, Inc. ("Seneca-Upshur") and KeySpan Exploration and Production, LLC ("KeySpan Exploration"). Seneca-Upshur is engaged in gas production and development activities primarily in West Virginia. KeySpan Exploration is involved in a joint venture with Merit Energy Corporation.

This segment is also engaged in pipeline development activities. KeySpan has a 26.25% interest in the Millennium Pipeline Company LLC, the developer of the Millennium pipeline project, which is expected to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning, New York to Ramapo, New York, where it will connect to an existing pipeline. Additionally, subsidiaries in this segment hold a 20% equity interest in the Iroquois Gas Transmission System LP, a pipeline that transports Canadian gas supply to markets in the northeastern United States. These investments are accounted for under the equity method. Accordingly, equity income from these investments is reflected as a component of operating income in the Consolidated Statement of Income.

The Islander East Pipeline Company, LLC ("Islander East") was created to pursue the authorization and construction of an interstate pipeline from Connecticut, across Long Island Sound, to a terminus near Shoreham, Long Island. KeySpan and Spectra Energy Corporation each owned a 50% interest in Islander East. On August 20, 2007 the U.S. District Court in Bridgeport Connecticut ruled in favor of Connecticut's objection to the development of the Islander East Pipeline project on the grounds that it had failed to comply with the state's coastal zone management plan. Based on this ruling a decision was made to no longer pursue the development of this pipeline. As a result, in the period January 1, 2007 through August 24, 2007 KeySpan wrote off the investment in Islander East resulting in a pre-tax impairment charge of $32.8 million.

Through its wholly owned subsidiary, KeySpan LNG, KeySpan owns a 600,000 barrel liquefied natural gas storage and receiving facility in Providence, Rhode Island. In 2005, KeySpan LNG entered into a precedent agreement with BG LNG Services, a subsidiary of British Gas, to provide liquefied natural gas terminalling service. KeySpan LNG proposed to upgrade the liquefied natural gas facility to accept marine deliveries and to triple vaporization (or regasification) capacity to provide these services. The proposed upgrade was subject to numerous Federal Energy Regulatory Commission ("FERC") proceedings, as well as proceedings with the Federal District Court in Rhode Island. At the time of the acquisition of KeySpan, National Grid plc decided not to pursue the upgrade of the LNG facility. As a result, deferred project costs of $11.3 million were written-off as a direct charge to equity as required by Statement of Financial Accounting Standards ("SFAS") 141 "Business Combinations."

Pursuant to PUHCA 2005, FERC has jurisdiction over certain of our holding company activities, including (i) regulating certain transactions among our affiliates within our holding company system; (ii) governing the issuance, acquisition and disposition of securities and assets by certain of our public utility subsidiaries; and (iii) approving certain utility mergers and acquisitions.

Moreover, our affiliate transactions also remain subject to certain regulations of the New York Sate Public Service Commission ("NYPSC"), the Massachusetts Department of Public Utilities ("MADPU") and the New Hampshire Public Utility Commission ("NHPUC") in addition to FERC.

Under our holding company structure, we have no independent operations or source of income of our own and conduct all of our operations through our subsidiaries and, as a result, we depend on the earnings and cash flow of, and dividends or distributions from, our subsidiaries to provide the funds necessary to meet our debt and contractual obligations. Furthermore, a substantial portion of our consolidated assets, earnings and cash flow is derived from the operations of our regulated utility subsidiaries, whose legal authority to pay dividends or make other distributions to us is subject to regulation by state regulatory authorities (See Note 11 "Rate Matters" regarding dividend restrictions associated with KEDNY and KEDLI).

KeySpan derives approximately 12% of its consolidated revenues from a series of agreements with LIPA pursuant to which we manage LIPA's transmission and distribution system and supply electricity to a majority of LIPA's customers.

B. Basis of Presentation

The Consolidated Financial Statements presented herein reflect the accounts of KeySpan and its subsidiaries. Due to the acquisition of KeySpan by National Grid plc and the change in KeySpan's fiscal year, KeySpan'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. Additionally, for all periods presented we have reclassified the operations of KeySpan's New York City merchant electric generating plants, its telecommunications subsidiary, as well as its engineering companies as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows. (See Note 7 – "Discontinued Operations" for additional details.)

Upon acquisition, KeySpan aligned certain of its accounting policies with National Grid plc's policies. Specifically and most importantly, 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. Additionally, 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. (See Note 10 "Acquisition of KeySpan" for additional details on the accounting policy changes.)

The preparation of financial statements in conformity with generally accepted accounting principles in the United States ("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. Accounting for the Effects of Rate Regulation

The accounting records for our six regulated gas utilities are maintained in accordance with the Uniform System of Accounts prescribed by the NYPSC, the NHPUC, and the MADPU. Our electric generation subsidiaries are not subject to state rate regulation, but they are subject to FERC regulation. Our financial statements reflect the ratemaking policies and actions of these regulators in conformity with GAAP for rate-regulated enterprises.

All of our six regulated gas utilities are subject to the provisions of SFAS 71, "Accounting for the Effects of Certain Types of Regulation." This statement recognizes the ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, we record these future economic benefits and obligations as regulatory assets and regulatory liabilities on the Consolidated Balance Sheet, respectively.

The following table presents our net regulatory assets at March 31, 2008 and December 31, 2006.

	March 31, 2008		December 31, 2006
(In Millions of Dollars)	Current	Non-Current	Non-Current
Regulatory Assets			
Regulatory tax asset	$ -	$ 32.1	$ 30.2
Property and other taxes	41.3	52.9	95.0
Environmental costs	8.6	813.8	482.5
Postretirement benefits	39.6	444.3	415.4
Costs associated with the KeySpan/LILCO transaction	3.9	-	15.6
Derivative financial instruments	5.9	72.6	206.5
Other	8.9	61.4	15.5
Total Regulatory Assets	$ 108.2	$ 1,477.1	$ 1,260.7
Regulatory Liabilities:			
Derivative financial instruments	$ (117.4)	$ (113.3)	$ (132.2)
Miscellaneous	(65.2)	(284.9)	(111.6)
Total Regulatory Liabilities	$ (182.6)	$ (398.2)	$ (243.8)
Net Regulatory Assets	(74.4)	1,078.9	1,016.9
Removal Costs Recovered	-	(627.9)	(556.2)
	$ (74.4)	$ 451.0	$ 460.7

The regulatory assets above are not included in utility rate base. However, we record carrying charges on the property tax and costs associated with the KeySpan/LILCO transaction cost deferrals. We also record carrying charges on our regulatory liabilities except for the current market value of our derivative financial instruments. The remaining regulatory assets represent, primarily, costs for which expenditures have not yet been made, and therefore, carrying charges are not recorded. We anticipate recovering these costs in our gas rates concurrently with future cash expenditures. If recovery is not concurrent with the cash expenditures, we will record the appropriate level of carrying charges. Deferred gas costs of $21.0 million (asset) and $46.3 million (asset) at March 31, 2008 and December 31, 2006, respectively are reflected in accounts receivable on the Consolidated Balance Sheet. Deferred gas costs are subject to current recovery from customers.

D. Revenues

Gas Distribution. Utility gas customers are billed monthly or bi-monthly on a cycle basis. Revenues include unbilled amounts related to the estimated gas usage that occurred from the most recent meter reading to the end of each month.

The cost of gas used is recovered when billed to firm customers through the operation of gas adjustment clauses ("GAC") included in utility tariffs. The GAC provision requires periodic reconciliation of recoverable gas costs and GAC revenues. Any difference is deferred pending recovery from or refund to firm customers. Further, net revenues from tariff gas balancing services, off-system sales and certain on-system interruptible sales are refunded, for the most part, to firm customers subject to certain sharing provisions.

The New York and Long Island gas utility tariffs contain weather normalization adjustments that largely offset shortfalls or excesses of firm net revenues (revenues less gas costs and revenue taxes) during a heating season due to variations from normal weather. Revenues are adjusted each month the clause is in effect. The New England gas utility rate structures contain no weather normalization feature, therefore their net revenues are subject to weather related demand fluctuations. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations. To mitigate the effect of fluctuations from normal weather on our financial position and cash flows, we may enter into weather related derivative instruments from time to time. (See Note 6, "Hedging, Derivative Financial Instruments and Fair Values" for additional information on these derivatives.)

In addition, effective January 1, 2006 the Boston Gas Company ("Boston Gas") was permitted by the MADPU to fully recover the gas cost component of bad debt write-offs through its cost-of-gas adjustment clause rather than filing for recovery as an exogenous cost. On October 31, 2006, the MADPU granted Boston Gas recovery of $12 million of the 2005 gas cost component of bad debt write-offs from Boston Gas ratepayers beginning November 1, 2006. This amount was recovered through the cost-of-gas adjustment clause.

Electric Services. Electric revenues are primarily derived from: billings to LIPA for management of LIPA's transmission and distribution system ("T&D System"), electric generation, and procurement of fuel.

LIPA Agreements. In 1998, KeySpan and LIPA entered into three major long-term service agreements that (i) provide to LIPA all operation, maintenance and construction services and significant administrative services relating to the Long Island electric T&D System pursuant to the Management Services Agreement (the "1998 MSA"); (ii) supply LIPA with electric generating capacity, energy conversion and ancillary services from our Long Island generating units pursuant to the Power Supply Agreement (the "1998 PSA"); and (iii) manage all aspects of the fuel supply for our Long Island generating facilities, as well as all aspects of the capacity and energy owned by or under contract to LIPA pursuant to the Energy Management Agreement (the "1998 EMA"). The 1998 MSA, 1998 PSA and 1998 EMA all are collectively referred to as the "1998 LIPA Agreements" and are discussed in greater detail below.

On February 1, 2006, KeySpan and LIPA entered into (i) an amended and restated Management Services Agreement (the "2006 MSA"), pursuant to which KeySpan will continue to operate and maintain the electric T&D System owned by LIPA on Long Island; (ii) a new Option and Purchase and Sale Agreement (the "2006 Option Agreement"), to replace the Generation Purchase Rights Agreement (as amended, the "GPRA"), pursuant to which LIPA had the option, through December 15, 2005, to effectively acquire substantially all of the electric generating facilities owned by KeySpan on Long Island; and (iii) a Settlement Agreement (the "2006 Settlement Agreement") resolving outstanding issues between the parties regarding the 1998 LIPA Agreements. The 2006 MSA, the 2006 Option Agreement and the 2006 Settlement Agreement are collectively referred to herein as the "2006 LIPA Agreements." The applicable rate components of each of the 2006 LIPA agreements became effective retroactive to January 1, 2006 upon receipt of all the required governmental approvals in 2007. (See Note 9, "2006 LIPA Settlement "for additional details on these agreements.)

In place of the previous compensation structure under the 1998 MSA (whereby KeySpan was reimbursed for budgeted costs, and earned a management fee and certain performance and cost-based incentives), KeySpan's compensation for managing the electric transmission and distribution system owned by LIPA under the 2006 MSA consists of two components: a minimum compensation component of $224 million per year and a variable component based on electric sales. The $224 million component will remain unchanged for three years and then increase annually by 1.7%, plus inflation. The variable component, which will comprise no more than 20% of KeySpan's compensation, is based on electric sales on Long Island exceeding a base amount of 16,558 gigawatt hours, increasing by 1.7% in each year. Above that level, KeySpan will receive approximately 1.34 cents per kilowatt hour for the first contract year, 1.29 cents per kilowatt hour in the second contract year (plus an annual inflation adjustment), 1.24 cents per kilowatt hour in the third contract year (plus an annual inflation adjustment), with the per kilowatt hour rate thereafter adjusted annually by inflation.

In addition, KeySpan sells to LIPA under the 1998 PSA all of the capacity and, to the extent requested, energy conversion services from its existing Long Island based oil and gas-fired generating plants. Sales of capacity and energy conversion services are made under rates approved by the FERC. Rates charged to LIPA include a fixed and variable component. The variable component is billed to LIPA on a monthly per megawatt hour basis and is dependent on the number of megawatt hours dispatched. The 1998 PSA provides incentives and penalties that can total $4 million annually for the maintenance of the output capability and the efficiency of the generating facilities.

Pursuant to the 1998 EMA, KeySpan (i) procures and manages fuel supplies for LIPA to fuel KeySpan's Long Island based generating facilities acquired from LILCO in 1998; (ii) performs off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs; and (iii) makes off-system sales of output from the Long Island based generating facilities and other power supplies either owned or under contract to LIPA. In exchange for these services KeySpan earns an annual fee of $1.5 million. LIPA is entitled to two-thirds of the profit from any off-system energy sales arranged by KeySpan. In addition, the 1998 EMA provides incentives and penalties that can total $5 million annually for performance related to fuel purchases and off-system power purchases. The original term for the fuel supply service described in (i) is 15 years, expiring May 28, 2013 and the original term for the off-system purchases and sales services described in (ii) and (iii), collectively, "Power Supply Management Services" was eight years, expiring May 28, 2006. The term for the Power Supply Management Services has been extended several times, most recently in 2007 when the parties amended the EMA to extend the term for such services until December 31, 2009, provided that LIPA shall have the right to terminate the Power Supply Management Services at any time upon 60 days prior notice.

In October 2007, LIPA issued a Request for Proposal ("RFP") to provide Power Supply Management Services commencing in October 2009. National Grid submitted a bid in response to the RFP. On June 26, 2008, LIPA announced that it had selected another bidder to provide these serves effective October 1, 2009. KeySpan will continue to supply fuel procurement services under the EMA. The loss of the Power Supply Management Services is not expected to have a material impact to KeySpan's results of operations or cash flows.

KeySpan Glenwood Energy Center, LLC and KeySpan Port Jefferson Energy Center, LLC have entered into 25 year Power Purchase Agreements with LIPA (the "PPAs"). Under the terms of the PPAs, these subsidiaries sell capacity, energy conversion services and ancillary services to LIPA. Each plant is designed to produce 79.9 MW. Under the PPAs, LIPA pays a monthly capacity fee, which provides full recovery of each plant's construction costs, as well as an appropriate rate of return on investment. The PPAs also obligate LIPA to pay for each plant's costs of operation and maintenance. These costs are billed on a monthly estimated basis and are subject to true-up for actual costs incurred.

The Electric Services segment also conducts retail marketing of electricity to commercial customers. Energy sales made by our electric marketing subsidiary are recorded upon delivery of the related commodity.

Energy Services. Revenues earned by our Energy Services segment for service and maintenance contracts associated with small commercial and residential appliances are recognized as earned or over the life of the service contract, as appropriate. We have unearned revenue recorded in deferred credits and other liabilities – other on the Consolidated Balance Sheet totaling $23.2 million and $19.6 million as of March 31, 2008, and December 31, 2006, respectively. These balances represent primarily unearned revenues for service contracts and are generally amortized to income over a one year period.

Gas Production and Development. Natural gas and oil revenues earned by our gas production and development activities are recognized using the entitlements method of accounting. Under this method of accounting, income is recorded based on the net revenue interest in production or nominated deliveries. Production gas volume imbalances are incurred in the ordinary course of business. Net deliveries in excess of entitled amounts are recorded as liabilities, while net under deliveries are recorded as assets. Imbalances are reduced either by subsequent recoupment of over and under deliveries or by cash settlement, as required by applicable contracts. Production imbalances are marked-to-market at the end of each month using the market price at the end of each period.

Discontinued Operations

Ravenswood Generating Station. Prior to January 1, 2008 the Ravenswood Generating Station earned revenue through the sale, at wholesale, of energy, capacity, and ancillary services to the NYISO. Energy and ancillary services were sold through a bidding process into the NYISO energy markets on a day ahead or real time basis. As discussed previously, KeySpan is in the process of selling KeySpan Ravenswood, LLC, which owns the Ravenswood Generating Station. In addition, the NYPSC required KeySpan to enter into an energy agreement whereby it would no longer have a financial interest in the NYISO energy market clearing prices.

On January 1, 2008, KeySpan Ravenswood, LLC commenced a one-year energy tolling agreement with a single counterparty pursuant to the requirements of the NYPSC – "Tolling Agreement." The agreement is for all the output from the Ravenswood Generating Station. The purpose of the agreement is to eliminate any financial interest KeySpan has in the performance of the NYISO energy markets by establishing a fixed amount as compensation for the Ravenswood Generating Station's energy output under the agreement, subject only to the operational performance of the facility. The counterparty assumed responsibility for offering the energy from the Ravenswood Generating Station to the NYISO market. KeySpan Ravenswood, LLC continues to be responsible for operating the Ravenswood Generating Station as well as the marketing and sale of capacity and certain fixed price ancillary services. The term of the Tolling Agreement is January 1, 2008 through December 31, 2008. The Tolling Agreement will be retained by the new owner of KeySpan Ravenswood, LLC after the sale. Accordingly, the Tolling Agreement will not be part of KeySpan's continuing operations after the sale. As noted previously, the operations of the Ravenswood Generating Station are classified as discontinued.

Engineering Services. Revenues earned for engineering services are derived from services rendered under fixed price and cost-plus contracts and generally are recognized on the percentage-of-completion method. Fiber optic service revenue is recognized upon delivery of service access.

E. Utility and Other Property - Depreciation and Maintenance

Property, principally utility gas property is stated at original cost of construction, which includes allocations of overheads, including taxes, and an allowance for funds used during construction. The rates at which KeySpan subsidiaries capitalized interest for the period January 1, 2007 through March 31, 2008 ranged from 1.78% to 6.48%. Capitalized interest for the period January 1, 2007 through March 31, 2008 and for the year ended December 31, 2006 was $4.2 million and $2.5 million respectively and is reflected as a reduction to interest expense.

Depreciation is provided on a straight-line basis in amounts equivalent to composite rates on average depreciable property. The cost of property retired is charged to accumulated depreciation.

KeySpan recovers cost of removal through rates charged to customers as a portion of depreciation expense. At March 31, 2008 and December 31, 2006, Keyspan had costs recovered in excess of costs incurred totaling $627.9 million and $556.2 million, respectively. These amounts are reflected as a regulatory liability.

The cost of repair and minor replacement and renewal of property is charged to maintenance expense. The composite rates on average depreciable property excluding the Ravenswood Generating Station were as follows:

	Year Ended	
	March 2008	December 2006
Electric	4.22%	3.80%
Gas	3.22%	3.14%

We also had $563.9 million of other property at March 31, 2008, consisting of assets held primarily by our corporate service subsidiary of $414.8 million, $40.7 million in Energy Services assets and $108.4 million in Investment assets. The corporate service assets consist largely of land, buildings, office equipment and furniture, vehicles, computer and telecommunications equipment and systems. These assets have depreciable lives ranging from three to 40 years. We allocate the carrying cost of these assets to our operating subsidiaries through our filed allocation methodology. Energy Services assets consist largely of computer equipment, office furniture and equipment and leasehold improvements with service lives ranging from 3 to 7 years. The Investment assets consist of land, storage facilities and various property and equipment.

KeySpan's repair and maintenance costs, including planned major maintenance in the Electric Services segment for turbine and generator overhauls, are expensed as incurred unless they represent replacement of property to be capitalized. Planned major maintenance cycles primarily range from seven to eight years. Smaller periodic overhauls are performed approximately every 18 months.

KeySpan capitalizes costs incurred in connection with its projects to develop and build energy facilities after a project has been determined to be probable of completion.

F. Gas Production and Development Property - Depletion

KeySpan maintains gas production and development activities through its two wholly-owned subsidiaries - KeySpan Exploration and Production, LLC ("KeySpan Exploration") and Seneca-Upshur Petroleum, Inc. ("Seneca-Upshur"). At March 31, 2008, these subsidiaries had net production and development property in the amount of $37.1 million. These assets are accounted for under the full cost method of accounting. Under the full cost method, costs of acquisition and development of natural gas and oil reserves plus asset retirement obligations are capitalized into a "full cost pool" as incurred. Unproved properties and related costs are excluded from the depletion and amortization base until a determination is made as to the existence of proved reserves. Properties are depleted and charged to operations using the unit of production method using proved reserve quantities.

To the extent that such capitalized costs (net of accumulated depletion) less deferred taxes exceed the present value (using a 10% discount rate) of estimated future net cash flows from proved natural gas and oil reserves and the lower of cost or fair value of unproved properties, less deferred taxes, such excess costs are charged to operations, but would not have an impact on cash flows. Once incurred, such impairment of gas properties is not reversible at a later date even if gas prices increase.

The ceiling test is calculated using natural gas and oil prices in effect as of the balance sheet date, held flat over the life of the reserves. We use derivative financial instruments that qualify for hedge accounting under SFAS 133 “Accounting for Derivative Instruments and Hedging Activities,” to hedge the volatility of natural gas prices. In accordance with current guidelines, we have included estimated future cash flows from our hedging program in ceiling test calculations.

As of March 31, 2008, we estimated that our capitalized costs did not exceed the ceiling test limitation. We used an average wellhead price of $10.97 per MCF, adjusted for derivative instruments.

Natural gas prices continue to be volatile and the risk that a write down to the full cost pool increases when, among other things, natural gas prices are low or there are significant downward revisions in our estimated proved reserves.

G. Goodwill and Other Intangible Assets

The balance of goodwill and other intangible assets was $4.2 billion at March 31, 2008 and $1.6 billion at December 31, 2006, representing primarily the excess of acquisition cost over the fair value of net assets acquired. Goodwill at March 31, 2008 reflects the acquisition of Keyspan by National Grid plc. The goodwill at December 31, 2006 reflects the Eastern and EnergyNorth acquisitions, the KeySpan/LILCO transaction, as well as acquisitions of non-utility energy-related service companies and also relates to certain ownership interests of 50% or less in energy-related investments, which are accounted for under the equity method. The intangible assets reflect the fair value of the Management Service Agreement and Energy Management Agreement with LIPA, emission credits kept by KeySpan and the fair value of customer relationships and plumbing licenses associated with KeySpan’s non-utility service companies.

The table below summarizes the goodwill and other intangible assets balance for each segment at March 31, 2008 and December 31, 2006:

	Goodwill		Intangible Assets	
(In Millions of Dollars)	March 2008	December 2006	March 2008	December 2006
Segment				
Gas Distribution	$ 3,156.5	$ 1,366.1	$ -	$ -
Electric	-	-	195.4	-
Energy Services	-	64.9	35.5	0.4
Energy Investments and other	781.8	235.0	-	-
Amounts allocated to Discontinued Operations	-	(50.2)	-	(0.4)
	$ 3,938.3	$ 1,615.8	$ 230.9	$ -

H. Hedging and Derivative Financial Instruments

From time to time, we employ derivative instruments to hedge a portion of our exposure to commodity price risk, interest rate risk and weather fluctuations. Additionally, prior to January 1, 2008, Keyspan employed derivative financial instruments to hedge cash flow variability associated with a portion of its peak electric energy sales. 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 the futures, options and swap instruments is no greater than that associated with the primary commodity contracts which they hedge.

Financially-Settled Commodity Derivative Instruments. We employ derivative financial instruments, such as futures, options and swaps, for the purpose of hedging the cash flow variability associated with forecasted purchases and sales of various energy-related commodities. All such derivative instruments are accounted for pursuant to 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”). 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 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 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.

Firm Gas Sales Derivatives Instruments – Regulated Utilities. We use derivative financial instruments to reduce cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our Gas Distribution operations. Our strategy is to minimize fluctuations in firm gas sales prices to our regulated firm gas sales customers in our New York and New England service territories. The accounting for these derivative instruments is subject to SFAS 71. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities 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.

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 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.

Weather Derivatives. The utility tariffs associated with our New England gas distribution operations do not contain weather normalization adjustments. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations. To mitigate the effect of fluctuations from normal weather on our financial position and cash flows, we may enter into derivative instruments from time to time. Based on the terms of the contracts, we account for these instruments pursuant to the requirements of Emerging Issues Task Force ("EITF") 99-2 "Accounting for Weather Derivatives." In this regard, we account for weather derivatives using the "intrinsic value method" as set forth in such guidance.

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. Equity Investments and Other

Certain subsidiaries own as their principal assets, investments (including goodwill), representing ownership interests of 50% or less in energy-related businesses that are accounted for under the equity method. None of these current investments are publicly traded. Additionally, KeySpan has corporate assets recorded on the Consolidated Balance Sheet representing funds designated for Supplemental Executive Retirement Plans. These funds are invested in corporate owned life insurance policies. KeySpan records changes in the value of these assets in accordance with SFAS Technical Bulletin 85-4 "Accounting for the Purchase of Life Insurance." As such, increases and decreases in the value of these assets are recorded through earnings in the Consolidated Statement of Income concurrent with the change in the value of the underlying assets.

J. Income and Excise Tax

Upon implementation of SFAS 109, "Accounting for Income Taxes," certain of our regulated subsidiaries 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. For the period January 1, 2007 through March 31, 2008 and the year ended December 2006, excise taxes collected and paid were $98.6 million and $60.4 million, respectively.

In July 2006, the FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109" ("FIN 48"). See Note 2, "Income Tax" for details on FIN 48.

K. Stock Based Compensation

Prior to the acquisition of Keyspan by National Grid plc on August 24, 2007, KeySpan awarded stock based compensation to officers, directors, consultants and certain other management employees, primarily under a Long Term Performance Incentive Compensation Plan (the "Incentive Plan"). Since the acquisition date, stock based compensation costs are allocated to KeySpan from the Parent using an appropriate allocation methodology. The Incentive Plan provided for the award of incentive stock options, non-qualified stock options, performance shares and restricted shares. The purpose of the Incentive Plan was to optimize KeySpan's performance through incentives that directly linked the participant's goals to those of KeySpan's shareholders and to attract and retain participants who made significant contributions to the success of KeySpan.

In January 2006, KeySpan adopted SFAS 123 (revised 2004) "Share-Based Payment ("SFAS 123R")." The implementation of this standard required KeySpan to expense certain stock options that had previously been accounted for under the requirements of APB Opinion 25 "Accounting for Stock Issued to Employees" and related Interpretations, i.e. awards issued prior to January 1, 2003. No compensation cost had been recognized for these fixed stock option plans in the Consolidated Financial Statements since the exercise prices and market values were equal on the grant dates. For the period January 1, 2007 through August 24, 2007, KeySpan recorded an expense of $1.9 million for stock option awards previously accounted for under APB 25.

The following table presents the actual expense for all of KeySpan's stock based compensation awards recorded in the Consolidated Statement of Income for the periods indicated.

(*In Millions of Dollars*)	For the Period January 1, 2007 - August 24, 2007	December 2006
Performance shares	$ 4.8	$ 8.2
Restricted stock	1.8	4.1
Stock options	1.9	6.1
EDSPP discount	4.1	4.8
Total stock-based compensation included in operations and maintenance expense	12.6	23.2
Income tax benefit	(4.4)	(8.1)
Total stock based compensation expense, net of tax	$ 8.2	$ 15.1

Prior to the adoption of SFAS 123R, KeySpan presented all tax benefits for deductions resulting from the exercise of stock options and disqualifying dispositions as operating cash flows in its Consolidated Statement of Cash Flows. SFAS 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Total cash flow will remain unchanged from what would have been reported under prior accounting rules.

During the period January 1, 2007 through August 24, 2007 and the twelve months ended December 31, 2006, cash received from stock options exercised was $12.6 million and $31.1 million, respectively. The tax benefit realized for tax deductions from stock options exercised during these periods was less than the recognized compensation expense and accordingly there were no excess tax deductions reported in the financing section of the Consolidated Statement of Cash Flows.

For a description of the performance shares, restricted stock awards, employee stock discount plan and stock options, all of which were discontinued upon the acquisition of KeySpan by National Grid plc, see KeySpan's Annual Report on Form 10K for the fiscal year ended December 31, 2006 Note 1, "Summary of Significant Accounting Policies" - Item N "Stock Based Compensation".

L. 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 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. KeySpan has not elected the fair value method.

In December 2007, the FASB issued SFAS 141R "Business Combinations." The objective of SFAS 141R is to improve the relevance and comparability of the financial information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement establishes principles and requirements for how the acquirer recognizes and measures the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in business combination; and determines what information to disclose. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. This Statement has no impact on KeySpan's current results of operations, cash flows or financial position.

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. KeySpan 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.

On September 15, 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. KeySpan is currently reviewing the requirements of SFAS 157, and at this point in time cannot determine what impact, if any, SFAS 157 will have on its results of operations or financial position. This Statement will have no impact on cash flow.

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. See Note 2, “Income Tax” for additional details on the impact of this implementation on KeySpan’s financial statements.

M. Accumulated Other Comprehensive Income

As required by SFAS 130, “Reporting Comprehensive Income,” the components of accumulated other comprehensive income are as follows:

(In Millions of Dollars)	March 2008	December 2006
Unrealized gains (losses) on marketable securities	$ (1.3)	$ 1.1
Accrued unfunded pension obligation	-	(25.6)
SFAS 158 Adjustment	(96.6)	(117.1)
Unrealized losses on derivative financial instruments	(3.9)	(2.8)
Accumulated other comprehensive loss	$ (101.8)	$ (144.4)

N. Pension and Other Postretirement Plan Assets

In December 2006, KeySpan adopted the provisions of SFAS 158 “Employers’ Accounting for Defined Benefit Pensions and Other Postretirement Benefit Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)” (“SFAS 158”). SFAS 158 requires employers to fully recognize all postretirement plans’ funded status on the balance sheet as a net liability or asset and required an offsetting adjustment to accumulated other comprehensive income in shareholders’ equity upon implementation. Consistent with past practice and as required by SFAS 158, KeySpan values its pension and other postretirement assets using the year-end market value of those assets. Benefit obligations are also measured at year-end. (See Note 3 “Postretirement Benefits” for additional details on KeySpan’s pension and other postretirement plans.)

O. Cash and Temporary Cash Investments

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

Note 2. Income Tax

KeySpan files a consolidated federal income tax return. A tax sharing agreement between the KeySpan's holding company and its subsidiaries provides for the allocation of a realized tax expense or benefit based upon separate return contributions of each subsidiary to the consolidated taxable income or loss in the consolidated income tax return. The subsidiaries record income tax payable or receivable from KeySpan resulting from the inclusion of their taxable income or loss in the consolidated return.

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

(In Millions of Dollars)	For the Period August 25, 2007 - March 31, 2008	For the Period January 1, 2007 - August 24, 2007	Twelve Months Ended December 2006
Current Income Tax			
Federal	115.2	424.9	(3.4)
State and Local	29.6	79.0	10.3
Total Current Income Tax	$ 144.8	$ 503.9	$ 6.9
Deferred Income Tax			
Federal	13.9	(257.2)	87.1
State and Local	1.6	(150.8)	19.0
Total Deferred Income Tax	$ 15.5	$ (408.0)	$ 106.1
Total income tax	$ 160.3	$ 95.9	$ 113.0

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 Millions of Dollars)	For the Period August 25, 2007 - March 31, 2008	For the Period January 1, 2007 - August 24, 2007	Twelve Months Ended December 31, 2006
Pre-Tax Income	$421.1	$47.8	$434.7
Computed at the statutory rate	147.3	16.7	152.1
Adjustments related to:			
State income tax, net of Federal benefit	18.9	6.3	18.9
Non deductible compensation payments	-	49.5	-
Non deductible other costs	-	9.5	-
Tax credits	-	-	(1.3)
Flowthrough of plant related tax benefits	(0.9)	(0.5)	(2.1)
Tax uncertainties and other adjustments	-	19.8	(3.8)
Medicare Subsidy	(1.6)	(3.6)	-
Dividends paid to employee benefit plan	-	-	(3.7)
Impact of IRS audit settlement	-	-	(44.5)
Impact of NYC audit settlement	-	-	(7.1)
Other items - net	(3.4)	(1.8)	4.5
Total income tax	$ 160.3	$ 95.9	$ 113.0
Effective income tax rate (1)	38%	201%	29%

KeySpan's consolidated effective income tax rate, including city and state income taxes, was 38% for the period August 25, 2007 through March 31, 2008; 201% for the period January 1, 2007 through August 24, 2007; and 28.8% for the twelve months ended December 31, 2006.

The period ending August 24, 2007 reflects substantial activity resulting from the acquisition of KeySpan on August 24, 2007 by National Grid plc. During this time, KeySpan incurred costs for payments to officers and directors directly related to the change in ownership that are not deductible for tax purposes having the effect of increasing the effective tax rate by 104%.

In 2006, KeySpan resolved its dispute with the New York City Department of Taxation and Finance with respect to income taxes relating to the operations of its merchant electric generating facility. As a result of the favorable settlement of this issue, KeySpan reversed a previously recorded tax reserve of $11.9 million ($7.1 million after federal income taxes).

In addition, pursuant to indemnity obligations contained in the LILCO / KeySpan merger agreement of May 1998, KeySpan had been working with the Internal Revenue Service ("IRS") to resolve certain disputes with regard to LILCO's tax returns for the tax years ended December 31, 1996 through March 31, 1999 and KeySpan's and The Brooklyn Union Gas Company's (d/b/a KEDNY) tax returns for the years ended September 30, 1997 through December 31, 1998. A settlement of the outstanding issues was reached in 2006 and was approved by the Joint Committee on Taxation in December 2007. Accordingly, KeySpan reversed $44.5 million of previously established tax reserves. Further, a $3.4 million benefit was recorded in 2006 reflecting amended tax returns claiming investment tax credits for the period 2000 through 2004.

The IRS has also commenced the examination of KeySpan's tax returns for the years ended December 31, 2000 through 2006. At this time, we cannot predict the result of these audits.

As of March 31, 2008, KeySpan has approximately $324 million of state net operating losses which will expire between 2011 and 2022.

At March 31, 2008 and December 31, 2006 the significant components of KeySpan's deferred tax assets and liabilities calculated under the provisions of SFAS No.109 "Accounting for Income Taxes" were as follows:

(In Millions of Dollars)	March 2008	December 2006
Reserves not currently deductible	$ (110.3)	$ (46.1)
State income tax	8.1	49.7
Property related differences	1,076.3	1,179.3
Regulatory tax asset	79.2	29.3
Employess benefits and compensation	(459.3)	(172.7)
Property taxes	60.4	82.7
Other items - net	(170.0)	(93.9)
Net deferred tax liability	$ 484.4	$ 1,028.3

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.

KeySpan adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, KeySpan recognized approximately a $20.5 million increase in the liability for unrecognized tax benefits which was accounted for as a reduction in retained earnings of $5.2 million and an increase to deferred tax assets of $15.3 million.

The following is a tabular reconciliation of the total amounts of unrecognized tax benefits for the period January 1, 2007 through March 31, 2008:

	(In Millions)
Unrecognized Tax Benefit - January 1, 2007	343.1
Gross increases - tax positions in prior period	-
Gross decreases - tax positions in prior period	-
Gross increases - tax positions in current period	23.8
Gross decreases - tax positions in current period	-
Settlements	-
Lapse of statute of limitations	-
Unrecognized Tax Benefit - March 31, 2008	366.9

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 approximately $100 million of tax benefits that, if recognized, would affect the effective tax rate.

KeySpan 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 on the Consolidated Balance Sheet as of March 31, 2008. Prior to August 24, 2007, KeySpan recognized interest and penalties related to unrecognized tax benefits in tax expense and tax payable. KeySpan's policy with respect to the classification of interest and penalties has been changed to comply with the accounting policies of its new parent company. KeySpan has accrued no penalties related to the unrecognized tax benefits noted above. KeySpan accrued interest of $20.2 million and $15.9 million during the periods of January 1, 2007 through August 24, 2007 and August 25, 2007 through March 31, 2008, respectively. In total, KeySpan has recognized a liability for interest of $22.1 million and $69.9 million as of December 31, 2006 and March 31, 2008, respectively.

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

KeySpan is subject to taxation in the US and various state jurisdictions. Through its various subsidiaries, KeySpan operates predominately in New York, Massachusetts, and New Hampshire. The following table indicates the earliest tax year subject to examination for each major jurisdiction:

Jurisdiction	Tax Year
Federal	2000
New York State	2000
Massachusetts	2000
New Hampshire	2003

Note 3. Postretirement Benefits

Pension Plans. The following information represents the consolidated net periodic pension cost for the periods August 25, 2007 through March 31, 2008; January 1, 2007 through August 24, 2007; and the twelve months ended December 31, 2006 for our noncontributory defined benefit pension plans which cover substantially all employees. Benefits are based on years of service and compensation. Funding for pensions is in accordance with requirements of federal law and regulations. KEDLI and Boston Gas Company are subject to certain deferral accounting requirements mandated by the NYPSC and the MADPU, respectively for pension costs and other postretirement benefit costs. Additionally, KEDNY is now subject to certain deferral accounting requirements as provided for in the recent Merger agreement with the NYPSC. (See Note 11, “Rate Matters” for additional details on this agreement.)

The calculation of net periodic pension cost is as follows:

(In Millions 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
Service cost, benefits earned during the period	$ 34.2	$ 39.3	$ 62.7
Interest cost on projected benefit obligation	106.7	102.6	155.1
Expected return on plan assets	(123.0)	(134.1)	(186.0)
Net amortization and deferral	-	37.3	88.7
Special termination benefits	11.0	-	-
Total pension cost	$ 28.9	$ 45.1	$ 120.5

The following table sets forth the pension plans' funded status at March 31, 2008 and December 31, 2006.

(In Millions 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 2006
Change in benefit obligation:			
Benefit obligation at beginning of period	$ (2,741.5)	$ (2,782.1)	$ (2,715.0)
Service cost	(34.2)	(39.3)	(62.7)
Interest cost	(106.7)	(102.6)	(155.0)
Amendments	-	(65.9)	(11.5)
Actuarial loss	46.9	159.7	28.3
Benefits paid	91.0	88.7	133.8
Curtailments/settlements/divestitures	8.5	-	-
Special termination benefits	(11.0)	-	-
Benefit obligation at end of period	$ (2,747.0)	$ (2,741.5)	$ (2,782.1)
Change in plan assets:			
Fair value of plan assets at beginning of period	2,621.2	2,474.2	2,213.5
Actual return on plan assets	(76.3)	142.5	299.6
Employer contribution	4.7	93.2	94.9
Benefits paid	(91.0)	(88.7)	(133.8)
Fair value of plan assets at end of period	2,458.6	2,621.2	2,474.2
Funded status	$ (288.4)	$ (120.3)	$ (307.9)

Amounts recognized in the statement of financial position consist of:	
Noncurrent assets	$ -
Current liabilities	(9.9)
Noncurrent liabilities	(278.5)
Total	$ (288.4)

Amounts recognized in accumulated other comprehensive income consist of:	
Net gain/(loss)	$ (144.0)
Prior service cost	-
Total	$ (144.0) *

Estimated amounts of accumulated other comprehensive income to be recognized in the next fiscal year through net periodic pension cost:	
Net gain/(loss)	$ (14.4)
Prior service cost	-
Total	$ (14.4) *

* The above amounts are before adjustments for regulatory deferrals and deferred taxes.

The table below details the end-of-year assumptions used for both the net periodic cost calculations and liability amounts.

	March 2008	December 2006
Assumptions:		
Obligation discount	6.50%	6.00%
Asset return, net of expenses	8.00%	8.50%
Average annual increase in compensation	4.00%	4.00%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the fiscal years indicated:

(In Millions of Dollars)	Pension Benefits
2009	$ 149.4
2010	$ 152.6
2011	$ 156.8
2012	$ 161.5
2013	$ 166.7
2014-2018	$ 929.8

Other Postretirement Benefits: The following information represents the consolidated net periodic other postretirement benefit cost for the periods August 25, 2007 through March 31, 2008, January 1, 2007 through August 24, 2007 and the twelve months ended December 31, 2006 for our noncontributory defined benefit plans covering certain health care and life insurance benefits for retired employees. We 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.

Net periodic other postretirement benefit cost included the following components:

(In Millions of Dollars)	For the Period August 25, 2007 - March 31, 2008	For the Period January 1, 2007 - August 24, 2007	Twelve Months December 2006
Service cost, benefits earned during the period	$ 13.1	$ 14.5	$ 24.9
Interest cost on accumulated postretirement benefit obligation	49.3	48.2	74.9
Expected return on plan assets	(22.5)	(24.9)	(36.6)
Net amortization and deferral	-	28.6	57.3
Curtailment charge	(0.1)	-	-
Special termination benefit	0.3	-	-
Other postretirement cost	$ 40.1	$ 66.4	$ 120.5

The following table sets forth the plans' funded status at March 31, 2008 and December 31, 2006.

(In Millions 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 2006
Change in benefit obligation:			
Benefit obligation at beginning of period	$ (1,287.0)	$ (1,323.0)	$ (1,414.3)
Actual Medicare Part D subsidy received	(1.7)	(1.2)	(0.9)
Expected less actual Medicare Part D subsidy received in	-	-	(2.7)
Service cost	(13.1)	(14.5)	(24.9)
Interest cost	(49.3)	(48.2)	(74.9)
Plan participants' contributions	-	-	(3.5)
Amendments	-	5.8	-
Actuarial gain (loss)	(60.0)	48.4	132.4
Benefits paid	36.8	45.7	65.8
Curtailments/settlements/divestitures	7.4	-	-
Special termination benefit	(0.4)	-	-
Benefit obligation at end of period	(1,367.3)	(1,287.0)	(1,323.0)
Change in plan assets:			
Fair value of plan assets at beginning of period	522.6	500.4	469.6
Actual return on plan assets	(15.4)	34.0	56.8
Employer contribution	18.5	33.9	36.3
Plan participants' contributions	-	-	3.5
Benefits paid	(36.8)	(45.7)	(65.8)
Fair value of plan assets at end of period	488.9	522.6	500.4
Funded status	$ (878.4)	$ (764.4)	$ (822.6)

Amounts recognized in the statement of financial position consist of:	
Noncurrent assets	$ 13.9
Current liabilities	(6.4)
Noncurrent liabilities	(885.9)
Total	$ (878.4)

Amounts recognized in accumulated other comprehensive income consist of:		
Net gain / (loss)	$ (90.7)	
Prior service cost	-	
Total	$ (90.7)	*

Estimated amounts of accumulated other comprehensive income to be recognized in the next fiscal year through net periodic pension cost:		
Net gain / (loss)	$ (8.5)	
Prior service cost	-	
Total	$ (8.5)	*

* The above amounts are before adjustments for regulatory deferrals and deferred taxes.

The table below details the end-of-period assumptions used for both the net periodic cost calculations and liability amounts.

	March 2008	December 2006
Assumptions:		
Obligation discount	6.50%	6.00%
Asset return, net of tax	7.60%	8.25%
Average annual increase in compensation	4.00%	4.00%

The measurement of plan liabilities assumes a health care cost trend rate of 10% grading down to 5% in the year 2013. A 1% increase in the health care cost trend rate would have the effect of increasing the accumulated postretirement benefit obligation as of March 31, 2008 by $173.8 million and the net periodic health care expense by $9.4 million. A 1% decrease in the health care cost trend rate would have the effect of decreasing the accumulated postretirement benefit obligation as of March 31, 2008 by $141.7 million and the net periodic health care expense by $7.5 million.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the fiscal years indicated:

(In Millions of Dollars)	Gross Benefit Payments		Subsidiary Receipts Expected**	
2009	$	67.9	$	3.8
2010	$	72.9	$	4.2
2011	$	77.7	$	4.5
2012	$	81.8	$	4.8
2013	$	85.0	$	5.2
2014 - 2018	$	473.0	$	30.0

** Rebates are based on calendar year in which prescription drug costs are incurred. Actual receipt of rebates may occur in the following year.

Pension/Other Post Retirement Benefit Plan Assets. KeySpan's weighted average asset allocations at March 31, 2008 and December 31, 2006, by asset category, for both the pension and other postretirement benefit plans are as follows:

	Pension		OPEB	
Asset Category	2008	2006	2008	2006
Equity securities	63%	67%	62%	69%
Debt securities	29%	26%	29%	24%
Cash and equivalents	1%	1%	4%	2%
Venture capital	7%	6%	5%	5%
Total	100%	100%	100%	100%

The long-term rate of return on assets (pre-tax) is assumed to be 8.0%, net of expenses which management believes is an appropriate long-term expected rate of return on assets based on our investment strategy, asset allocation mix and the historical performance of equity and fixed income investments over long periods of time. The actual ten- year compound rate of return, net of expenses, for our Plans is greater than 8.0%.

KeySpan has developed a multi-year funding strategy for its plans. We believe that it is reasonable to assume assets can achieve or outperform the assumed long-term rate of return with the target allocation as a result of historical performance of equity investments over long-term periods.

Cash Contributions. In fiscal year 2009, KeySpan is expected to contribute approximately $138 million to its pension plan and approximately $70 million to its other postretirement benefit plan.

Defined Contribution Plan. KeySpan also offers both its union and management employees a defined contribution plan. Both the KeySpan Energy 401(k) Plan for Management Employees and the KeySpan Energy 401(k) Plan for Union Employees are available to all eligible employees. Effective August 24, 2007, the KeySpan Energy 401(k) Plan for Management Employees and the KeySpan Energy 401(k) Plan for Union Employees were merged into National Grid USA's (a subsidiary of National Grid plc) Incentive Thrift Plan I and the National Grid USA's Incentive Thrift Plan II, respectively. These Plans are defined contribution plans subject to Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"). Eligible employees contributing to the Plan may receive certain employer contributions including matching contributions and a 10% discount on the purchase of National Grid plc common stock in the Plan. The matching contributions were in KeySpan's common stock until January 2006. The matching contributions are now determined at the election of KeySpan employees. For the periods August 25, 2007 through March 31, 2008; January 1, 2007 through August 24, 2007; and the twelve months ended December 31, 2006, we recorded an expense of $7.7 million, $8.6 million and $14.7 million, respectively.

Note 4. Long-Term Debt And Commercial Paper

Notes Payable. In 2006, KeySpan issued at KEDNY and KEDLI, respectively, $400 million and $100 million of Senior Unsecured Notes at 5.6% due November 29, 2016. Additionally, KEDLI has $400 million of 7.875% Medium-Term Notes due February 1, 2010, outstanding at March 31, 2008 which is guaranteed by KeySpan.

KeySpan also has $1.9 billion of medium and long term notes outstanding of which $950 million of these notes were associated with the acquisition of Eastern and ENI. These notes were issued in two series as follows: $700 million of 7.625% Notes due 2010 and $250 million of 8.00% Notes due 2030. KeySpan also has $160 million of 4.9% notes outstanding with a maturity date of May 2008 and $307.2 million of 5.8% notes outstanding with a maturity date of April 2035 issued pursuant to the MEDS Equity Units conversion in 2005. The remaining debt of $483.0 million had interest rates ranging from 4.65% to 9.75%. KEDLI repaid $125 million of Medium-Term Notes at 6.90% at time of maturity, January 15, 2008.

Gas Facilities Revenue Bonds. KEDNY can issue tax-exempt bonds through the New York State Energy Research and Development Authority ("NYSERDA"). Whenever bonds are issued for new gas facilities projects, proceeds are deposited in trust and subsequently withdrawn to finance qualified expenditures. There are no sinking fund requirements on any of our Gas Facilities Revenue Bonds ("GFRBs"). At March 31, 2008, $640.5 million of GFRBs were outstanding, $230 million of which are variable-rate auction bonds. The interest rate on the variable rate series due through July 1, 2026 is reset weekly and ranged from 3.00% to 6.27% for the period January 1, 2007 through March 31, 2008. The variable-rate auction 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 reverted 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. To date, the effect on interest expense has not been material.

Promissory Notes to LIPA. In connection with the KeySpan/LILCO transaction, KeySpan and certain of its subsidiaries issued promissory notes to LIPA to support certain debt obligations assumed by LIPA. At March 31, 2008, $155.4 million of these promissory notes remained outstanding with maturity dates between 2013 and 2025. Under these promissory notes, KeySpan is required to obtain letters of credit to secure its payment obligations if its long-term debt is not rated at least in the "A" range by at least two nationally recognized statistical rating agencies. At March 31, 2008, KeySpan was in compliance with this requirement.

Industrial Development Revenue Bonds. At March 31, 2008, KeySpan had outstanding $128.3 million of tax-exempt bonds with a 5.25% coupon maturing in June 2027 - $53.3 million dollars of these Industrial Development Revenue Bonds were issued in its behalf through the Nassau County Industrial Development Authority for the construction of the Glenwood Energy Center, an electric-generation peaking plant, and the balance of $75 million was issued in its behalf by the Suffolk County Industrial Development Authority for the Port Jefferson Energy Center an electric-generation peaking plant. KeySpan has guaranteed all payment obligations of these subsidiaries with regard to these bonds.

First Mortgage Bonds. Colonial Gas Company had outstanding $85 million of first mortgage bonds at March 31, 2008. These bonds are secured by gas utility property. The first mortgage bond indentures include, among other provisions, limitations on: (i) the issuance of long-term debt; (ii) engaging in additional lease obligations; and (iii) the payment of dividends from retained earnings. At March 31, 2008, these bonds remain outstanding and have interest rates ranging from 6.34% to 8.8% and maturities that range from 2008-2028. Colonial repaid $10 million of First Mortgage Bonds on their maturity date in March 2008.

Authority Financing Notes. Certain of our electric generation subsidiaries can issue tax-exempt bonds through the NYSERDA. At March 31, 2008, $41.1 million of Authority Financing Notes 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate on these notes is reset based on an auction procedure. The interest rate ranged from 3% to 17.75% during the period January 1, 2007 through March 31, 2008, at which time the rate was 6.85%.

We also have outstanding $24.9 million variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027. The interest rate on these bonds is reset weekly and ranged from 1.23% to 5.6% for the period January 1, 2007 through March 31, 2008, at which time the rate was 3.6%.

Ravenswood Master Lease. We have an arrangement with an unaffiliated variable interest financing entity through which we lease a portion of the Ravenswood Facility. We acquired the Ravenswood Facility, in part, through the variable interest entity, from the Consolidated Edison Company of New York ("Consolidated Edison") on June 18, 1999 for approximately $597 million. In order to reduce the initial cash requirements, we entered into a lease agreement (the "Master Lease") with the variable interest entity that acquired a portion of the facility, i.e. the three steam generating units, directly from Consolidated Edison and leased it to a KeySpan subsidiary. The variable interest financing entity acquired the property for $425 million, financed with debt of $412.3 million (97% of capitalization) and equity of $12.7 million (3% of capitalization). KeySpan has no ownership interests in the units or the variable interest entity. KeySpan has guaranteed all payment and performance obligations of our subsidiary under the Master Lease. Monthly lease payments are substantially equal to the monthly interest expense on the debt securities.

The Master Lease has been consolidated on the Consolidated Balance Sheet based on our current status as primary beneficiary as defined in Financial Accounting Standards Board Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." As part of the process to sell KeySpan Ravenswood, LLC, KeySpan terminated the Master Lease in June 2008 at a cost of $456 million. KeySpan now classifies the operations of the Ravenswood Facility as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

Commercial Paper and Revolving Credit Agreements. At March 31, 2008, KeySpan had two credit facilities totaling $1.5 billion - $920 million for five years through 2010, and $580 million through 2009, which continue to support KeySpan's commercial paper program for ongoing working capital needs.

The fees for the facilities are based on KeySpan's current credit ratings and are increased or decreased based on a downgrading or upgrading of our ratings. The current annual facility fee is 0.08% based on our credit rating of Baa1 by Moody's Investor Services and A- by Standard & Poor's for each facility. Both credit facilities allow for KeySpan to borrow using several different types of loans; specifically, Eurodollar loans, ABR loans, or competitively bid loans. Eurodollar loans are based on the Eurodollar rate plus a margin that is tied to our applicable credit ratings. ABR loans are based on the higher of the Prime Rate, the base CD rate plus 1%, or the Federal Funds Effective Rate plus 0.5%. Competitive bid loans are based on bid results requested by KeySpan from the lenders. We do not anticipate borrowing against these facilities; however, if the credit rating on our commercial paper program were to be downgraded, it may be necessary to do so.

The facilities contain certain affirmative and negative operating covenants, including restrictions on KeySpan's ability to mortgage, pledge, encumber or otherwise subject its utility property to any lien, as well as certain financial covenants that require us to, among other things, maintain a consolidated indebtedness to consolidated capitalization ratio of no more than 65% at the last day of any fiscal quarter. Violation of these covenants could result in the termination of the facilities and the required repayment of amounts borrowed thereunder, as well as possible cross defaults under other debt agreements. At March 31, 2008, KeySpan's consolidated indebtedness was 35.2% of its consolidated capitalization and KeySpan was in compliance with all covenants.

Subject to certain conditions set forth in the credit facility, KeySpan has the right, at any time, to increase the commitments under the $920 million facility up to an additional $300 million. In addition, KeySpan has the right to request that the termination date be extended for an additional period of 365 days prior to each anniversary of the closing date. This extension option, however, requires the approval of lenders holding more than 50% of the total commitments to such extension request. Under the agreements, KeySpan has the ability to replace non-consenting lenders with other pre-approved banks or financial institutions.

At March 31, 2008, we had cash and temporary cash investments of $588.0 million. During the period January 1, 2007 through March 31, 2008, we borrowed $201.8 million of commercial paper and, at March 31, 2008, $286.8 million of commercial paper was outstanding. At March 31, 2008, KeySpan had the ability to issue up to an additional $1.2 billion under its commercial paper program.

Capital Leases. Our subsidiaries lease certain facilities and equipment under long-term leases, which expire on various dates through 2014. The weighted average interest rate on these obligations was 6.2%.

Debt Maturity. The following table reflects the maturity schedule for our debt repayment requirements, including capitalized leases and related maturities, at March 31, 2008:

(In Millions of Dollars)	Long-Term Debt	Capital Leases	Total
Repayments:			
2009	170.0	1.2	171.2
2010	400.0	1.2	401.2
2011	720.0	1.3	721.3
2012	10.0	1.4	11.4
2013	10.0	1.5	11.5
Thereafter	2,565.4	1.5	2,566.9
	$ 3,875.4	$ 8.1	$ 3,883.5

The following table represents the ratings of KeySpan’s senior unsecured long-term debt at March 31, 2008.

	Standard & Poor's	Moody's Investor Services	FitchRatings
KeySpan Corporation	A-	Baa1	A-
KEDNY	A	N/A	A+
KEDLI	A	A3	A
Boston Gas	A-	Baa1	N/A
Colonial Gas	A-	A3	N/A
KeySpan Generation	A-	Baa1	N/A

Note 5. Contractual Obligations, Financial Guarantees and Contingencies

Lease Obligations. Lease costs included in operating expense were $117.6 million for the period January 1, 2007 through March 31, 2008 including the lease of KeySpan’s Brooklyn headquarters of $12.4 million. KeySpan has a leveraged lease financing arrangement associated with the Ravenswood Expansion. KeySpan is in the process of selling KeySpan Ravenswood, LLC. However, KeySpan will remain responsible for the lease payments under this arrangement through the maturity of the lease – May 2040. See Note 12 “Ravenswood Sale Transaction” for additional details on this sale. The yearly operating lease expense is approximately $17 million. Lease costs also include leases for other buildings, office equipment, vehicles and power operated equipment. Lease costs for the year ended December 31, 2006 was $76.2 million. As previously mentioned, the Master Lease is consolidated and, as a result, lease payments have been reflected as continuing interest expense on the Consolidated Statement of Income. The future minimum cash lease payments under various leases, excluding the Master Lease, but including the Ravenswood Expansion lease, all of which are operating leases, are $105.0 million per year over the next five years and $557.1 million, in the aggregate, for all years thereafter. (See discussion below for further information regarding the Master Lease and the Ravenswood Expansion sale/leaseback transaction.)

Variable Interest Entity. KeySpan has an arrangement with a variable interest entity through which it leases a portion of the Ravenswood Facility. We acquired the Ravenswood Facility, a 2,200-megawatt electric generating facility located in Queens, New York, in part, through the variable interest entity, from Consolidated Edison on June 18, 1999, for approximately $597 million. In order to reduce the initial cash requirements, we entered into a lease agreement (the “Master Lease”) with a variable interest, unaffiliated financing entity that acquired a portion of the facility, i.e. three steam generating units, directly from Consolidated Edison and leased it to our subsidiary, KeySpan Ravenswood LLC. The variable interest unaffiliated financing entity acquired the property for $425 million, financed with debt of $412.3 million (97% of capitalization) and equity of $12.7 million (3% of capitalization). KeySpan has no ownership interests in the units or the variable interest entity. KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, under the Master Lease. Monthly lease payments substantially equal the monthly interest expense on such debt securities. KeySpan classifies the operations of the Ravenswood Facility except for interest expense as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows. (See Note 7, "Discontinued Operations" and Note 12, "Ravenswood Sale Transaction" for additional details).

Sale/leaseback Transaction. KeySpan also has a leveraged lease financing arrangement associated with the Ravenswood Expansion. In May 2004, the unit was acquired by a lessor from our subsidiary, KeySpan Ravenswood, LLC, and simultaneously leased back to that subsidiary. All the obligations of KeySpan Ravenswood, LLC have been unconditionally guaranteed by KeySpan. This lease transaction qualifies as an operating lease under SFAS 98 "Accounting for Leases: Sale/Leaseback Transactions Involving Real Estate; Sales-Type Leases of Real Estate; Definition of the Lease Term; an Initial Direct Costs of Direct Financing Leases, an amendment of FASB Statements No.13, 66, 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11." KeySpan has agreed to sell KeySpan Ravenswood, LLC to TransCanada Facility USA, Inc., a wholly owned subsidiary of TransCanada Corporation. The transaction provides for the restructuring and transfer of KeySpan's interest in the Ravenswood Expansion. TransCanada will prepay this sublease and provide back-to-back guarantees. However, the original lease will remain in place and KeySpan will continue to make the required payments under such lease.

Asset Retirement Obligations. KeySpan has various asset retirement obligations primarily associated with its gas distribution and electric generation activities. Generally, KeySpan's largest asset retirement obligations relate to: (i) legal requirements 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; or dispose of sections of gas main when removed from the pipeline system; (ii) cleaning and removal requirements associated with storage tanks containing waste oil and other waste contaminants; and (iii) legal requirements to remove asbestos upon major renovation or demolition of structures and facilities.

The following table presents our asset retirement obligation at March 31, 2008 and December 31, 2006:

(In Millions of Dollars)			
For the period ended		March 2008	December 2006
Asset Retirement Obligations			
Asbestos removal	(i)	$ 3.5	$ 3.5
Tanks removal and cleaning	(ii)	7.4	7.3
Main -cutting, purging and capping	(iii)	32.7	29.7
Wells - plug and capping	(iv)	0.2	0.2
KeySpan LNG tank demolition	(v)	2.3	2.3
Waste water treatment pond removal	(vi)	1.5	1.5
Fiber network removal	(vii)	1.0	0.9
Exploration wells-plug and capping	(viii)	2.0	1.9
Reclassification of Discontinued Operations		(1.9)	(1.9)
Total Asset Retirement Obligations		$ 48.7	$ 45.4

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

(ii) KeySpan has numerous storage tanks that contain among other things waste oil, #2 and #6 grade 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) KeySpan 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.

(iv) KeySpan owns approximately 52% of an underground gas storage facility in western New York State. The facility includes 39 gas injection and extraction wells. There is a regulatory obligation to close and seal the wells.

(v) KeySpan owns a 600,000 gallon Liquefied Natural Gas ("LNG") tank and ancillary facilities located in Providence, RI under a 30 year contract with New England Gas Company entered into on November 1, 1999. At the end of the contract, the contract can be; (i) extended; or (ii) New England Gas Company can require KeySpan to dismantle and remove the LNG tank and ancillary facilities or; (iii) KeySpan can elect to dismantle and remove the LNG tank and ancillary facilities. Since we may or may not be required to dismantle and remove the LNG tank and ancillary facilities, the obligation to perform was discounted to a 50% probability as premitted under FIN 47.

(vi) KeySpan has several wastewater treatment ponds associated with certain of its power stations. There are closure requirements for wastewater treatment pond systems based on regulations promulgated by the State of New York which were effective May 11, 2003.

(vii) KeySpan Communications has portions of its fiber optic network (underground and above ground) that are required to be removed upon termination of various agreements, a substantial portion of which will be the responsibility of the new owner upon the sale of this business.

(viii) KeySpan has a regulatory obligation to close and seal the wells primarily associated with its gas production and development activities.

Financial Guarantees. KeySpan has issued financial guarantees in the normal course of business, on behalf of its subsidiaries, to various third party creditors. At March 31, 2008, the following amounts would have to be paid by KeySpan in the event of non-payment by the primary obligor at the time payment is due:

Nature of Guarantee (In Millions of Dollars)			Amount of Exposure	Expiration Dates
Guarantees for Subsidiaries				
Medium-Term Notes - KEDLI	(i)	$	400.0	2010
Industrial Development Revenue Bonds	(ii)		128.3	2027
Ravenswood - Master Lease	(iii)		425.0	2009
Ravenswood - Sale/leaseback	(iv)		431.0	2040
Surety Bonds	(v)		72.9	Revolving
Commodity Guarantees and Other	(vi)		27.7	2008 - 2009
Letters of Credit	(vii)		76.7	2008 - 2011
		$	1,561.6	

The following is a description of KeySpan's outstanding subsidiary guarantees:

(i) KeySpan has fully and unconditionally guaranteed $400 million to holders of Medium-Term Notes issued by KEDLI. These notes are due to be repaid February 1, 2010. KEDLI is required to comply with certain financial covenants under the debt agreements. The face value of these notes is included in long-term debt on the Consolidated Balance Sheet as appropriate.

(ii) KeySpan has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to $128.3 million of Industrial Development Revenue Bonds issued through the Nassau County and Suffolk County Industrial Development Authorities for the construction of two electric-generation peaking plants on Long Island. The face value of these notes are included in long-term debt on the Consolidated Balance Sheet.

(iii) KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, the lessee under the Master Lease. The term of the lease had been extended to June 20, 2009. This guarantee has been terminated following the termination of the Master Lease in June 2008, other than with respect to certain continued indemnity obligations that are considered highly remote and likely immaterial.

(iv) KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, the lessee under the sale/leaseback transaction associated with the Ravenswood Expansion, including future decommissioning costs. The initial term of the lease is for 36 years. As noted previously, this lease qualifies as an operating lease and is not reflected on the Consolidated Balance Sheet. The cash consideration for KeySpan Ravenswood, LLC includes a prepayment from TransCanada to KeySpan of these payments on a present value basis. KeySpan's requirement to make these regular payments will continue after the sale of KeySpan Ravenswood, LLC. TransCanada will provide various guarantees to ensure that KeySpan does not have a continuing interest in the performance of the plant.

(v) KeySpan has agreed to indemnify the issuers of various surety and performance bonds associated with certain construction projects being performed by certain current and former subsidiaries. In the event that the subsidiaries fail to perform their obligations under contracts, the injured party may demand that the surety make payments or provide services under the bond. KeySpan would then be obligated to reimburse the surety for any expenses or cash outlays it incurs. Although KeySpan is not guaranteeing any new bonds for any of the former subsidiaries, KeySpan's indemnity obligation supports the contractual obligation of these former subsidiaries. KeySpan has also received from a former subsidiary an indemnity bond issued by a third party insurance company, the purpose of which is to reimburse KeySpan in an amount up to $80 million in the event it is required to perform under all other indemnity obligations previously incurred by KeySpan to support such company's bonded projects existing prior to divestiture. At March 31, 2008, the total cost to complete such remaining bonded projects is estimated to be approximately $16.0 million.

(vi) KeySpan has guaranteed commodity-related payments for subsidiaries within the Electric Services segment. These guarantees are provided to third parties to facilitate physical and financial transactions involved in the purchase of natural gas, oil and other petroleum products for electric production and marketing activities. The guarantees cover actual purchases by these subsidiaries that are still outstanding as of March 31, 2008.

(vii) KeySpan has arranged for stand-by letters of credit to be issued to third parties that have extended credit to certain subsidiaries. Certain vendors require us to post letters of credit to guarantee subsidiary performance under our contracts and to ensure payment to our subsidiary subcontractors and vendors under those contracts. Certain of our vendors also require letters of credit to ensure reimbursement for amounts they are disbursing on behalf of our subsidiaries, such as to beneficiaries under our self-funded insurance programs. Such letters of credit are generally issued by a bank or similar financial institution. The letters of credit commit the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, KeySpan would be required to reimburse the issuer of the letter of credit.

To date, KeySpan has not had a claim made against it for any of the above guarantees and we have no reason to believe that our subsidiaries or former subsidiaries will default on their current obligations. However, we cannot predict when or if any defaults may take place or the impact any such defaults may have on our consolidated results of operations, financial condition or cash flows.

As noted previously, KeySpan owns a 26.25% ownership interest in the Millennium Pipeline Company LLC ("Millennium"), the developer of the Millennium Pipeline project. The Millennium Pipeline project is anticipated to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning, New York to Ramapo, New York, interconnecting with the pipeline systems of various other utilities in New York. Subject to the receipt of certain remaining permits and financing, Millennium expects that the first phase of the project will be in service by November 2008.

KeySpan has guaranteed $210 million of an $800 million Millennium Pipeline construction loan. The $210 million represents KeySpan's proportionate share of the $800 million loan based on KeySpan's 26.25% ownership interest in the Millenium Pipeline project. In addition, Consolidated Edison, KEDLI and Columbia Transmission have each entered into precedent agreements to purchase capacity on the pipeline. Upon and subject to the terms and conditions set forth in Precedent Agreements, KeySpan has agreed to guarantee the full and prompt payment of $15.8 million (the "Guaranteed Amount") of the contingent $60 million financial obligation that Millennium may incur for liquidated damages under the Precedent Agreements to Consolidated Edison and KEDLI. The liquidated damages are intended to reimburse Consolidated Edison and KEDLI for costs incurred to secure additional capacity if Millennium is unable to provide the contracted capacity. The $15.8 million guaranteed amount reflects KeySpan's proportionate share of the $60 million of financial security that is required to be provided to Consolidated Edison and KEDLI pursuant to the Precedent Agreements based on KeySpan's proportionate ownership interest in the Millennium Pipeline project. These guarantees have been accounted for in accordance with FIN 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtness of Others." At March 31, 2008, the fair value of these guarantees was $2.7 million and is reflected as a component of equity investments, and other deferred credits and other liabilities on the Consolidated Balance Sheet.

Fixed Charges Under Firm Contracts. KeySpan's gas distribution subsidiaries have 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 $585 million. KeySpan and its gas distribution subsidiaries are liable for these payments regardless of the level of services required from third parties. Such charges are currently recovered from utility customers as gas costs.

Legal Matters. From time to time we are subject to various legal proceedings arising out of the ordinary course of our business. Except as described below, we do not consider any of such proceedings to be material to our business or likely to result in a material adverse effect on our results of operations, financial condition or cash flows.

Since July 12, 2006, eight lawsuits have been filed which allege damages resulting from contamination associated with the historic operations of former manufactured gas plants located in Bay Shore. KeySpan has been conducting site investigations and remediations at these locations pursuant to Administrative Orders on Consent ("ACO") with the New York State Department of Environmental Conservation ("DEC"). One of these lawsuits was settled on May

15, 2008 by purchasing a residential property. There is one lawsuit pending related to the former Clifton manufactured gas plant on Staten Island. KeySpan intends to contest each of the remaining proceedings vigorously.

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 DEC and AG to address environmental conditions associated with the remainder of the properties. KeySpan has entered into an 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.

In May 2007, KeySpan received a Civil Investigative Demand ("CID") from the United States Department of Justice, Antitrust Division, requesting the production of documents and information relating to its investigation of competitive issues in the New York City electric energy capacity market prior to National Grid's acquisition of KeySpan. The CID is a request for information in the course of an investigation and does not constitute the commencement of legal proceedings, and no specific allegations have been made against KeySpan. In April 2008, KeySpan received a second CID in connection with this matter. KeySpan continues to believe that its activity in the capacity market is consistent with all applicable laws and regulations and will continue to fully cooperate with this investigation.

On December 18, 2007, the United States Court of Appeals for the District of Columbia Circuit ("Court") denied the petitions of the New York Independent System Operator ("NYISO") and various New York Transmission Owners seeking refunds for charges in the January - March 2000 reserve market. The Court held that the Federal Energy Regulatory Commission ("FERC") provided reasonable explanations with respect to why it was using its discretion to deny refunds, even though there was a tariff violation. The Court also supported FERC's reasoning for not invoking the NYISO's Temporary Extraordinary Procedures to grant refunds as well as its reasoning for why the exclusion of certain resources from the market (i.e., excluded at the request of the resource to preserve energy availability) was not a market design flaw. As a result of this favorable decision, KeySpan reversed a previously established reserve for these proceedings of $18.1 million. As required by SFAS 141, this amount was not reflected on the Consolidated Statement of Income, but rather was recorded as a direct benefit to equity.

Environmental Matters. Air. Our generating facilities are located within a Clean Air Act ("CAA") ozone non-attainment and PM 2.5 (fine particulate matter) non-attainment area, and are subject to increasingly stringent NOx emission limitations to be implemented under forthcoming requirements of the United States Environmental Protection Agency ("EPA") pursuant to the Clean Air Interstate Rule ("CAIR") and potentially under the Ozone Transport Commission's initiative to achieve additional NOx reductions. These efforts are designed to improve both ozone and particulate matter air quality. Our previous investments in low NOx boiler combustion modifications, the use of natural gas firing systems at our steam electric generating stations, and the compliance flexibility available under these cap and trade programs, have enabled KeySpan to achieve our prior emission reductions in a cost-effective manner. We are currently developing a compliance strategy to address these anticipated requirements. We plan to install enhanced NOx controls at certain of our Long Island based electric generating facilities as part of a prior commitment to LIPA. This will be conducted in conjunction with an efficiency improvement project at these facilities; a mechanism for recovery of these investments through fuel savings has been established. The cost of these improvements is estimated to be approximately $100 million. Additional NOx controls are planned for other Long Island based electric generating facilities at an estimated cost of $8 million. Such amounts are recoverable from LIPA.

Water. Additional capital expenditures associated with the renewal of the surface water discharge permits for our power plants will likely be required by the DEC. We are currently conducting studies as directed by the DEC to determine the impacts of our discharges on aquatic resources and are engaged in discussions with the DEC regarding the nature of capital upgrades or other mitigation measures necessary to reduce any impacts. These upgrades are expected to cost up to $60 million for the Long Island units, however, such amounts are recoverable from LIPA. The actual expenditures will depend upon the outcome of the ongoing studies and the subsequent determination by the DEC of how to apply the standards set forth in recently promulgated federal regulations under Section 316 of the Clean Water Act designed to mitigate such impacts.

Land, Manufactured Gas Plants and Related Facilities.
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 its approach 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 KeySpan increased the reserve for estimated manufactured gas plant ("MGP") related environmental activities by approximately $343 million. 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. Through various rate orders issued by the NYPSC, MADPU and NHPUC, costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers. As a result, approximately $331 million of this reserve adjustment is reflected as a component of regulatory assets with the remaining $12 million as goodwill.

New York Sites: Within the State of New York we have identified 54 historical MGP sites and related facilities which were owned or operated by KeySpan subsidiaries or such companies' predecessors. These former sites, some of which are no longer owned by KeySpan, have been identified to 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/or remediation activities associated for all sites, except for two sites which are subject of an ACO that is currently being negotiated.

KeySpan has identified 27 of these sites as being associated with the historical operations of KEDNY. One site has been fully remediated. Subject to the issues described in the preceding paragraph, the remaining 26 sites will be investigated and, if necessary, remediated under the terms and conditions of ACOs, VCAs, or Brownfield Cleanup Agreements ("BCA"). Expenditures incurred to date by us with respect to KEDNY MGP-related activities total $119.3 million.

The remaining 27 sites have been identified as being associated with the historical operations of KEDLI. One site has been fully investigated and requires no further action. The remaining sites will be investigated and, if necessary, remediated under the terms and conditions of ACOs, VCAs, or BCAs. Expenditures incurred to date by us with respect to KEDLI MGP-related activities total $106.3 million.

KeySpan presently estimates the remaining cost for environmental remediation activities of its KEDNY and KEDLI MGP sites and related facilities will be $541.4 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.

With respect to remediation costs, KEDNY and KEDLI rate plans generally provide for the recovery from customers of investigation and remediation costs of certain sites. At March 31, 2008, we have reflected a regulatory asset of $735.4 million for KEDNY/KEDLI MGP sites.

KeySpan is also responsible for environmental obligations associated with the Ravenswood Facility, purchased from Consolidated Edison in 1999, including remediation activities associated with its historical operations and those of the MGP facilities that formerly operated at the site. KeySpan is not responsible for liabilities arising from disposal of waste at off-site locations prior to the acquisition closing and any monetary fines arising from Consolidated Edison's pre-closing conduct. We presently estimate the remaining environmental clean up activities for this site will be $1.2 million, which amount has been accrued by us. Expenditures incurred to date total $3.8 million.

New England Sites: Within the Commonwealth of Massachusetts and the State of New Hampshire, we are aware of 77 former MGP sites and related facilities within the existing or former service territories of KEDNE.

Boston Gas Company, Colonial Gas Company and Essex Gas Company may have or share responsibility under applicable environmental laws for the remediation of 67 of these sites. Another subsidiary of National Grid USA, formerly New England Electric System, has assumed responsibility for remediating 11 of these sites, subject to a limited contribution from Boston Gas Company, and has provided full indemnification to Boston Gas Company with respect to eight other sites. In addition, Boston Gas Company, Colonial Gas Company, and Essex Gas Company have assumed responsibility for remediating 10 sites. At this time, it is uncertain as to whether Boston Gas Company, Colonial Gas Company or Essex Gas Company have or share responsibility for remediating any of the other sites. No notice of responsibility has been issued to us for any of these sites from any governmental environmental authority.

KeySpan presently estimates the remaining cost of the Massachusetts KEDNE MGP-related environmental cleanup activities will be $36.2 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. Expenditures incurred since November 8, 2000, the acquisition date of these subsidiaries, with respect to these MGP-related activities total $38.7 million.

KeySpan may have or share responsibility under applicable environmental laws for the remediation of 10 MGP sites and related facilities associated with the historical operations of EnergyNorth in New Hampshire. At four of these sites, KeySpan has entered into cost sharing agreements with other parties who share responsibility for remediation of these sites. EnergyNorth also entered into an agreement with the EPA for the contamination from the Nashua site that was allegedly commingled with asbestos at the so-called Nashua River Asbestos Site, adjacent to the Nashua MGP site. The Nashua River Asbestos Site now has been fully remediated.

KeySpan presently estimates the remaining cost of EnergyNorth MGP-related environmental cleanup activities will be $41.4 million, which amount has been accrued 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. Expenditures incurred since November 8, 2000, the acquisition date of this subsidiary, with respect to the MGP-related activities total $30.6 million.

By rate orders, the MADPU and the NHPUC provide for the recovery of site investigation and remediation costs and, accordingly, at March 31, 2008, we have reflected a regulatory asset of $87.0 million for the KEDNE MGP sites.

KeySpan New England, LLC Sites: KeySpan is aware of three non-utility sites associated with KeySpan New England, LLC, a successor company to Eastern Enterprises, for which it may have or share environmental remediation or ongoing maintenance responsibility. These three sites, located in Philadelphia, Pennsylvania; New Haven, Connecticut; and Everett, Massachusetts, were associated with historical operations involving the production of coke and related industrial processes. Honeywell International, Inc. and Beazer East, Inc. (both former owners and/or operators of certain facilities at Everett (the "Everett Facility") together with KeySpan, have entered into an ACO with the Massachusetts Department of Environmental Protection for the investigation and development of a remedial response plan for a portion of that site. KeySpan, Honeywell and Beazer East entered into a cost-sharing agreement under which each company agreed to pay one-third of the costs of compliance with the consent order, while preserving any claims it may have against the other companies for, among other things, reallocation of proportionate liability. In 2002, Beazer East commenced an action in the U.S. District Court for the Southern District of New York which sought a judicial determination on the allocation of liability for the Everett Facility. A confidential settlement agreement was executed on terms favorable to KeySpan and the Beazer lawsuit has been discontinued.

KeySpan presently estimates the remaining cost of the environmental cleanup activities for these three non-utility sites will be approximately $23.2 million, which amount has been accrued as a reasonable estimate of probable costs 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. Expenditures incurred since November 8, 2000, with respect to these sites total $22.8 million.

KeySpan believes that in the aggregate, the accrued liability for these MGP sites and related facilities identified above are reasonable estimates of the probable cost for the investigation and remediation of these sites and facilities. As circumstances warrant, we periodically re-evaluate the accrued liabilities associated with MGP sites and related facilities. We may be required to investigate and, if necessary, remediate each site previously noted, or other currently unknown former sites and related facility sites, the cost of which is not presently determinable but may be material to our financial position, results of operations or cash flows.

Insurance Reimbursement of MGP Response Costs. We have instituted lawsuits in New York, Massachusetts and New Hampshire against numerous insurance carriers for reimbursement of costs incurred for the investigation and remediation of these MGP sites.

In January 1998 and July 2001, KEDLI and KEDNY, respectively, 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 KEDLI and KEDNY. The outcome of these proceedings cannot yet be determined.

In March 1999, Boston Gas Company and a subsidiary of National Grid filed a complaint for the recovery of remediation costs in the Massachusetts Superior Court against various insurance companies that issued comprehensive general liability policies to National Grid and its predecessors with respect to, among other things, the 11 sites for which Boston Gas Company has agreed to make a limited contribution. In October 2002, Boston Gas Company filed a complaint in the United States District Court – Massachusetts District against one of the insurance companies that issued comprehensive general liability policies to Boston Gas Company for its remaining sites. In November 2005, the trial commenced on the declaratory judgment action of Boston Gas against Century Indemnity for insurance coverage for the costs incurred in the investigation and remediation at the former Boston Gas Everett MGP site and in December 2005, the jury returned a verdict in favor of KeySpan. KeySpan anticipates that Century Indemnity will appeal this verdict. The outcome of these proceedings cannot yet be determined.

EnergyNorth has filed a number of lawsuits in both the New Hampshire Superior Court and the United States District Court for the District of New Hampshire for recovery of its remediation costs against the various insurance companies that issued comprehensive general liability and excess liability insurance policies to EnergyNorth and its predecessors. In October 2004, EnergyNorth's case against the London Market Insurers for the costs incurred investigating and remediating the former MGP site in Laconia went to trial and the jury returned a verdict in favor of EnergyNorth, finding that EnergyNorth was entitled to recover against London Market Insurers. In February 2005, the trial of EnergyNorth's coverage action for the Dover MGP site began against the only remaining defendant, Century Indemnity (all other carriers settled prior to trial) and at the conclusion of the trial the federal judge directed a verdict in EnergyNorth's favor on all issues. Century Indemnity filed an appeal with the First Circuit Court of Appeals and in a decision dated June 28, 2006, the First Circuit court of Appeals denied Century Indemnity's appeal in its entirety. In a jury trial in the Nashua MGP action commenced against the London Market Insurers and Century Indemnity in November 2005, the jury returned a verdict in favor of KeySpan finding that London and Century Indemnity were obligated to indemnify EnergyNorth for response costs incurred at the site. Century Indemnity has sought reconsideration of this verdict. The outcome of this proceeding cannot yet be determined.

In 1993, KeySpan New England LLC filed a declaratory judgment action against the Hanover and Travelers insurance companies in the Superior Court for Middlesex County for the Everett Facility. The declaratory judgment action sought to have the court compel the insurers to defend KeySpan New England, LLC in connection with the Massachusetts Department of Environmental Protection's Notice of Responsibility ("NOR"). In 2004, the Court granted KeySpan New England LLC's unopposed motion for leave to file a Second Amended Complaint in this action to seek a declaratory ruling that the insurers have a duty to indemnify KeySpan New England LLC for the costs associated with the Everett NOR and certain other related private actions. The Second Amended Complaint also adds certain excess insurance carriers as defendants in the action. The outcome of this proceeding cannot yet be determined.

KeySpan entered into confidential settlement agreements with certain of the defendant insurance carriers for recovery of costs associated with the investigation and remediation of the sites included in the above proceedings. Pursuant to these settlements, KeySpan recorded a benefit of $5.5 million in its Consolidated Statement of Income for the twelve months ended December 31, 2006, reflecting the benefit accruing to KeySpan's shareholders. Recovery of environmental costs from insurance carriers associated with utility MGP sites are refunded to KeySpan's ratepayers, subject to certain sharing provisions. In 2006, KeySpan received approximately $22 million from insurance carriers in settlements for recovery of environmental costs associated with remediation of MGP sites.

Note 6. Hedging, Derivative Financial Instruments and Fair Values

From time to time, KeySpan subsidiaries have utilized derivative financial instruments, such as futures, options and swaps, for the purpose of hedging the cash flow variability associated with changes in commodity prices. KeySpan is exposed to commodity price risk primarily with regard to its gas distribution operations and gas production and development activities. As discussed in greater detail below, certain derivative financial instruments employed by KeySpan are accounted for as cash-flow hedges and receive hedge accounting treatment under SFAS 133 “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS 149 “Amendment of Statement 133 on Derivative Instruments and Hedging Activities,” collectively SFAS 133. However, KeySpan also employs derivative financial instruments that do not qualify for hedge accounting treatment. Certain derivative financial instruments employed by our Gas Distribution operations are subject to SFAS 71 “Accounting for the Effects of Certain Types of Regulation.”

Commodity Derivative Instruments – Hedge Accounting: Our Energy Investments subsidiary, Seneca-Upshur, utilizes over-the-counter (“OTC”) natural gas swaps to hedge the cash flow variability associated with the forecasted sales of a portion of its natural gas production. At March 31, 2008, Seneca-Upshur has hedge positions in place for approximately 70% of its estimated 2008 through 2009 gas production, net of gathering costs. We use market quoted forward prices to value these swap positions. The maximum length of time over which Seneca-Upshur has hedged such cash flow variability is through December 2009. The fair value of these derivative instruments at March 31, 2008 was a liability of $7.0 million. As required by SFAS 141, at the time of the acquisition of KeySpan all accumulated other comprehensive income balances were reclassified into equity. As a result, $5.1 million of losses are currently included in accumulated other comprehensive income and expected to be reclassified to earnings in the next twelve months. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the period August 25, 2007 through March 31, 2008.

These derivative financial instruments are cash flow hedges that are accounted for as hedges under SFAS 133 and are not considered held for trading purposes as defined by current accounting literature. Accordingly, we carry the fair value of these derivative instruments on the Consolidated Balance Sheet as either a current or deferred asset or liability, as appropriate, and record the effective portion of unrealized gains or losses in accumulated other comprehensive income. Gains and losses are reclassified from accumulated other comprehensive income to the Consolidated Statement of Income in the period the hedged transaction affects earnings. Gains and losses on settled transactions are reflected as a component of revenue. Hedge ineffectiveness results from changes during the period in the price differentials between the index price of the derivative contract and the price of the purchase or sale for the cash flow that is being hedged, and is recorded directly to earnings.

Commodity Derivative Instruments that are not Accounted for as Hedges: As discussed in Note 1, Item D “Revenues”, KeySpan is required by the NYPSC to divest of the Ravenswood Generating Station. KeySpan is in the process of selling KeySpan Ravenswood, LLC, which owns the Ravenswood Generating Station. In addition, the NYPSC required KeySpan to enter into an energy agreement whereby it would no longer have a financial interest in the NYISO energy market clearing prices. In January 2008, KeySpan Ravenswood, LLC entered into a one-year energy tolling agreement with a single counterparty pursuant to the requirements of the NYPSC just mentioned. This agreement contains certain embedded derivatives that were determined to be clearly and closely related to the host contract and appropriately not valued. KeySpan has no other derivative positions associated with the Ravenswood Generating Station.

The Electric Services segment conducts retail marketing of electricity to a limited number of commercial customers. These contracts are usually at fixed prices. Our retail marketing subsidiary utilizes electric OTC power swaps to hedge the cash flow variability associated with the forecasted sales of electric power. We use market quoted forward prices to value these derivative positions. The maximum length of time over which KeySpan has hedged such cash flow variability is through December 2008. The fair value of these derivative instruments at March 31, 2008 was $1.5 million.

Additionally, KeySpan employs a limited number of unleaded gas swaps to hedge a small portion of its risk associated with changing prices for fleet fuel, as well as a limited number of natural gas swaps to hedge the risk associated with fixed price natural gas sales contracts for certain large gas sales customers. These financial derivative instruments do not qualify for hedge accounting treatment. The maximum length of time over which derivative financial instruments are in-place is through December 31, 2008. The fair value of these contracts at March 31, 2008 was $0.9 million. We use market quoted forward prices to value these contracts.

Based upon KeySpan's experience in the New York City electric capacity market and management's assessment that a financial opportunity existed related to this market, KeySpan entered into an International SWAP Dealers Association Master Agreement for a fixed for float unforced capacity financial swap (the "Swap Agreement") with Morgan Stanley Capital Group Inc. ("Morgan Stanley") on January 18, 2006 in an effort to enhance shareholder value. The Swap Agreement involves a financial transaction and was not intended to be an economic hedge of our physical generation assets or a contract for the physical delivery of capacity or energy. However, the same market dynamics that impacted KeySpan's physical generation business impacted the value of the financial Swap Agreement.

The Swap Agreement has a three year term that began on May 1, 2006. The notional quantity is 1,800,000kW (the "Notional Quantity") of In-City Unforced Capacity and the fixed price is $7.57/kW-month ("Fixed Price"), subject to adjustment upon the occurrence of certain events. Cash settlement occurs on a monthly basis based on the In-City Unforced Capacity price determined by the relevant NYISO Spot Demand Curve Auction Market ("Floating Price"). For each monthly settlement period, the price difference equals the Fixed Price minus the Floating Price. If such price difference is less than zero, Morgan Stanley will pay KeySpan an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference. Conversely, if such price difference is greater than zero, KeySpan will pay Morgan Stanley an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference.

This derivative instrument does not qualify for hedge accounting treatment under SFAS 133. At contract inception, the initial fair value of the Swap Agreement was fully reserved under the provision of EITF 02-3 “Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities,” due to KeySpan’s assessment that market prices for the underlying capacity were unobservable. Accordingly, no fair value was recorded on the Consolidated Balance Sheet at the inception of the contract.

In June 2006, stakeholders, including the NYPSC and the Consolidated Edison Company of New York, Inc. (“Con Ed”), complained to the NYISO that the summer 2006 In-City capacity market prices did not decline as some expected following the introduction of additional capacity into the market. After a stakeholder process, the NYISO proposed additional supplier mitigation measures to the FERC, but the NYISO’s filing was rejected. FERC instead opened an investigation of the New York City capacity market. The purpose of FERC’s investigation was to determine whether changes in the market are needed to attract and maintain necessary infrastructure without over compensating or under compensating suppliers. Subsequently, FERC ordered the NYISO to file comprehensive market reforms. On October 4, 2007, the NYISO proposed new mitigation measures to FERC involving mitigation of both suppliers and purchasers, with the intended effect of establishing both price caps and, during times of surplus, bid floors. Comments and alternative proposals were filed with FERC on November 19, 2007.

On March 7, 2008, the FERC approved the NYISO In-City capacity mitigation measures and revised the In-City capacity bid caps. The revised bid caps are expected to result in the SWAP Agreement floating price being set to equal the strike price, thereby eliminating all cash flow between KeySpan and Morgan Stanley for the remaining term of the Swap Agreement. As required by SFAS 141, KeySpan calculated the fair value of this derivative instrument to be a liability of $17.9 million at August 24, 2007; such amount was recorded as a current liability and a direct charge to equity. KeySpan does not anticipate any further cash settlements after payment of the $17.9 million, based on current and expected NYISO bid caps.

Commodity Derivative Instruments - Regulated Utilities: We use derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our Gas Distribution operations. Our strategy is to minimize fluctuations in gas sales prices to our regulated firm gas sales customers in our New York and New England service territories. The accounting for these derivative instruments is subject to SFAS 71. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities 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 derivative instruments was $110.9 million.

SFAS 133 establishes criteria that must be satisfied in order for option contracts, forward contracts with optionality features, or contracts that combine a forward contract and a purchase option contract to qualify for the normal purchases and sales exception. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities do not qualify for normal purchases under SFAS 133. Since these contracts are for the purchase of natural gas sold to regulated firm gas sales customers, the accounting for these contracts is subject to SFAS 71. Additionally, KEDNY has gas transportation service agreements with large generating facilities that contain embedded derivatives. These contracts and related embedded derivatives are also afforded SFAS 71 accounting treatment. At March 31, 2008, these derivatives had a net fair value of $40.3 million.

Weather Derivatives: The utility tariffs associated with KEDNE's operations do not contain weather normalization adjustments. As a result, fluctuations from normal weather may have a significant positive or negative effect on the results of these operations.

KeySpan entered into heating-degree day put options to mitigate the effect of fluctuations from normal weather on KEDNE's financial position and cash flows for the 2007/2008 winter heating season – November 2007 through March 2008. These put options would have paid KeySpan $40,000 per heating degree day when the actual temperature was approximately 5% warmer than normal or below 4,141 heating degree days, based on the most recent 20-year average for normal weather. The maximum amount KeySpan would have received on these purchased put options was $16 million. The net premium cost for these options was $1.9 million and was amortized over the heating season. Since weather was colder than normal during the November 2007 through March 2008 heating season, these weather derivatives had no value.

In 2006, we entered into heating-degree day put options to mitigate the effect of fluctuations from normal weather on KEDNE's financial position and cash flows for the 2006/2007 winter heating season – November 2006 through March 2007. These put options would have paid KeySpan $37,500 per heating degree day when the actual temperature was approximately 5% warmer than normal or below 4,159 heating degree days, based on the most recent 20-year average for normal weather. The maximum amount KeySpan would have received on these purchased put options was $15 million. The net premium cost for these options was $1.7 million and was amortized over the heating season. Since weather was warmer than normal during the fourth calendar quarter of 2006, KeySpan recorded a $9.1 million benefit to earnings associated with the weather derivative. However, weather for the first calendar quarter of 2007 was colder than normal. Therefore, for the entire winter heating season –November 2006 through March 2007 – weather was slightly colder than normal. As a result, in the first calendar quarter of 2007 KeySpan reversed the $9.1 million accrual recorded in the fourth quarter of 2006.

We account for these derivatives pursuant to the requirements of EITF 99-2, "Accounting for Weather Derivatives." In this regard, such instruments are accounted for using the "intrinsic value method" as set forth in such guidance.

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, KeySpan has received $0.1 million from its counterparties as collateral associated with outstanding derivative contracts. This amount has been recorded as restricted cash, with an offsetting position in current liabilities on the Consolidated Balance Sheet.

Long-term Debt*:* The following tables depict the fair values and carrying values of KeySpan's long-term debt at March 31, 2008 and December 2006.

Fair Values of Long-Term Debt

(In Millions of Dollars)	March 2008	December 2006
First Mortgage Bonds	$ 96.2	$ 111.4
Notes	2,884.0	3,078.5
Gas Facilities Revenue Bonds	636.0	647.3
Authority Financing Notes	66.0	66.0
Promissory Notes	155.9	156.7
Tax Exempt Bonds	120.6	131.0
	$ 3,958.7	$ 4,190.9

Carrying Values of Long-Term Debt

(In Millions of Dollars)	March 2008	December 2006
First Mortgage Bonds	$ 85.0	$ 95.0
Notes	2,800.2	2,925.4
Gas Facilities Revenue Bonds	640.5	640.5
Authority Financing Notes	66.0	66.0
Promissory Notes	155.4	155.4
Tax Exempt Bonds	128.3	128.3
	$ 3,875.4	$ 4,010.6

The Ravenswood Master lease is classified as a discontinued liability on the Consolidated Balance Sheet. The Fair Value and Carrying Value of the Ravenswood Master Lease at March 2008 were $423.3 million and $412.3 million, respectively. All other financial instruments included in the Consolidated Balance Sheet such as cash, commercial paper, accounts receivable and accounts payable, are stated at amounts that approximate fair value.

Note 7 – Discontinued Operations

On August 22, 2007 the NYPSC approved the merger application between KeySpan and National Grid PLC. As a condition of the approval of the Merger, KeySpan is required to divest the Ravenswood Generating Station. In addition, National Grid Plc, has determined that the KeySpan telecommunications and engineering subsidiaries do not fit into the post-merger business model. As such, KeySpan will be exiting these businesses. The operating results and financial positions of these companies are reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Cash Flows.

The sale of KeySpan's telecommunications business was completed on July 25, 2008. The assets and liabilities of this subsidiary was fair valued at August 24, 2008 and as a result the final sale has no impact on the Consolidated Income Statement.

The information below highlights the major classes of assets and liabilities of the discontinued operations, as well as major income and expense captions.

(In Millions of Dollars)	March 31, 2008	December 31, 2006
Property	2,792.7	705.1
Current assets	167.1	196.1
Deferred Charges	65.6	78.7
Current liabilities	608.1	561.0
Deferred Credits and Other Liabilities	1,252.7	219.3

(In Millions 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 2006	Previously Disclosed Amounts	Revised Disclosures
Revenues	$ 347.7	$ 584.3	$ 930.2	7,181.7	6,251.5
Operating Expenses:					
Fuel and purchase power	171.6	350.2	522.8	3,880.3	3,357.5
Operations and maintenance	95.2	100.0	157.0	1,680.0	1,523.0
Depreciation and amortization	3.3	22.9	34.6	397.4	362.8
Operating taxes	23.4	27.4	43.6	411.1	367.5
Sale of assets and income from equity investments	-	-	0.3	14.7	14.4
Operating Income	54.2	83.8	172.5	827.6	655.1
Other income (deductions)	0.1	(2.6)	2.6	(217.8)	(220.4)
Income taxes	23.4	35.0	62.6	175.6	113.0
Income from discontinued operations	$ 30.9	$ 46.2	$ 112.5	-	112.5
Net Income				$ 434.2	$ 434.2

The financial statements as of and for the year ended December 31, 2006, were audited by other independent auditors, whose report dated February 22, 2007 expressed an unqualified opinion on those financial statements. KeySpan has restated the above line items on its Consolidated Balance Sheet and Statement of Income as of and for the year ended December 31, 2006 to reflect the discontinued operations of the Ravenswood Generating Station, as well as KeySpan's telecommunications and engineering subsidiaries.

Note 8. Application of SFAS 101 "Regulated Enterprises - Accounting for the Discontinuation of Application of FASB Statement No. 71" for the LIPA Service Agreements.

As discussed in more detail in Note 9 "2006 LIPA Settlement," on May 28, 1998, KeySpan and LIPA entered into three major long-term service agreements. Negotiations between KeySpan and LIPA to amend certain aspects of these agreements were substantially concluded in 2006 and while KeySpan and LIPA performed in accordance with certain elements of these restated agreements beginning January 1, 2006, additional changes to these contract terms and the approvals needed to create binding agreements were not obtained until 2007. The changes in these service agreements impacted KeySpan's accounting for certain transactions conducted between KeySpan and LIPA.

Under both the original and amended and restated service agreements, KeySpan is responsible for the management of employee benefit plans associated with employees providing service to LIPA and LIPA is responsible for the cost of funding and maintaining those plans. From May 28, 1998 through December 31, 2006, KeySpan followed SFAS 71, "Accounting for the Effects of Certain Types of Regulation", in accounting for the agreements with LIPA and capitalized as a receivable the difference between the accrued liability associated with these plans and the funding based upon the recoveries agreed to in the rate plans with LIPA.

Certain events occurred over the course of 2006 and 2007 that constituted a change in facts and circumstances that made the continued application of SFAS 71 no longer appropriate and therefore KeySpan implemented Statement of Financial Accounting Standard 101 "Regulated Enterprises - Accounting for the Discontinuation of Application of FASB Statement No. 71" ("SFAS 101") effective January 1, 2007. Specifically, management's determination to apply SFAS 101, was based upon its analyses of the continued applicability of paragraph 5 of SFAS 71, as well as its assessment of the increasing competitive environment in relation to renewal of the service agreements with LIPA.

Paragraph 5 of SFAS 71, requires that regulated rates be set to recover the enterprise's specific costs of providing the regulated services or products. However, in two material respects these amended and restated agreements did not maintain the direct link between the cost of providing LIPA with the agreed to services and the revenues recovered in providing those services. First, these amended and restated agreements contained a revised revenue formula that introduced a departure from cost of service recovery that had been in place since 1998. Second, although, KeySpan's rights to be reimbursed for employee benefit plan costs in the future have been completely preserved in the amended and restated service agreements, these rights of recovery are not fully reflected in the revised service agreements' current rates. Management has therefore concluded that the cause-and-effect relationship between costs and revenues no longer exists for its service agreements with LIPA.

Moreover, recent actions taken and comments made by New York State officials indicate renewal of the service agreements with LIPA will be based on competitive tendering using New York State procurement practices and standards as opposed to the practice to date where the utility franchise had effectively been awarded to KeySpan.

Based on facts and circumstances detailed above, management has concluded that the amended and restated service agreements no longer meet all of the relevant SFAS 71 criteria. As a result, KeySpan implemented SFAS 101 effective January 1, 2007, the beginning of the period in which the changes that give rise to the need for the discontinuance of SFAS 101 became probable. Implementation of SFAS 101 resulted in KeySpan's de-recognition of a $442 million receivable with LIPA, of which $113.9 million (after tax) was recorded as an extraordinary charge for the period January 1, 2007 through August 24, 2007. The remaining amount was initially recorded through accumulated other comprehensive income and then ultimately charged to goodwill, net of tax, as a result of purchase accounting adjustments.

Note 9. 2006 LIPA Settlement

LIPA is a corporate municipal instrumentality and a political subdivision of the State of New York. On May 28, 1998, certain of the Long Island Lighting Company's ("LILCO's") business units were merged with KeySpan and LILCO's common stock and remaining assets were acquired by LIPA. Also effective on that date, KeySpan and LIPA entered into three major long-term service agreements that (i) provide to LIPA all operation, maintenance and construction services and significant administrative services relating to the Long Island electric transmission and distribution ("T&D") system pursuant to a Management Services Agreement (the "1998 MSA"); (ii) supply LIPA with electric generating capacity, energy conversion and ancillary services from our Long Island generating units pursuant to a Power Supply Agreement (the "1998 PSA") and other long-term agreements through which we provide LIPA with approximately one half of its customers' energy needs; and (iii) manage all aspects of the fuel supply for our Long Island generating facilities, as well as all aspects of the capacity and energy owned by or under contract to LIPA pursuant to an Energy Management Agreement (the "1998 EMA"). We also purchase energy, capacity and ancillary services in the open market on LIPA's behalf under the 1998 EMA. The 1998 MSA, 1998 PSA and 1998 EMA all became effective on May 28, 1998 and are collectively referred to as the "1998 LIPA Agreements".

On February 1, 2006, KeySpan and LIPA entered into (i) an amended and restated Management Services Agreement (the "2006 MSA"), pursuant to which KeySpan will continue to operate and maintain the electric T&D System owned by LIPA on Long Island; (ii) a new Option and Purchase and Sale Agreement (the "2006 Option Agreement"), to replace the Generation Purchase Rights Agreement (as amended, the "GPRA"), pursuant to which LIPA had the option, through December 15, 2005, to acquire substantially all of the electric generating facilities owned by KeySpan on Long Island; and (iii) a Settlement Agreement (the "2006 Settlement Agreement") resolving outstanding issues between the parties regarding the 1998 LIPA Agreements. The 2006 MSA, the 2006 Option Agreement and the 2006 Settlement Agreement are collectively referred to herein as the "2006 LIPA Agreements." The applicable rate components of each of the 2006 LIPA Agreements became effective retroactive to January 1, 2006, upon receipt of all the required governmental approvals.

Following the announcement of the acquisition of KeySpan by National Grid plc, LIPA, National Grid plc and KeySpan engaged in discussions concerning the impact of the transaction on LIPA's operations. KeySpan, National Grid plc and LIPA reached an agreement pursuant to which LIPA agreed to waive its contractual right to terminate the 1998 LIPA Agreements and the 2006 LIPA Agreements upon consummation of the Acquisition of KeySpan by National Grid plc, in exchange for enhancements to certain of the 2006 LIPA Agreements and certain other considerations. The amended and enhanced agreements became effective upon the completion of the acquisition of KeySpan by National Grid plc and the approval by the New York State Attorney General and the New York State Comptroller.

2006 Settlement Agreement

Pursuant to the terms of the 2006 Settlement Agreement, KeySpan and LIPA agreed to resolve issues that have existed between the parties relating to the various 1998 LIPA Agreements. In addition to the resolution of these matters, KeySpan's entitlement to utilize LILCO's available tax credits and other tax attributes increased from approximately $50 million to approximately $200 million. These credits and attributes were used to satisfy KeySpan's previously incurred indemnity obligation to LIPA for any federal income tax liability that resulted from the settlement with the IRS regarding the audit of LILCO's tax returns for the years ended December 31, 1996 through March 31, 1999. On October 30, 2006, the IRS submitted the settlement provisions of the concluded IRS audit to the Joint Committee on Taxation for approval – such approval was granted in December 2007. Key provisions of the settlement included the resolution of the tax basis of assets transferred to KeySpan at the time of the KeySpan/LILCO merger, the tax deductibility of certain merger related costs and the tax deductibility of certain environmental expenditures. The settlement enabled KeySpan to utilize 100% of the available tax credits. (See KeySpan's Annual Report on Form 10-K for the year-ended December 31, 2006 Note 3 to the Consolidated Financial Statements "Income Taxes" for additional information on this settlement.) In recognition of these items, as well as for the modification and extension of the 1998 MSA and the amendments to the GPRA, KeySpan recorded a contractual asset in the amount of approximately $160 million, of which approximately $110 million was attributed to the right to utilize such additional credits and attributes and approximately $50 million to be amortized over the eight year term of the 2006 MSA. This amount was subsequently adjusted to a $130 million intangible asset upon the acquisition of Keyspan by National Grid plc. In order to compensate LIPA for the foregoing, KeySpan paid LIPA $69 million in cash and settled certain accounts receivable in the amount of approximately $90 million due from LIPA.

Generation Purchase Rights Agreement and 2006 Option Agreement.

Under an amended GPRA, LIPA had the right to acquire certain of KeySpan's Long Island-based generating assets formerly owned by LILCO, at fair market value at the time of the exercise of such right. LIPA was initially required to make a determination by May 2005, but KeySpan and LIPA agreed to extend the date by which LIPA was to make this determination to December 15, 2005. As part of the 2006 settlement between KeySpan and LIPA, the parties entered into the 2006 Option Agreement whereby LIPA had the option during the period January 1, 2006 to December 31, 2006 to purchase only the steam generating units at KeySpan's Far Rockaway and/or E.F. Barrett Generating Stations (and certain related assets) at a price equal to the net book value of each facility. In December 2006, KeySpan and LIPA entered into an amendment to the 2006 Option Agreement whereby the parties agreed to extend the expiration of the option period to the later of (i) December 31, 2007 or (ii) 180 days following the effective date of the 2006 Option Agreement. Pursuant to the National Grid plc, KeySpan and LIPA negotiations, the parties further amended the 2006 Option Agreement to extend the expiration of the option period to May 31, 2008, which was subsequently extended to December 31, 2008. The 2006 Option Agreement, as amended, replaces the GPRA. If LIPA were to exercise the option and purchase one or both of the generation facilities (i) LIPA and KeySpan will enter into an operation and maintenance agreement, pursuant to which KeySpan will continue to operate these facilities, through May 28, 2013, for a fixed management fee plus reimbursement for certain costs; and (ii) the 1998 PSA and 1998 EMA will be amended to reflect that the purchased generating facilities would no longer be covered by those agreements. It is anticipated that the fees received pursuant to the operation and maintenance agreement will offset the reduction in the operation and maintenance expense recovery component of the 1998 PSA and the reduction in fees under the 1998 EMA.

Management Services Agreements

In place of the previous compensation structure (whereby KeySpan was reimbursed for budgeted costs, and earned a management fee and certain performance and cost-based incentives), KeySpan's compensation for managing the T&D System under the 2006 MSA consists of two components: a minimum compensation component of $224 million per year and a variable component based on electric sales. The $224 million component remains unchanged for three years and then increases annually by 1.7%, plus inflation. The variable component, which comprises no more than 20% of KeySpan's compensation under the 2006 MSA, is based on electric sales on Long Island exceeding a base amount of 16,558 gigawatt hours, increasing by 1.7% in each year. Above that level, KeySpan receives approximately 1.34 cents per kilowatt hour for the first contract year, 1.29 cents per kilowatt hour in the second contract year (plus an annual inflation adjustment), 1.24 cents per kilowatt hour in the third contract year (plus an annual inflation adjustment), with the per kilowatt hour rate thereafter adjusted annually by inflation. Subject to certain limitations, KeySpan retains all operational efficiencies realized during the term of the 2006 MSA.

LIPA continues to reimburse KeySpan for certain expenditures incurred in connection with the operation and maintenance of the T&D System, and other payments made on behalf of LIPA, including: real property and other T&D System taxes, return postage, capital construction expenditures and storm costs.

On July 19, 2007, LIPA signed an agreement addressing KeySpan's receipt of a Civil Investigative Demand ("CID") from the United States Department of Justice, Antitrust Division ("DOJ") regarding the DOJ's investigation into competitive issues in the New York City electric capacity market. The Letter Amendment to the 2006 MSA, dated as of June 29, 2007, amends the 2006 MSA to add an additional event of default, such that LIPA will have the contractual right to terminate the 2006 MSA if, in connection with the DOJ's investigation referenced in the CID, (a) there is a finding (through either a final, non-appealable judgment by a court of competent jurisdiction or final consent decree with the DOJ) that KeySpan or any of its affiliates violated Section 1 or 2 of the Sherman Act and (b) pursuant to which KeySpan or any of its affiliates is assessed or has agreed to be assessed a monetary or criminal penalty or sanction or is the subject of injunctive relief. See Note 5 “Contractual Obligations, Financial Guarantees and Contingencies” for additional information on the CID.

Note 10. Acquisition Of Keyspan

Goodwill and Intangible Assets

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 assets and liabilities based on their estimated fair values at the date of acquisition. The historical cost basis of KeySpan’s assets and liabilities associated with its gas distribution businesses, 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. Further, the historical cost basis of KeySpan’s assets and liabilities associated with its electric generating units on Long Island that are under long-term power supply agreements with LIPA, with minor exceptions, was determined to represent fair value due to the Power Supply Agreement with LIPA that provides for the recovery of historical costs and a fair return thereon. The excess of the purchase price over the fair value of the net assets acquired, or goodwill, was calculated to be $3.9 billion, including previously recorded goodwill. It should be noted that KeySpan was consolidated into National Grid plc from August 24, 2007 onward.

The following table summarizes the fair value adjustments and calculation of goodwill:

(In Millions of Dollars)		
Purchase Price	$	7,574.3
KeySpan's Consolidated Equity at August 24, 2007		4,300.8
Goodwill Prior to Acquisition		1,665.9
KeySpan's Adjusted Consolidated Equity		2,634.9
Goodwill before Fair Value Adjustments		4,939.4
Fair Value Adjustments		
Assets Impacted:		
Accounts Receivable		(12.4)
Materials and Supplies - inventory		251.5
Equity Investments and Other		(11.3)
Property Plant and Equipment		224.4
Regulatory Assets - miscellaneous		221.6
Deferred Charges - other		(75.3)
Liabilities Impacted:		
Accounts Payable and Other Liabilities		(46.7)
Taxes Accrued		(130.1)
Regulatory Liabilities		(189.6)
Postretirement benefits and other Reserves		(145.1)
Deferred Credits and Other Liabilities - other		(612.2)
Deferred Income Tax		(20.0)
Long-term Debt and Capital Leases		(58.2)
Net Adjustment		(603.4)
Intangible Asset Adjustment		230.8
Assets Held for Sale Fair Value Adjustments		1,373.7
Total Goodwill After Acquisition	$	3,938.3

A discussion of the more significant fair value adjustment follows.

Equity Investments: As noted earlier, KeySpan owns a 600,000 barrel liquefied natural gas ("LNG") storage and receiving facility in Providence, Rhode Island, through its wholly owned subsidiary KeySpan LNG. KeySpan LNG proposed to upgrade the liquefied natural gas facility to accept marine deliveries and to triple vaporization (or regasification) capacity to provide these services. The proposed upgrade was subject to numerous FERC proceedings, as well as proceedings with the Federal District Court in Rhode Island. At the time of the acquisition of KeySpan, National Grid plc decided not to pursue the upgrade of the LNG facility. As a result, deferred project costs of $11.3 million were written-off as a direct charge to equity.

Property, Plant and Equipment: As required by SFAS 141, upon acquisition KeySpan calculated the fair value of its property, plant and equipment for all its business segments. As noted previously, the historical cost basis of KeySpan's assets and liabilities associated with its gas distribution businesses, 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. Further, the historical cost basis of KeySpan's electric generating units on Long Island that are under long-term power supply agreements with LIPA, with minor exceptions, was determined to represent fair value. The historical cost basis of property, plant and equipment related to KeySpan's non-regulated business, primarily land, was increased by $263.2 million to represent fair value at date of acquisition.

As discussed in Note 1, Item F. "Gas Production and Development Property – Depletion" KeySpan maintains gas production and development activities through its two wholly-owned subsidiaries - KeySpan Exploration and Seneca-Upshur. As of March 31, 2008, KeySpan estimated that the capitalized costs associated with natural gas and oil reserves of these entities did not exceed the ceiling test limitation. However, the fair value exercise associated with SFAS 141 required a higher level of estimated operating costs and capital expenditures, compared to the estimates required to be used in the ceiling test calculation resulting in a write down of $30 million to natural gas and oil reserves.

As part of its synergy savings strategy, KeySpan is relinquishing three floors in its corporate headquarters at MetroTech. As a result, Keypan reduced its property, plant and equipment by $10.3 million associated with past leasehold improvement costs. Additionally, KeySpan will incur a $10 million fee in consideration for the early termination of part of its lease of the MetroTech office; this fee has been recorded as a current liability.

Regulatory Assets and Reserves: Upon acquisition, KeySpan made certain adjustments to its pension and other postretirement reserve balances, as well as to its environmental 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. The majority of KeySpan's gas distribution subsidiaries are subject to certain deferral accounting requirements mandated by the NYPSC and the MADPU for pension costs and other postretirement benefit costs. As a result, approximately $109 million of the decrease to the pension and other postretirement reserves was recorded as an "offset" to regulatory assets.

KeySpan also 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. KeySpan's gas distribution subsidiaries are subject to certain deferral accounting requirements mandated by the NYPSC and the MADPU for environmental costs. As a result, approximately $331 million of the increase to the environmental reserve was recorded as an "offset" to regulatory assets.

As noted in Note 5, " Contractual Obligations, Financial Guarantees and Contingencies – Legal" on December 18, 2007, the United States Court of Appeals for the District of Columbia Circuit ("Court") denied the petitions of the NYISO and various New York Transmission Owners seeking refunds for charges in the January - March 2000 reserve market. As a result of this favorable decision, KeySpan reversed a previously established reserve for these proceedings of $18.1 million. As required by SFAS 141, this amount was recorded as a direct benefit to equity.

Accounts Payable and Other Liabilities: As discussed in Note 6, "Hedging, Derivative Financial Instruments and Fair Values", on March 7, 2008, the FERC approved the NYISO In-City capacity mitigation measures and revised the In-City capacity bid caps. The revised bid caps are expected to result in the Swap Agreement (between KeySpan and Morgan Stanley) floating price being set to equal the strike price, thereby eliminating all cash flow between the two parties for the remaining term of the Swap Agreement. KeySpan calculated the fair value of this derivative instrument to be a liability of $17.9 million at August 24, 2007; such amount was recorded as a current liability and a direct charge to equity.

Prior to the acquisition of KeySpan by National Grid plc, KeySpan had a proposed project for the construction of a 250 MW combined cycle electric generation plant. In anticipation of this facility, KeySpan purchased a gas turbine generator several years ago. KeySpan and LIPA executed a "memo of understanding" for a power purchase agreement ("PPA") in 2001; however the PPA was never executed by LIPA. As previously noted, the NYPSC ordered KeySpan to divest the Ravenswood Generating Station to mitigate concerns on vertical market power. National Grid plc is proceeding with such divestiture and as a result it is highly unlikely that a new investment in electric generation by National Grid plc would be possible. As a result, KeySpan recorded a $7.5 million current liability for consideration of contract breakage costs associated with a maintenance contract for the gas turbine generator.

As discussed in Note 5, " Contractual Obligations, Financial Guarantees and Contingencies – Legal Matters", on May 31, 2007, KeySpan received a Civil Investigative Demand ("CID") from the United States Department of Justice, Antitrust Division, requesting the production of documents and information relating to its investigation of competitive issues in the New York City electric energy capacity market. KeySpan recorded a $5.3 million current liability representing the fair value for estimated legal fees associated with this proceeding.

Regulatory Liabilities: As part of the NYPSC approval of the KeySpan acquisition, a Gas Rates Joint Proposal ("the Rates JP") was agreed to by KeySpan, the NYPSC and the other parties. The Rates JP provides for five-year rate plans for KEDNY and KEDLI which go into effect on January 1, 2008. Included in the Rates JP are approximately $189.6 million of certain ratepayer refunds that were agreed to by KEDNY and KEDLI. The significant terms of the Rates JP are discussed in Note 11, "Rate Matters."

Long-term Debt: As part of the fair value exercise, KeySpan calculated the fair value of outstanding debt for all its non-regulated enterprises. This analysis required KeySpan to eliminate prior balances associated with debt discounts and premiums, as well as settled interest rate hedges that were being amortized. KeySpan recorded a $58 million long-term liability as a result of this fair value analysis. The long-term debt associated with KeySpan's regulated gas distribution businesses were not fair valued due to the existence of regulatory-approved rate plans that provide for the recovery of historical costs.

Intangible Asset: In addition to the above, certain intangible assets were created as a result of the acquisition. KeySpan's MSA Agreement with LIPA and KeySpan's EMA Agreement with LIPA were valued at $150.7 million. These intangible assets will be amortized over 20 years and six years respectively. Additionally, intangible assets of $35.4 million were recorded for KeySpan's appliance service companies. These intangible assets relate to contractual relationships and plumbing licenses. The intangible asset associated with the plumbing license will be amortized over eight years, while the intangible asset associated with contractual relationships has an indefinite life.

Fair Value of Assets Held for Sale: As part of the purchase accounting exercise and in conjunction with the sale of the Ravenswood Generating Station and KeySpan's engineering and telecommunications companies, KeySpan conducted an evaluation of the fair value of these investments. The evaluation resulted in an increase to the net book value of these companies of approximately $1.3 billion, net of deferred taxes and estimated selling costs.

Other Items: As discussed in Note 5, "Contractual Obligations, Financial Guarantees and Contingencies" KeySpan will continue to be responsible for lease payments under the Sale/Leaseback arrangement associated with the Ravenswood Expansion throughout the remaining life of the arrangement. The remaining lease payments have been valued at $363 million; such amount has been recorded in deferred credits and other liabilities.

KeySpan is entitled to emission credits associated with its electric generating facilities on Long Island. These emission credits had a fair value of $296.2 million on August 24, 2007. As agreed to in KeySpan's EMA Agreement with LIPA, LIPA is entitled to $251.5 million of this amount. The LIPA portion of the emission credits is reflected in deferred credits and other liabilities and $44.7 million as an intangible asset.

As allowed for under SFAS 141, the fair value measurement of assets, liabilities and intangible assets, and the resulting impact on goodwill and related allocations to KeySpan's business units, 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) continued measurement of the fair value of the Ravenswood Generating Station assets that are held for sale; (ii) continued measurement of the fair value of the LIPA Service Agreements; (iii) finalization and measurement of the financial implications associated with the more significant aspects of the Gas Rates Joint Proposal as discussed in Note 11, "Rate Matters;" (iv) measurement of the financial implications of the more significant aspects of the LIPA Service Agreement amendments as discussed in Note 9, "2006 LIPA Settlement"; (v) continued measurement and identification of intangible assets; (vi) continue assessment of the deferred tax implications associated with the above adjustments and (vii) 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.

Other Acquisition Matters

KeySpan's officers were entitled to certain severance benefits detailed in KeySpan's Change of Control Plan. The Change of Control Plan provided for the payment of severance and other benefits upon certain qualifying terminations of such executives within two years of a "change of control." The protection period under the Change of Control Plan commences upon the date that KeySpan entered into a definitive agreement contemplating a change of control and continues for a period of two years after the effective date of the actual change of control. Upon the signing of the definitive Merger Agreement with National Grid plc, the protection period went into effect on February 25, 2006. The benefits payable under the Change of Control Plan provide for: (i) the payment of the executive's base salary and compensation previously deferred by the executive, earned through the date of termination; (ii) the payment of an amount equal to three times an executive's base salary and highest annual bonus for any President, any Executive Vice President and any Senior Vice President and two times an executive's base salary and highest annual bonus for Vice Presidents; (iii) the payment of amounts under retirement plan formulas, including the applicable two to three year period as added service and compensation under the plans; and (iv) the continuation of medical, dental and life insurance benefits for a period of two to three years depending on the executive's position with KeySpan. In addition to severance benefits provided under the Change of Control Plan, the occurrence of a change of control also resulted in the acceleration of vesting of all equity based awards. KeySpan expensed these employee benefits prior to acquisition and recorded a corresponding liability of approximately $141 million.

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. Of the 630 eligible employees, 273 are KeySpan employees and 249 KeySpan employees accepted the VERO offer. KeySpan estimates the cost of VERO offer, to KeySpan, will be approximately $79 million, of which approximately $33 million has been deferred for recovery from gas distribution ratepayers. The remaining $46 million will be expensed over a three year period or over the remaining service period (through October 1, 2010) which ever is shorter. To date, KeySpan has expensed $15.2 million of VERO costs.

Note 11. Rate Matters

On August 22, 2007, the 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 and KEDLI ("the Order"). In addition, KEDNY and KEDLI reached an agreement in principle with the Staff of the NYPSC and other parties related to gas rates for KEDNY and KEDLI 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; potential revenue adjustments that are based on safety, reliability and customer service performance measures; and requirements concerning the sale of the Ravenswood Generating Station. The Order also makes some revenue requirement determinations for KEDNY and KEDLI that are discussed more fully below.

The Order includes the following restrictions and/or requirements that KEDNY and KEDLI 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 KEDNY or KEDLI or in the determination of KEDNY and KEDLI's rates and the calculation of their respective earned returns.

2. KEDNY and KEDLI will each 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 and KEDLI will each be barred from paying dividends when (a) its least secure form of debt is at the lowest investment grade and at least one rating agency has issued an 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 and KEDLI'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 or KEDLI's customers. KEDNY's and KEDLI's earnings sharing calculations will then reflect the actual debt rates outstanding for the companies.

5. KEDNY's and KEDLI's debt ratios for any 12-month period ending at the end of a fiscal quarter will not exceed 56% and 58%, respectively. If these limits are exceeded, KEDNY and KEDLI would have a nine month period to reduce their debt balance accordingly, during which the dividends paid out as a percentage of total equity may not be increased. If the stated debt ratios are not met by the end of the nine month cure period, KEDNY and/or KEDLI may not pay any dividends until the debt limits are met.

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

7. There will be a regulated money pool in which KEDNY and KEDLI 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 and KEDLI.

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

In addition to the above, KEDNY and KEDLI are subject to maintaining certain service quality and reliability performance standards. KEDNY's or KEDLI'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 gas leaks. Failure to meet the safety and reliability performance measures can result in downward revenue adjustments of up to $7.0 million and $6.2 million for KEDNY and KEDLI, respectively. 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 and $9.9 million for KEDNY and KEDLI, respectively.

National Grid plc is also required, as a condition to NYPSC approval, to sell the Ravenswood Generating Station within the next three years. KeySpan has announced that it has agreed to sell KeySpan Ravenswood, LLC to TransCanada and expects to complete the transaction during the summer of 2008. Additionally, National Grid plc took steps to assure that it is financially indifferent to the price of energy in the New York City electric energy market with respect to the electric output of the Ravenswood Generating Station by entering into a single contract on January 1, 2008 to sell all the Ravenswood Generating Station's energy for the period prior to the divestiture of the Ravenswood Generating Station. Capacity and ancillary services from the Ravenswood Generating Station will continue to be bid into the market. However, commencing with the New York Independent System Operator auction for 2008, capacity for the Ravenswood Generating Station must be bid at zero or an agreed to level based solely on the marginal cost to maintain the plant in service.

The Gas Rates Joint Proposal

As noted, KEDNY and KEDLI reached an agreement with the NYPSC and other parties related to gas rates for KEDNY and KEDLI. 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. KEDLI's base delivery rates will be increased by $60 million on January 1, 2008. In rate years two through five, base delivery rates for KEDLI will be increased $10 million. However, the increase in KEDLI's base delivery rates will also be deferred and used to offset future increases in special franchise taxes and environmental investigation and remediation costs. In addition, for both KEDNY and KEDLI, certain gas related costs previously recovered in base delivery rates were transferred out of base delivery rates on January 1, 2008 and are currently being recovered through the gas adjustment clause. The calculation of the revenue requirement for each company 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 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 Pensions and Other Postretirement Employee Benefits along with a direct charge to equity. The regulatory liability will be amortized over the next five years. KEDLI has followed the Statement of Policy for Pensions and Other Postretirement Employee Benefits since it was issued.

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. KEDLI is currently following this procedure. KEDLI, however, was required to record a $62 million regulatory liability associated with a Nassau County property tax litigation matter. This amount was recorded as a direct charge to equity and the regulatory liability will be amortized over five years. Additionally, both companies are 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 for both companies provide 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 and KEDLI. Earnings between 12.5% - 13.5% are shared 65% to gas sales customers and the remaining 35% to KEDNY and KEDLI. Earnings in excess of 13.5% are refunded to gas sales customers.

Additionally, certain "exogenous costs" that are outside the control of KEDNY and KEDLI, may be deferred for future recovery from or refund to gas sales customers. Exogenous costs are incremental effects on KEDNY's and KEDLI'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.

Also as part of the Rates JP, the temperature controlled monthly price cap that can be charged to large volume duel-fuel temperature controlled customers was changed to an annual price cap. In our large-volume heating and other interruptible (non-firm) markets, which include large apartment houses, government buildings and schools, gas service is provided under rates that are designed to compete with prices of alternative fuel, including No. 2 and No. 6 grade heating oil. These "dual-fuel" customers can consume either natural gas or fuel oil for heating purposes. Also, based on NYPSC regulations, gas sales to some of these customers may be interrupted when the temperature falls below 15 degrees to ensure system reliability to firm gas sales customers. Under the new mechanism, effective January 1, 2008, temperature controlled prices, including the minimum charge, are subject to an annual price cap based on the commercial heating rate paid by firm gas sale customers. KeySpan estimates that this pricing change, under certain circumstances, could reduce consolidated earnings by $12 million.

Other Matters

On February 23, 2008, EnergyNorth Natural Gas, Inc., filed for a $10 million rate increase in natural gas delivery rates with the NHPUC. This filing represents the first delivery rate increase since 1992 and reflects an 11.5 percent return on equity and a 50/50 debt to equity capital structure. The filing enables gas delivery rates to go in effect, subject to refund, in late August 2008, with the final approved gas delivery rate increase expected in February 2009.

Note 12. Ravenswood Sale Transaction

On March 31, 2008, KeySpan announced that it had signed an agreement to sell KeySpan Ravenswood, LLC to TransCanada Corporation for total cash consideration of $2.9 billion, payable upon completion of the sale ("Ravenswood Sale Transaction".) The total cash consideration includes working capital, fuel stock and a lease prepayment and is subject to customary closing conditions and adjustments.

The sale is subject to regulatory approvals of the FERC, the NYPSC and clearance under the United States anti-trust and foreign investment laws. Subject to these approvals, we expect to complete the sale by the 2008 summer.

In advance of this sale, KeySpan terminated the Ravenswood Master Lease (the lease under which KeySpan operates the Ravenswood Facility) on June 20, 2008, which was otherwise due to expire in 2009. Termination of the Master Lease results in KeySpan's ownership of the assets held under the lease. These assets and other assets are part of the assets being sold to TransCanada. The Ravenswood Sale Transaction also provides for the restructuring and transfer of our interest in the Ravenswood Expansion. However, KeySpan will remain responsible for all future lease payments under the sales/leaseback arrangement through May 2040. The total consideration received from the Ravenswood Sale Transaction includes a prepayment from TransCanada of the future payments under the sales/leaseback arrangement on a present value basis.

Note 13. Related Party Transactions

KeySpan engages in various transactions with National Grid USA a subsidiary of National Grid plc and an affiliate of KeySpan. Certain activities and costs, such as executive and administrative, financial (including accounting, auditing, risk management, tax, treasury/finance), human resources, information technology, legal, and strategic planning are shared between the companies and allocated to each company appropriately. At March 31, 2008, KeySpan had a net accounts payable to affiliates of $45.6 million for these services. Additionally, any excess cash generated by National Grid USA that is not needed for its working capital purposes is invested by KeySpan in liquid temporary cash investments. KeySpan reimburses National Grid USA, without interest, when the cash is needed by National Grid USA to support its working capital requirements. At March 31, 2008, KeySpan has invested $408.0 million for National Grid USA in temporary cash investments; such amount is reflected as an accounts payable, affiliates on KeySpan's Consolidated Balance Sheet. Therefore, at March 31, 2008 KeySpan's accounts payable, affiliate balance is $453.6 million.