THIS DOCUMENT AND THE ACCOMPANYING PROXY CARD ARE IMPORTANT AND REQUIRE YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take, you should immediately consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000.

If you sell or have sold or otherwise transferred all of your National Grid Shares or National Grid ADSs, please send this document, together with the accompanying Proxy Card, as soon as possible to the purchaser or transferee, or to the stockbroker, bank or other agent through whom the sale or transfer was effected, for onward transmission to the purchaser or transferee. The distribution of this document in jurisdictions other than the United Kingdom may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction.

Deutsche Bank AG, which is authorised under German Banking Law (competent authority: BaFin-Federal Financial Supervising Authority) and with respect to UK commodity derivatives business by the Financial Services Authority; regulated by the Financial Services Authority for the conduct of UK business, and Morgan Stanley & Co. Limited, which is authorised and regulated in the United Kingdom by the Financial Services Authority, are acting exclusively for National Grid and no one else in relation to (or in connection with) the Acquisition and will not be responsible to anyone other than National Grid for providing the protections afforded to clients of Deutsche Bank AG and Morgan Stanley & Co. Limited or for providing advice in relation to the Acquisition or any matter referred to in the contents of this document.

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national**grid**

NATIONAL GRID PLC

(Incorporated in England and Wales under the Companies Act with registered number 4031152)

Proposed Acquisition of KeySpan Corporation and Notice of Extraordinary General Meeting

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This document should be read as a whole. Your attention is drawn to the letter from the Chairman of National Grid which is set out on pages 3 to 7 of this document and which recommends that you vote in favour of the Resolution to be proposed at the Extraordinary General Meeting referred to below.

FOR A DISCUSSION OF CERTAIN RISK FACTORS WHICH SHOULD BE TAKEN INTO ACCOUNT WHEN CONSIDERING WHAT ACTION YOU SHOULD TAKE IN CONNECTION WITH THE EXTRAORDINARY GENERAL MEETING, SEE PART II OF THIS DOCUMENT.

A notice of the Extraordinary General Meeting, to be held at The ICC, Birmingham at 2.15 p.m. or, if later, immediately following the Annual General Meeting, on 31 July 2006, is set out at the end of this document. A Proxy Card for use at the Extraordinary General Meeting is enclosed with this document. To be valid, a Proxy Card must be received by post or (during normal business hours only) by hand at Capita Registrars, The Registry, Proxy Department, 34 Beckenham Road, Beckenham, Kent BR3 4TU by no later than 2.15 p.m. on 29 July 2006. Completion and return of a Proxy Card will not prevent National Grid Shareholders from attending and voting in person should they wish to do so.

A holder of National Grid ADSs on the register with The Bank of New York should complete a Voting Instruction Card, in relation to the voting rights attached to the National Grid Shares represented by their National Grid ADSs, and return the card to The Bank of New York at National Grid plc, c/o Bank of New York, PO Box 11243, New York, NY 10203-0243 as soon as possible and in any event by 5.00 p.m. (New York time) on 27 July 2006. Anyone holding National Grid ADSs through a bank, broker or other financial institution should consult with the institution to determine the deadline by which their voting instructions must be returned.

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EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Latest time and date for receipt by the Depositary of Voting Instruction Cards in respect of National Grid ADSs	5.00 p.m. (New York time) 27 July 2006
Latest time and date for receipt of Proxy Cards	2.15 p.m. 29 July 2006
Extraordinary General Meeting	31 July 2006
Expected date of Completion	Early 2007

All times shown in this document are London times unless otherwise stated.

Currency conversion

Currency conversions between US dollars and pounds sterling for financial information relating to the Acquisition have been calculated at an exchange rate of $1.75 to £1, being the closing rate as at 27 February 2006, the date on which the Acquisition was announced.

Financial information extracted from the balance sheet of KeySpan as at 31 December 2005 has been converted from US dollars to pounds sterling at an exchange rate of $1.72 to £1, being the closing rate as at that date.

Financial information extracted from the balance sheet of KeySpan as at 31 March 2006 has been converted from US dollars to pounds sterling at an exchange rate of $1.74 to £1, being the closing rate as at that date.

Financial information extracted from the income statement of KeySpan for the year ended 31 December 2005 has been converted from US dollars to pounds sterling at an exchange rate of $1.82 to £1, being the average exchange rate for 2005.

This document contains certain statements that are neither reported financial results nor other historical information. These statements are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Because these forward-looking statements are subject to assumptions, risks and uncertainties, actual future results may differ materially from those expressed in or implied by such statements. Many of these assumptions, risks and uncertainties relate to factors that are beyond National Grid's ability to control or estimate precisely, such as delays in obtaining, or adverse conditions contained in, regulatory and shareholder approvals and contractual consents, including those in connection with the announced US acquisitions, unseasonable weather and changes in historical weather patterns affecting demand for electricity and gas, competition and industry restructuring, changes in economic conditions, currency fluctuations, changes in interest and tax rates, changes in energy market prices, changes in laws, regulations or regulatory policies, developments in legal or public policy doctrines, the impact of changes to accounting standards and technological developments. Other factors that could cause actual results to differ materially from those described in this document include the ability to complete the announced US acquisitions when or as planned and to integrate the businesses relating to such acquisitions with the Group and realise the expected synergies from such integration, the availability of new acquisition opportunities and the timing and success of future acquisition opportunities, the impact of the sales of businesses by the Group, the failure for any reason to achieve reductions in costs or to achieve operational efficiencies, the failure to retain key management, the behaviour of UK electricity market participants on system balancing, the timing of amendments in prices to shippers in the UK gas market, the performance of National Grid's pension schemes, and the regulatory treatment of pension costs, and any adverse consequences arising from outages on or otherwise affecting energy networks, including gas pipelines, which National Grid owns or operates. For a more detailed description of some of these assumptions, risks and uncertainties, together with any other risk factors, please refer to ''Risk Factors'' in Part II of this document. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. Except as required by law or regulation, National Grid does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this document.

PART I

LETTER FROM THE CHAIRMAN OF NATIONAL GRID

nationalgrid

1-3 Strand
London WC2N 5EH
www.nationalgrid.com

National Grid plc
Registered Office: 1-3 Strand, London WC2N 5EH
Registered in England and Wales No. 4031152

28 June 2006

Dear Shareholder,

Agreed Acquisition of KeySpan

1 Introduction

On 27 February 2006, the boards of National Grid and KeySpan announced that they had signed a Merger Agreement under which National Grid will acquire KeySpan, a major energy delivery company in the northeastern US.

Under the terms of the Merger Agreement, KeySpan Shareholders will receive $42.00 for each KeySpan Share held. As announced on 27 February 2006, the terms valued the equity of KeySpan at approximately $7.3 billion (£4.2 billion) and the enterprise value of KeySpan at approximately $11.8 billion (£6.7 billion) (including estimated net debt of approximately $4.5 billion (£2.6 billion) as at 31 December 2005). The Board intends to finance the Acquisition wholly from borrowings.

The Acquisition is conditional upon, amongst other things, regulatory and other consents and approvals in the US and the approval of the shareholders of KeySpan and, in view of its size, the shareholders of National Grid. The approval of KeySpan Shareholders will be sought at a meeting expected to be held in August 2006. The approval of National Grid Shareholders will be sought at an Extraordinary General Meeting of the Company to be held at 2.15 p.m. or, if later, immediately following the Annual General Meeting on 31 July 2006 at The ICC (International Convention Centre), Birmingham. A notice convening the Extraordinary General Meeting is set out at page 128 of this document. The Acquisition is targeted to complete in early 2007.

The purpose of this document is to provide you with details of the Acquisition, to explain why the Directors unanimously consider the Acquisition to be in the best interests of National Grid Shareholders and to recommend that you vote in favour of the Resolution to be proposed at the Extraordinary General Meeting.

2 Information on KeySpan and reasons for the Acquisition

KeySpan is a major US utility, focused primarily on gas distribution and electricity generation, transmission and distribution. It is listed on the New York Stock Exchange and registered with the SEC (the Securities and Exchange Commission).

Leading gas and electricity delivery business

KeySpan owns and operates six regulated utilities that distribute natural gas to approximately 2.6 million customers: approximately 1.7 million in New York City and Long Island and approximately 0.9 million in Massachusetts and New Hampshire. It is the fifth largest gas distribution company in the US and the largest in the northeastern US. Over 90 per cent. of its customer base comprises residential and small commercial customers.

KeySpan also has a contract to operate the electricity transmission and distribution system owned by LIPA (the Long Island Power Authority), which serves approximately 1.1 million customers in Long

Island. KeySpan and LIPA recently agreed to extend, subject to approval by the relevant authorities, the contract from 2008 to 2013. These approvals remain outstanding as at the date of this document – please refer to Part II: ''Risk Factors'' for further details.

Excellent strategic and operational fit

The Acquisition considerably strengthens National Grid's presence in the northeastern US. KeySpan's energy delivery businesses are located in New York, Massachusetts and New Hampshire, states where National Grid is already present and where it has strong regulatory relationships. The geographic fit between the two businesses will facilitate the operation of the Enlarged Group and increase opportunities for integration savings and economies of scale. National Grid USA will be the third largest energy delivery business in the US based on number of customers.

The Acquisition is a natural extension of National Grid's business and plays to its strengths, allowing the Group to deploy its core skills of owning and operating network infrastructure within an incentive-based regulatory environment and to share best practices between all its businesses. The Acquisition will build upon National Grid's successful track record in the US.

Low risk generation portfolio

KeySpan owns 6.6 GW of fossil-fuelled generation capacity located in Long Island and New York City. These well managed and well maintained plants cover some 80 per cent. of Long Island's power needs and approximately 25 per cent. of the power needs of New York City. National Grid believes that the KeySpan generation assets are low risk and have high quality characteristics.

The Long Island facilities (amounting to 4.2 GW) are used to provide LIPA with generating capacity, energy conversion and ancillary services under a power supply agreement due to expire in 2013. Under this contract the rates, which are regulated by FERC (the Federal Energy Regulatory Commission), ensure full recovery of costs plus an appropriate rate of return.

The remaining 2.4 GW of generation capacity is derived from the Ravenswood Facility, which is located within the constrained New York City ''load pocket''. Approximately half of the plant's revenues are derived from the capacity market and its dual fuel capability provides flexibility to manage movements in commodity costs. The local reliability rules currently require that 80 per cent. of the city's electricity capacity needs be provided by ''in-city'' generators such as the Ravenswood Facility.

3 Benefits of the Acquisition

National Grid believes that the Acquisition will create significant shareholder value and deliver a return on invested capital greater than National Grid's cost of capital. The Acquisition is expected to be earnings and cash flow enhancing, on a Business Performance basis, in the first full year following Completion. The Enlarged Group is expected to maintain strong operational cash flows.

National Grid believes that KeySpan represents an opportunity to create significant value in its US business from two principal areas:

Integration cost savings and improved operating performance

National Grid expects to deliver $200 million per year of identified integration savings through the rationalisation of overlapping functions and the sharing of best practices. National Grid projects these savings to be achieved within four years of Completion, with savings of approximately 50 per cent. of this amount realised in the first full financial year post-Completion.

Growth opportunities

Currently 53 per cent. of the residential customer base and 61 per cent. of the commercial base in KeySpan's service territories use gas for heating purposes. Given these relatively low levels of market penetration, particularly in the Long Island and New England markets, National Grid believes there is significant opportunity for organic growth in this business.

The enlarged National Grid business will constitute a stronger platform for future growth in the US. Furthermore, the Acquisition will increase National Grid's focus on the US gas sector. Combined with KeySpan's investment in gas pipelines and gas storage, the enlarged National Grid USA will be well placed to take advantage of a broader range of future opportunities in the US.

4 Financial information on KeySpan

KeySpan reported, under US GAAP, consolidated net income of $390 million (approximately £214 million) for the year ended 31 December 2005, and consolidated gross assets of $13.8 billion (approximately £8.0 billion) and consolidated net assets of $4.5 billion (approximately £2.6 billion) as at that date. This selected financial information has been extracted, without material adjustment, from Part IV of this document. Part IV contains financial information which has been extracted, without material adjustment, from KeySpan's audited financial statements for the three years ended 31 December 2005 and also its unaudited financial statements for the three months ended 31 March 2006.

Section III of Part IV of this document reconciles the consolidated net income and consolidated net assets of KeySpan prepared under US GAAP to IFRS in order to present it on a basis which is consistent in all material respects with National Grid's accounting policies. Under IFRS, consolidated net income attributable to the ongoing operations of KeySpan amounted to $554 million (approximately £305 million) for the year ended 31 December 2005, and consolidated gross assets amounted to $12.5 billion (approximately £7.3 billion) and consolidated net assets amounted to $3.3 billion (approximately £1.9 billion) as at that date.

5 Financial effects of the Acquisition

Completion of the Acquisition will result in a cash outflow of approximately $7.3 billion (approximately £4.2 billion). At the latest published balance sheet date of 31 March 2006, National Grid had consolidated net debt of £10.9 billion and KeySpan had consolidated net debt of $4.1 billion (approximately £2.4 billion). The consolidated net assets of National Grid and KeySpan at that date were £3.5 billion and $4.6 billion (approximately £2.6 billion), respectively. This selected financial information has been extracted, without material adjustment, from the audited results for the year ended 31 March 2006 of National Grid under IFRS and from the unaudited results for the three months ended 31 March 2006 of KeySpan under US GAAP. Given that the consideration will be financed wholly through borrowings, it is expected that the Acquisition will have no impact on the consolidated net assets of National Grid.

The Enlarged Group will have strong operational cash flows allowing it to meet its operating and financing requirements. National Grid expects that its credit ratings post-Completion will be downgraded by no more than one notch and it remains committed to its ratings target of an A range for both of its rated UK operating companies.

National Grid Shareholders should read the whole of this document and should not rely on the key or summarised financial information set out in this letter.

6 Board, management and employees

Board and management

A Joint Integration Committee of National Grid USA and KeySpan has been established to ensure a smooth transition in the period to Completion.

National Grid's management is confident that the good relationship that has been established between the management teams of KeySpan and National Grid will assist in the negotiation of the regulatory approval process and the subsequent integration phase.

Following Completion, Michael E. Jesanis will continue as President and Chief Executive Officer of the enlarged National Grid USA. It is intended that Robert B. Catell, current Chairman and Chief Executive Officer of KeySpan, will join the Board as non-executive Deputy Chairman of National Grid and will also become Chairman of National Grid USA. A service contract for Robert B. Catell will be negotiated nearer to Completion.

Employees

It is anticipated that career opportunities for employees of the Enlarged Group will be enhanced as a result of the Acquisition and both sets of employees will benefit from potential transfers within the Enlarged Group. National Grid has confirmed that all KeySpan's employment agreements will be honoured.

7 Terms of the Acquisition

The Acquisition will be effected in accordance with the terms of the Merger Agreement, under which KeySpan Shareholders will be entitled to receive a cash payment of $42.00 per KeySpan Share held at Completion. The Merger Agreement also provides that, subject to certain exceptions, KeySpan may only declare and pay to KeySpan Shareholders quarterly dividends of up to 46.50 cents per KeySpan Share up until Completion, and a stub dividend pro-rated for the quarter in which Completion takes place.

The Merger Agreement includes a $250 million break fee payable by KeySpan to National Grid should certain specified events occur, including if KeySpan were to terminate the Agreement to accept a superior offer. Similarly, the Merger Agreement also includes a break fee payable by National Grid.

The Merger Agreement may be terminated by either party if the Acquisition has not been completed 15 months from the date of the Merger Agreement, subject to a three month extension.

For a more detailed description of the Merger Agreement, please refer to Part III of this document.

8 Regulatory consents and other approvals

The Acquisition is subject to certain conditions that are required to be satisfied prior to Completion, which include the granting of regulatory and other consents and approvals in the US. The principal regulatory approvals required are:

- the termination or expiration of certain waiting periods under the US Hart-Scott-Rodino Anti-trust Improvements Act of 1976;
- clearance under foreign investment laws;
- the authorisation by FERC (the Federal Energy Regulatory Commission) under the Federal Power Act;
- the authorisation by the US Federal Communications Commission for the transfer of certain telecommunications permits and licences; and
- the authorisation by various state public utility regulatory commissions, including the NYPSC (the New York Public Service Commission) and the NHPUC (the New Hampshire Public Utilities Commission).

The Acquisition will become effective at the time when a certificate of merger is delivered for filing with the Secretary of State in the State of New York and is targeted to occur in early 2007.

Although not conditions to Completion, certain other approvals and consents may also be sought, including:

- confirmation from LIPA that it will not exercise its right, in the event of a change of control of KeySpan, to terminate KeySpan's contracts with that agency;
- the consent of the NJBPU (the New Jersey Board of Public Utilities) and the NYPSC for the transfer of ownership of KeySpan's telecommunications operations in those states; and
- finance, accounting, cost allocation or rate approvals from FERC and the New York, Massachusetts and New Hampshire public utility regulatory commissions for the regulated companies in the combined system.

9 Financing the Acquisition and working capital

Under the terms of the Merger Agreement, the total cash consideration payable is $7.3 billion (£4.2 billion). At Completion, the net debt of KeySpan, which was $4.1 billion (approximately £2.4 billion) as at 31 March 2006, will form part of the Enlarged Group's net debt.

On the basis that the Acquisition takes place, National Grid is of the opinion that it does not have sufficient working capital for its present requirements, that is, for at least the next twelve months from the date of this document.

This is because National Grid has decided not to put in place, at the present time, additional financing to cover its working capital requirements as increased by the cost of the Acquisition, due to the extended period to Completion and National Grid's desire not to incur commitment fees on financing arrangements unnecessarily.

At an appropriate time prior to Completion, National Grid intends to raise additional financing by issuing or putting in place additional bonds, committed medium term bank facilities, and shorter term committed bank facilities. National Grid has already had discussions with a number of banks and other financial

institutions regarding their willingness to provide such financing. Therefore, taking into account these financing plans and the outcome of these discussions, as well as bonds in issue or to be issued, available committed facilities and other uncommitted money market facilities, National Grid is of the opinion that the Group will have sufficient funds to complete the Acquisition and to meet the Enlarged Group's present working capital requirements.

10 Current trading and future prospects

On 18 May 2006, National Grid announced its preliminary results for the year ended 31 March 2006. The Directors believe that these results demonstrate that National Grid continues to perform well and deliver on its strategy. Current trading of National Grid continues to be within management's expectations and there has been no significant change in the financial or trading position of the Company and its subsidiaries since 31 March 2006.

The Directors believe that the prospects of National Grid will be enhanced by the Acquisition.

11 Extraordinary General Meeting

Completion of the Acquisition is conditional, amongst other things, on National Grid Shareholders' approval being obtained at the Extraordinary General Meeting. Accordingly, you will find set out at the end of this document a notice convening an Extraordinary General Meeting to be held at The ICC, Birmingham at 2.15 p.m. or, if later, immediately following the Annual General Meeting on 31 July 2006 at which the Resolution will be proposed to approve the Acquisition.

12 Action to be taken

You will find enclosed a Proxy Card for use at the Extraordinary General Meeting. Whether or not you intend to be present at the Extraordinary General Meeting, you are requested to complete the Proxy Card and return it as soon as possible and in any case so as to be received by Capita Registrars no later than 2.15 p.m. on 29 July 2006. The return of a Proxy Card will not prevent you from attending the meeting and voting in person if you wish.

Holders of National Grid ADSs on the register with The Bank of New York should complete a Voting Instruction Card, in relation to the voting rights attached to the National Grid Shares represented by their National Grid ADSs, and return the card to The Bank of New York at National Grid plc, c/o Bank of New York, PO Box 11243, New York, NY 10203-0243 as indicated on the Voting Instruction Card as soon as possible and in any event by 5.00 p.m. (New York time) on 27 July 2006. Anyone holding ADSs through a bank, broker or other financial institution should consult with the institution to determine the deadline by which their voting instructions must be returned.

13 Further information

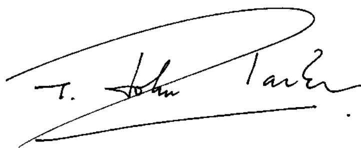
Your attention is drawn to the further information contained in Parts II to VII of this document and in particular, to the Risk Factors in Part II.

14 Recommendation

The Board of National Grid, which has received financial advice from Rothschild, considers the Acquisition to be in the best interests of National Grid and its shareholders as a whole. In providing advice to the Board, Rothschild has relied on the Board's commercial assessment of the Acquisition.

Accordingly, the Board unanimously recommends that National Grid Shareholders vote in favour of the Acquisition, as the Directors intend to do in respect of their own beneficial holdings amounting in aggregate to 564,785 National Grid Shares, representing approximately 0.02 per cent. of the current Issued Ordinary Share Capital of National Grid (excluding treasury shares).

Yours sincerely



Sir John Parker
Chairman

PART II

RISK FACTORS

Prior to making any decision to vote in favour of the proposed Resolution at the EGM, investors should carefully consider, together with all other information contained in this document, the specific factors and risks described below. The Directors consider the following risks, which are not set out in any order of priority, to be all the known material risks to existing National Grid Shareholders. There may be other risks of which the Directors are not aware or which the Directors currently deem immaterial which may, in the future, be connected to the Acquisition and have an adverse effect on the Enlarged Group's business, financial condition, results or future prospects.

RISKS RELATED TO NATIONAL GRID, AND FOLLOWING COMPLETION, THE ENLARGED GROUP

Regulatory and environmental risks

Changes in law or regulation in the geographies in which the Group operates could have an adverse effect on the Group's results of operations

Many of the Group's businesses are utilities or networks that are subject to regulation by governments and other regulatory authorities. Consequently, changes in law or regulation in the countries or states in which the Group operates could adversely affect the Group. Regulatory decisions concerning, for example, whether licences or approvals to operate are renewed, whether market developments have been satisfactorily implemented, whether there has been any breach of the terms of a licence or approval, the level of permitted revenues for the Group's businesses and proposed business development activities could have an adverse impact on the Group's results of operations, cash flows, the financial condition of its businesses and the ability to develop those businesses in the future.

Breaches of or changes in environmental or health and safety laws or regulations could expose the Group to claims for financial compensation and adverse regulatory consequences, as well as damaging the Group's reputation

Aspects of the Group's activities are potentially dangerous, such as the operation and maintenance of electricity lines and the transmission and distribution of natural gas. Electricity and gas utilities also typically use and generate in their operations hazardous and potentially hazardous products and by-products. In addition, there may be other aspects of the Group's operations that are not currently regarded or proved to have adverse effects but could become so, for example, the effects of electric and magnetic fields. The Group is subject to laws and regulations relating to pollution, the protection of the environment, and how the Group uses and disposes of hazardous substances and waste materials. The Group is also subject to laws and regulations governing health and safety matters including air quality, water quality, waste management, natural resources and the health and safety of the public and its employees. Any breach of these obligations, or even incidents relating to the environment or health and safety that do not amount to a breach, could adversely affect the results of operations and the Group's reputation.

Operational risks

Network failure or the inability to carry out critical non-network operations may have significant adverse impacts on both the Group's financial position and its reputation

The Group may suffer a major network failure or may not be able to carry out critical non-network operations. Operational performance could be adversely affected by a failure to maintain the health of the system or network, inadequate forecasting of demand or inadequate record keeping. This could cause the Group to fail to meet agreed standards or be in breach of a licence or approval, and even incidents that do not amount to a breach could result in adverse regulatory action and financial consequences, as well as harming the Group's reputation. In addition to these risks, the Group is subject to other risks that are largely outside of its control such as the impact of weather or unlawful acts of third parties. Weather conditions can affect financial performance, particularly in the US, and severe weather that causes outages or damages infrastructure will adversely affect operational, and, potentially, business performance. Terrorist attack, sabotage or other intentional acts may also physically damage the Group's businesses or otherwise significantly affect corporate activities and as a consequence affect the results of operations.

The Group's reputation may be harmed if consumers of energy suffer a disruption to their supply even if this disruption is outside of the Group's control

The Group's energy delivery businesses are responsible for transporting available electricity and gas. The Group consults with and provides information to regulators, governments and industry participants about future demand and the availability of supply. However, where there is insufficient supply, the Group's role is to manage the relevant system safely, which, in extreme circumstances, may require the Group to disconnect consumers.

The Group's results of operations depend on a number of factors relating to business performance including performance against regulatory targets and the delivery of anticipated cost and efficiency savings

Earnings maintenance and growth from the Group's regulated gas and electricity businesses will be affected by its ability to meet or better regulatory efficiency targets set by Ofgem and other regulators. From time to time, the Group also publishes cost and efficiency savings targets for its businesses in the UK and the US. To meet these targets, the Group must continue to improve managerial and operational performance. In the US, under the Group's state rate plans, earnings from the Group's regulated businesses will be affected by its ability to deliver integration and efficiency savings. Earnings from the Group's regulated businesses in both the UK and the US also depend on meeting service quality standards set by regulators. To meet these standards, the Group must improve service reliability and customer service. If the Group does not meet these targets and standards, both the results of its operations and its reputation may be harmed.

KeySpan's generation business is subject to competition and general economic conditions impacting demand for services

KeySpan recently expanded its merchant generation plant, the Ravenswood Facility, with the Ravenswood Expansion, a 250 MW combined cycle generating unit. However, the Ravenswood Facility and Ravenswood Expansion continue to be subject to competition that could adversely impact the market price for the capacity, energy and ancillary services they sell. In addition, if new generation and/or transmission facilities are constructed, and/or the availability of its Ravenswood Generation Station deteriorates, then the quantities of capacity and energy sales could be adversely affected.

A substantial portion of KeySpan's revenues are derived from its agreements with LIPA and no assurances can be made that these arrangements will not be discontinued at some point in the future or that the new agreements will become effective

KeySpan derives a substantial portion of its revenues in its electric services segment from a series of agreements with LIPA pursuant to which KeySpan manages LIPA's transmission and distribution system and supplies the majority of LIPA's customers' electricity needs. On 1 February 2006, KeySpan and LIPA entered into amended and restated agreements whereby KeySpan will continue to operate and maintain the electric transmission and distribution system owned by LIPA on Long Island. As part of the amended agreements, the GPRA, pursuant to which LIPA had the option, up to 15 December 2005, to acquire substantially all of the electric generating facilities owned by KeySpan on Long Island, is replaced with the 2006 Option Agreement where LIPA only has the right to acquire two of KeySpan's facilities, its Far Rockaway and/or E.F. Barrett Generating Stations during the period 1 January 2006 to 31 December 2006. Additionally, the new agreements resolve many outstanding issues between the parties regarding the current LIPA Agreements and provide new pricing and extensions of the LIPA Agreements. There is a risk that these agreements will not receive the necessary governmental approvals, which are pending, and the effectiveness of each of the 2006 LIPA Agreements is conditioned upon all of the 2006 LIPA Agreements becoming effective. If the 2006 LIPA Agreements do not become effective, there is uncertainty as to whether LIPA will exercise their option under the GPRA and the status of the resolution of the various disputes between KeySpan and LIPA.

Financial risks

Fluctuations in exchange rates, interest rates and commodity price indices and, in particular, the US dollar could have a significant impact on the Group's results of operations because the Group has substantial business interests in the US and because of the significant proportion of the Group's borrowings, derivative financial instruments and commodity contracts that may potentially be affected by such fluctuations

The Group has significant operations in the US and the proportion of its activities located there will substantially increase following the completion of the acquisition of KeySpan. These businesses are subject to the risks normally associated with foreign operations, including the need to translate US assets and liabilities, and income and expenses, into sterling, the Group's primary reporting currency. The Group's results of operations may be similarly impacted because a significant proportion of its borrowings, derivative financial instruments and commodity contracts are affected by changes in exchange rates, interest rates and commodity price indices, in particular, the US dollar to pounds sterling exchange rate.

The nature and extent of the Group's borrowings means that an increase in interest rates could have an adverse impact on its financial position and business results

A significant proportion of the Group's borrowings are subject to variable interest rates that may fluctuate with changes to prevailing interest rates. Increases in these interest rates could therefore increase the Group's costs and diminish its profits.

The Group's financial position may be adversely affected by a number of factors including restrictions in borrowing and debt arrangements, changes to credit ratings and effective tax rates

The Group is subject to certain covenants and restrictions in relation to its listed debt securities and its bank lending facilities. The Group is also subject to restrictions on financing that have been imposed by regulators. These restrictions may hinder the Group in servicing the financial requirements of its current businesses or the financing of newly acquired or developing businesses. The debt issued by the Group and certain of its subsidiaries is rated by credit rating agencies and changes to these ratings may affect both the borrowing capacity of the Group as a whole and the cost of these borrowings. The effective rate of tax paid by the Group may be influenced by a number of factors including changes in law and accounting standards and the Enlarged Group's overall approach to such matters, the results of which could increase or decrease that rate.

New or revised accounting standards, rules and interpretations by the UK, US or international accounting standard setting boards and other relevant bodies could have an adverse effect on the Group's reported financial results

With the adoption of IFRS, changes in the accounting treatment of replacement expenditure, regulatory assets and pension and post-retirement benefits, derivative financial instruments and commodity contracts have significantly affected the way the Group reports its financial position and results of operations. New standards, rules or interpretations may be issued that could also have significant effects. In addition, as a body of practice develops, the application of accounting principles to the Group's particular circumstances may change.

Commodity price risks

Changes to the regulatory treatment of commodity costs may have an adverse effect on the results of operations

Changes in commodity prices could potentially impact the Group's energy delivery businesses. Current regulatory arrangements in the UK and US provide the ability to pass through virtually all of the increased costs related to commodity prices to consumers. However, if regulators in the UK or the US were to restrict this ability, it could have an adverse effect on the Group's operating results.

Risk associated with KeySpan's financial swap agreement for in-city unforced capacity

KeySpan believes that the New York City market represents a strong capacity market due to, among other things, its local reliability rules. KeySpan anticipates that demand will increase and that the high cost to construct capacity in New York City will result in favourable in-city unforced capacity prices. Therefore, KeySpan entered into an ISDA Master Agreement for a fixed and floating unforced capacity financial swap for a notional quantity of 1,800,000kW at the fixed price of $7.57/kW-month. If the demand is less than KeySpan's estimate, additional resources enter the market or costs are less than forecast, In-City Unforced Capacity prices could be on average less than the fixed price, resulting in a loss to KeySpan, which under certain circumstances could be material.

RISKS RELATED TO THE ACQUISITION

Conditions to the Acquisition

The Acquisition is subject to a number of conditions precedent, in particular, approvals from relevant regulators and the approval of both KeySpan Shareholders and National Grid Shareholders. There is a risk that these approvals may not be received and that the Acquisition may not complete or that approvals are granted but on terms that are different than anticipated.

Integration risks

The Group will encounter numerous integration challenges as a consequence of the Acquisition including challenges which are not currently foreseeable. In addition, the Group's management and resources may be diverted away from the core business activities due to personnel being required to assist in the integration process. The Group may not be successful in addressing risks or problems encountered in connection with the integration and failure to do so may adversely affect its business or financial condition.

Sufficiency of working capital

The Company intends to finance the Acquisition wholly from borrowings but has decided not to put in place additional financing to cover its working capital requirements at the present time because of the extended period to Completion and its desire not to incur commitment fees on financing arrangements unnecessarily. As a result, the working capital statement contained in Part V of this document states that on the basis that the Acquisition takes place, the Company is of the opinion that it does not have sufficient working capital for its present requirements. There is a risk that the Company may obtain such facilities on terms less favourable than anticipated.

Third party consents arising from the change of control

KeySpan has a number of contracts and agreements with third parties that require the Company or KeySpan to obtain consent from these other parties in connection with the Acquisition. If these third party consents cannot be obtained on favourable terms, the Enlarged Group may suffer a loss of potential future revenues. In particular, the agreements with LIPA allow LIPA to terminate the agreements in the event of a change of control of KeySpan. The Company and LIPA are in discussions to obtain LIPA's consent to the change in control and allow the contracts to remain in place thereafter.

Achievement of commercial objectives following the Acquisition

The Company expects to deliver $200 million per year of integration savings through the rationalisation of overlapping functions and the sharing of best practices. There is no assurance that these savings will be achieved or that the cost of achieving the savings will not be more than expected.

The Company also believes there is significant opportunity for organic growth in the Long Island and New England markets, given the low levels of market penetration. It is possible that growth in these markets may not be possible or will be less than expected. KeySpan's gas distribution segment faces competition from distributors of alternative fuels and forms of energy, including fuel oil and propane. The gas distribution industry has experienced a decrease in consumption per customer over time, partially due to increased efficiency of customers' appliances, economic factors and price elasticity. While KeySpan's Long Island and New England utilities have significant growth potential, the Company cannot be sure that new customers will continue to offset the decrease in consumption of the existing customer base.

PART III

SUMMARY OF THE MERGER AGREEMENT

The following is a summary of the principal terms of the Merger Agreement.

1 Introduction

Under the terms of the Merger Agreement, National Grid US8 Inc., a wholly-owned subsidiary of National Grid, will merge with and into KeySpan, whereby each outstanding share of KeySpan's capital stock will be converted into the right to receive $42.00 in cash. KeySpan will be the surviving entity in the Acquisition and, as a result of the Acquisition, will become a wholly-owned subsidiary of National Grid USA.

The Merger Agreement sets out the conditions to Completion. It also contains certain termination rights, mutual representations and warranties and various covenants, including certain limitations on the operation of the business of KeySpan in the period prior to Completion.

2 Principal conditions

The Acquisition is subject to the fulfilment of several customary conditions, including receipt of the approval of both National Grid Shareholders and KeySpan Shareholders, receipt of US state and federal regulatory approvals, and there having been no material adverse effect on KeySpan since the date of the Merger Agreement.

Each of National Grid and KeySpan must use their ''reasonable best efforts'' to obtain the required regulatory approvals. The principal regulatory approvals required are approval by FERC together with certain approvals from the states of New York and New Hampshire. The Acquisition also requires clearance under US anti-trust and foreign investment laws and the Federal Communications Commission.

3 Termination rights

The Merger Agreement may be terminated by mutual agreement of National Grid and KeySpan. It may also be terminated by either party if a final order, decree or ruling restrains the Acquisition, if the other party breaches the agreement such that the closing conditions cannot be satisfied (or cured within 30 days), if either party's shareholders do not approve the Acquisition, or if the Acquisition has not been consummated by the end date (15 months from the date of the Merger Agreement, subject to a three month extension).

Additionally, National Grid may terminate the Merger Agreement if the board of directors of KeySpan withdraws or qualifies its recommendation of the Acquisition or approves or recommends another takeover proposal or if a tender offer is commenced for 20 per cent. or more of the outstanding stock of KeySpan, and KeySpan's board of directors does not recommend against such tender offer, or by KeySpan if, prior to its shareholder meeting, it accepts a takeover proposal meeting certain conditions and pays National Grid the required termination fee.

4 Effect of termination in certain circumstances

KeySpan is required to make a payment to National Grid of $250 million under the following circumstances:

- If National Grid terminates because the board of directors of KeySpan does not recommend, or withdraws or qualifies its recommendation of the Acquisition and National Grid terminates the Merger Agreement;
- If National Grid terminates because the board of directors of KeySpan approves or recommends a competing takeover proposal;
- If National Grid terminates because the board of directors of KeySpan fails to recommend against a tender or exchange offer commenced for 20 per cent. or more of KeySpan's capital stock;

- If KeySpan terminates because it determined to accept a superior takeover proposal meeting certain conditions prior to it shareholders meeting and National Grid did not adequately improve its offer; or
- If the Merger Agreement is terminated by either National Grid or KeySpan because the KeySpan shareholder vote was not obtained, or because the end date was reached, and, prior to termination, any person directly or indirectly discloses publicly a takeover proposal and KeySpan enters into a business combination transaction prior to the 12 month anniversary of the termination of the Merger Agreement.

National Grid is required to pay a termination fee to KeySpan equal to the lesser of $250 million or 1 per cent. of National Grid's market capitalisation, which amounts to £160 million as at 27 June 2006, if the Merger Agreement is terminated because the National Grid's Shareholder vote was not obtained and, prior to termination, any person publicly disclosed an acquisition proposal for more than 50 per cent. of the capital stock of National Grid, or all or substantially all of its assets and National Grid enters into a business combination transaction prior to the 12 month anniversary of the termination of the Merger Agreement.

5 Representations and warranties

In the Merger Agreement, each of KeySpan, National Grid and National Grid US8 Inc. makes uncapped representations and warranties about itself and its business. These representations and warranties cease to have effect on Completion and are customary for a transaction of this nature, relating to such matters as:

- the organisation of the parties and their subsidiaries and similar corporate matters;
- the required shareholder votes, information supplied in connection with obtaining the required shareholder votes, and certain corporate governance matters;
- the absence of breach or conflict and compliance with applicable laws, regulations, organisational documents, agreements and existing obligations;
- legal proceedings with respect to National Grid and its subsidiaries and KeySpan and its subsidiaries;
- with respect to National Grid, ownership of KeySpan common stock;
- with respect to KeySpan, its capital structure, taxes, insurance coverage and financial statements;
- with respect to KeySpan, environmental compliance and liability;
- with respect to KeySpan, the absence of material adverse changes and the non-occurrence of certain events;
- with respect to KeySpan, receipt of a fairness opinion from its financial adviser;
- with respect to KeySpan, intellectual property necessary to carry on its business; and
- with respect to KeySpan, labour and employee relations.

The principal purposes of the warranties and representations are to confirm material information regarding each party, allocate risk between the parties and to confer a right of termination on the party which is not in breach in circumstances where the breach is material.

6 Covenants

Under the Merger Agreement, KeySpan has agreed, as to itself and its subsidiaries, that during the period from the date of the Merger Agreement to Completion, except as expressly contemplated or permitted in the Merger Agreement or as otherwise disclosed to National Grid prior to signing of the Merger Agreement or as required by a Governmental entity of competent jurisdiction or any applicable law, rule or regulation, or subject to the prior written consent of National Grid (not to be unreasonably withheld), KeySpan (and each of its subsidiaries) will, among other things, carry on its business in the usual, regular and ordinary course consistent with past practice and good utility practice and will not engage in material acquisitions or disposals except in the ordinary course of business consistent with past practice, incur any capital expenditure or indebtedness in excess of certain specified amounts, or take any action that would, or is reasonably likely to, result in a material breach of any provision of the

Merger Agreement or a failure of any representation or warranty of KeySpan to be true and correct or take any action that is intended, or reasonably likely, to result in any of the conditions to the Acquisition not being satisfied.

National Grid and National Grid US8 Inc. each has agreed, as to itself and its subsidiaries, that during the period from the date of the Merger Agreement until Completion, except as expressly contemplated or permitted in the Merger Agreement or as required by a Governmental entity of competent jurisdiction or by applicable law, rule or regulation, or disclosed to KeySpan prior to signing of the Merger Agreement, or subject to the prior written consent of KeySpan, it will refrain from entering into any agreement that would reasonably be expected to prevent National Grid or National Grid US8 Inc. from performing its obligations under the Merger Agreement.

PART IV

FINANCIAL INFORMATION ON KEYSPAN

Set out in this Part IV is financial information relating to KeySpan, prepared under US GAAP and which has been extracted without material adjustment from the following financial statements previously filed on Forms 10-K and 10-Q with the SEC, respectively:

(i) Section I – Audited financial statements for the three years ended 31 December 2005; and

(ii) Section II – Unaudited financial statements for the three months ended 31 March 2006.

In addition, set out in Section III are the adjustments required in order to restate the financial information presented in Sections I and II on a basis consistent in all material respects with the accounting policies of National Grid.

Any cross-references to US filings contained in this Part IV are not to be incorporated by reference herein and any such information does not form part of this document.

SECTION I: KEYSPAN'S AUDITED FINANCIAL STATEMENTS FOR THE THREE YEARS ENDED 31 DECEMBER 2005: US GAAP

1 Nature of financial information

The financial information contained in this Part IV does not constitute statutory accounts within the meaning of Section 240 of the Companies Act. The financial information set out in this Section I below has been extracted without material adjustment from the audited financial statements of KeySpan for the years ended 31 December 2003, 2004 and 2005 included in KeySpan's 2004 and 2005 Forms 10-K as filed with the SEC, each of which received an unqualified audit opinion.

KEYSPAN CORPORATION

CONSOLIDATED BALANCE SHEET

	December 31,		
	2005	**2004**	**2003**
	(In Millions of Dollars)		
ASSETS			
Current Assets			
Cash and temporary cash investments	**$ 124.5**	$ 922.0	$ 203.5
Restricted cash	**13.2**	—	—
Accounts receivable	**1,035.6**	788.5	909.6
Unbilled revenue	**685.6**	590.8	446.6
Allowance for uncollectible accounts	**(62.8)**	(67.8)	(75.8)
Gas in storage, at average cost	**766.9**	515.5	488.5
Material and supplies, at average cost	**140.5**	123.4	118.9
Derivative contracts	**142.8**	0.6	—
Other	**173.8**	162.7	114.2
Assets of discontinued operations	**—**	42.9	181.8
	3,020.1	3,078.6	2,387.3
Investments and Other	**242.4**	272.9	248.6
Property			
Gas	**7,275.9**	6,871.2	6,522.3
Electric	**2,492.3**	2,402.1	2,636.5
Other	**416.3**	398.6	407.8
Accumulated depreciation	**(2,922.6)**	(2,702.3)	(2,601.7)
Gas exploration and production, at cost	**184.2**	187.1	3,088.2
Accumulated depletion	**(109.2)**	(97.5)	(1,167.4)
Property of discontinued operations	**—**	8.7	8.6
	7,336.9	7,067.9	8,894.3
Deferred Charges			
Regulatory assets:			
Miscellaneous assets	**688.3**	535.3	578.4
Derivative contracts	**30.9**	20.1	—
Goodwill and other intangible assets, net of amortization	**1,666.3**	1,677.6	1,717.0
Goodwill of discontinued operations	**—**	—	92.7
Derivative contracts	**75.2**	29.2	—
Other	**752.5**	682.5	721.9
	3,213.2	2,944.7	3,110.0
Total Assets	**$ 13,812.6**	$ 13,364.1	$ 14,640.2

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION
CONSOLIDATED BALANCE SHEET

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
LIABILITIES AND CAPITALIZATION			
Current Liabilities			
Accounts payable and other liabilities	**$ 1,087.0**	$ 906.7	$ 1,065.7
Commercial paper	**657.6**	912.2	481.9
Current maturities of long-term debt & capital leases	**13.0**	16.1	1.5
Current redemption requirement of preferred stock	**—**	55.3	—
Taxes accrued	**176.3**	161.6	43.9
Dividends payable	**81.1**	74.1	72.3
Customer deposits	**39.1**	43.3	40.4
Interest accrued	**53.8**	48.8	64.6
Other current liability, derivative contracts	**47.3**	—	—
Liabilities of discontinued operations	**—**	64.2	82.0
	2,155.2	2,282.3	1,852.3
Deferred Credits and Other Liabilities			
Regulatory liabilities:			
Miscellaneous liabilities	**69.9**	66.5	104.0
Removal costs recovered	**516.4**	496.5	450.0
Derivative accounts	**175.4**	7.4	—
Asset retirement obligations	**47.4**	1.9	—
Deferred income tax	**1,157.9**	1,124.1	1,275.6
Postretirement benefits and other reserves	**1,118.4**	900.4	961.9
Derivative contracts	**44.3**	43.9	—
Other	**127.5**	94.3	121.7
	3,257.2	2,735.0	2,913.2
Commitments and Contingencies (See Note 7)	**—**	—	—
Capitalization			
Common stock	**3,975.9**	3,502.0	3,487.6
Retained earnings	**866.9**	792.2	621.4
Accumulated other comprehensive income	**(74.8)**	(54.3)	(59.9)
Treasury stock	**(303.9)**	(345.1)	(378.4)
Total common shareholders' equity	**4,464.1**	3,894.8	3,670.7
Preferred stock	**—**	19.7	83.5
Long-term debt and capital leases	**3,920.8**	4,418.7	5,611.0
Total Capitalization	**8,384.9**	8,333.2	9,365.2
Minority Interest in Consolidated Companies	**15.3**	13.6	509.5
Total Liabilities and Capitalization	**$ 13,812.6**	$ 13,364.1	$ 14,640.2

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION

CONSOLIDATED STATEMENT OF INCOME

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars, Except Per Share Amounts)		
Revenues			
Gas Distribution	**$ 5,390.1**	$ 4,407.3	$ 4,161.3
Electric Services	**2,042.7**	1,738.7	1,606.0
Energy Services	**191.2**	182.4	158.9
Houston Exploration	**—**	268.1	495.3
Energy Investments	**38.0**	54.0	114.0
Total Revenues	**7,662.0**	6,650.5	6,535.5
Operating Expenses			
Purchased gas for resale	**3,597.3**	2,664.5	2,495.1
Fuel and purchased power	**752.1**	540.3	414.6
Operations and maintenance	**1,617.9**	1,567.0	1,622.6
Depreciation, depletion and amortization	**396.5**	551.8	571.7
Operating taxes	**407.1**	404.2	418.2
Impairment charges	**—**	41.0	—
Total Operating Expenses	**6,770.9**	5,768.8	5,522.2
Gain on sale of property	**1.6**	7.0	15.1
Income from equity investments	**15.1**	46.5	19.2
Operating Income	**907.8**	935.3	1,047.6
Other Income and (Deductions)			
Interest charges	**(269.3)**	(331.3)	(307.7)
Sale of subsidiary stock	**4.1**	388.3	13.3
Cost of debt redemption	**(20.9)**	(45.9)	(24.1)
Minority interest	**(0.4)**	(36.8)	(63.9)
Other	**16.6**	30.6	42.1
Total Other Income and (Deductions)	**(269.9)**	4.9	(340.3)
Income Taxes			
Current	**206.6**	201.9	(99.8)
Deferred	**32.7**	123.6	381.1
Total Income Taxes	**239.3**	325.5	281.3
Earnings from Continuing Operations	**398.6**	614.7	426.0
Discontinued Operations			
Income (loss) from operations, net of tax	**(4.1)**	(79.0)	(1.9)
Gain (loss) on disposal, net of tax	**2.3**	(72.0)	—
Loss from Discontinued Operations	**(1.8)**	(151.0)	(1.9)
Cumulative Change in Accounting Principles, net of tax	**(6.6)**	—	(37.4)
Net Income	**390.2**	463.7	386.7
Preferred stock dividend requirements	**2.2**	5.6	5.8
Earnings for Common Stock	**$ 388.0**	$ 458.1	$ 380.9
Basic Earnings Per Share			
Continuing Operations, less preferred stock dividends	**$ 2.33**	$ 3.80	$ 2.65
Discontinued Operations	**(0.01)**	(0.94)	(0.01)
Cumulative Change in Accounting Principles	**(0.04)**	—	(0.23)
Basic Earnings Per Share	**$ 2.28**	$ 2.86	$ 2.41
Diluted Earnings Per Share			
Continuing Operations, less preferred stock dividends	**$ 2.32**	$ 3.78	$ 2.63
Discontinued Operations	**(0.01)**	(0.94)	(0.01)
Cumulative Change in Accounting Principles	**(0.04)**	—	(0.23)
Diluted Earnings Per Share	**$ 2.27**	$ 2.84	$ 2.39
Average Common Shares Outstanding (000)	**169,940**	160,294	158,256
Average Common Shares Outstanding—Diluted (000)	**170,801**	161,277	159,232

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2005	**2004**	**2003**
	(In Millions of Dollars)		
Operating Activities			
Net income	**$ 390.2**	$ 463.7	$ 386.7
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Depreciation, depletion and amortization	**396.5**	551.8	571.7
Deferred income tax	**32.7**	123.6	188.7
Income from equity investments	**(15.1)**	(46.5)	(18.0)
Dividends from equity investments	**9.3**	14.2	2.8
Amortization of financing fees / interest rate swaps	**(1.4)**	(14.9)	(9.9)
Gain on sale of investments and property	**(5.6)**	(395.3)	(28.5)
Hedging (gain)/losses	**(3.2)**	2.5	(1.0)
Amortization of property taxes	**126.2**	101.9	87.5
Impairment charges	**—**	41.0	—
Loss from discontinued operations	**1.8**	151.0	1.9
Cumulative change in accounting principle	**6.6**	—	37.4
Environmental reserve adjustment	**—**	—	(10.5)
Minority interest	**0.4**	36.8	63.9
Changes in assets and liabilities			
Accounts receivable	**(305.7)**	(234.2)	60.4
Materials and supplies, fuel oil and gas in storage	**(268.4)**	(39.0)	(199.0)
Accounts payable and accrued expenses	**196.3**	159.5	225.8
Prepaid property taxes	**(136.2)**	(112.1)	(133.9)
Reserve payments	**(35.7)**	(37.3)	(36.5)
Insurance settlements	**21.1**	—	—
Other	**(6.5)**	(16.6)	33.9
Net Cash Provided by Continuing Operating Activities	**403.3**	750.1	1,223.4
Investing Activities			
Construction expenditures	**(539.5)**	(750.3)	(1,009.4)
Cost of removal	**(27.8)**	(36.3)	(31.1)
Net proceeds from sale of property and investments	**47.0**	1,021.3	309.7
Derivative margin call	**(8.9)**	—	—
Other investments	**—**	—	(211.3)
Issuance of long-term note	**—**	—	(55.0)
Net Cash (Used in) Provided by Continuing Investing Activities	**(529.2)**	234.7	(997.1)
Financing Activities			
Treasury stock issued	**41.2**	33.4	96.7
Common stock issuance	**460.0**	—	473.6
Issuance of long-term debt	**—**	49.3	1,024.5
Payment of long-term debt	**(515.0)**	(920.1)	(614.3)
Issuance / (payment) of commercial paper	**(254.6)**	430.4	(433.8)
Redemption of preferred stock	**(75.0)**	(8.5)	(14.3)
Net proceeds from sale/leasback transaction	**—**	382.0	—
Redemption of promissory notes	**—**	—	(447.0)
Common and preferred stock dividends paid	**(308.4)**	(291.1)	(280.6)
Gain on interest rate swap	**—**	12.7	—
Other	**(5.4)**	36.1	15.0
Net Cash Used in Continuing Financing Activities	**(657.2)**	(275.8)	(180.2)
Net (Decrease) Increase in Cash and Cash Equivalents	**$ (783.1)**	$ 709.0	$ 46.1
Cash Flow from Discontinued Operations—Operating Activities(*)	**(3.8)**	8.1	(16.5)
Cash Flow from Discontinued Operations—Investing Activities(*)	**(10.6)**	1.3	2.3
Cash Flow from Discontinued Operations—Financing Activities(*)	**—**	0.2	0.9
Cash and Cash Equivalents at Beginning of Period	**922.0**	203.4	170.6
Cash and Cash Equivalents at End of Period	**$ 124.5**	$ 922.0	$ 203.4
Interest Paid	**$ 262.7**	$ 336.5	$ 355.1
Income Tax Paid	**$ 181.5**	$ 122.0	$ 65.5

(*) Revised—See Note 1

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Balance at Beginning of Period	**$ 792.2**	$ 621.4	$ 522.8
Net Income for Period	**390.2**	463.7	386.7
	1,182.4	1,085.1	909.5
Deductions:			
Cash dividends declared on common stock	**313.3**	287.3	282.3
Cash dividends declared on preferred stock	**2.2**	5.6	5.8
Balance at End of Period	**$ 866.9**	$ 792.2	$ 621.4

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Net Income	**$ 390.2**	$ 463.7	$ 386.7
Other comprehensive income, net of tax			
Net losses (gains) on derivative instruments	**23.8**	(0.3)	23.0
Unrealized (losses) gains on derivative financial instruments	**(35.1)**	15.4	(25.4)
Deconsolidation of certain subsidiaries	**—**	9.3	—
Foreign currency translation adjustments	**(5.0)**	(21.5)	28.7
Unrealized gains (losses) on marketable securities	**(0.5)**	7.1	8.5
Premium on derivative instrument	**—**	3.4	(3.4)
Accrued unfunded pension obligation	**(3.7)**	(7.8)	8.4
Other comprehensive income (loss), net of tax	**(20.5)**	5.6	39.8
Comprehensive Income	**$ 369.7**	$ 469.3	$ 426.5
Related tax (benefit) expense			
Net losses (gains) on derivative instruments	**12.8**	(0.2)	12.4
Unrealized (losses) gains on derivative financial instruments	**(20.7)**	8.2	(13.6)
Deconsolidation of certain subsidiaries	**—**	5.0	—
Foreign currency translation adjustments	**(2.7)**	(11.6)	15.4
Unrealized gains (losses) on marketable securities	**(0.2)**	3.8	4.6
Accrued unfunded pension obligation	**(2.1)**	(4.2)	4.5
Premium on derivative instrument	**—**	1.9	(1.9)
Total Tax (Benefit) Expense	**$ (12.9)**	$ 2.9	$ 21.4

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION
CONSOLIDATED STATEMENT OF CAPITALIZATION

	December 31,			December 31,		
	2005	2004	2003	2005	2004	2003
				(In Millions of Dollars)		
Common Shareholders' Equity	Shares Issued					
Common stock, $0.01 par value	184,864,124	172,737,654	172,737,654	**$ 1.7**	$ 1.7	$ 1.7
Premium on capital stock				**3,974.2**	3,500.3	3,486.0
Retained earnings				**866.9**	792.2	621.4
Other comprehensive income				**(74.8)**	(54.3)	(59.9)
Treasury stock	(10,495,743)	(11,919,343)	(13,073,219)	**(303.9)**	(345.1)	(378.5)
Total Common Shareholders' Equity	174,368,381	160,818,311	159,664,435	**4,464.1**	3,894.8	3,670.7
Preferred Stock—Redemption Required						
Par Value $100 per share						
7.07% Series B—private placement	—	553,000	553,000	**—**	55.3	55.3
7.17% Series C—private placement	—	197,000	197,000	**—**	19.7	19.7
6.00% Series A—private placement			85,676	**—**	—	8.6
Less: current redemption requirements	—	(553,000)	—	**—**	(55.3)	—
Total Preferred Stock—Redemption Required	—	197,000	835,676	**—**	19.7	83.6
Long-Term Debt	**Interest Rate**	**Maturity**				
Notes						
Medium term notes	4.65% - 9.75%	2006 - 2035		**2,437.2**	2,485.0	3,185.0
Senior secured notes	6.08% - 8.8%	2008 - 2013		**—**	—	96.4
Senior subordinate notes	7.0%	2013		**—**	—	175.0
Total Notes				**2,437.2**	2,485.0	3,456.4
Gas Facilities Revenue Bonds	Variable	2020 - 2026		**230.0**	125.0	125.0
	4.70% - 6.95%	2020 - 2026		**410.5**	515.5	523.5
Total Gas Facilities Revenue Bonds				**640.5**	640.5	648.5
Promissory Notes to LIPA						
Pollution Control Revenue Bonds	5.15%	2016 - 2028		**108.0**	108.0	108.0
Electric Facilities Revenue Bonds	5.30%	2023 - 2027		**47.4**	47.4	47.4
Total Promissory Notes to LIPA				**155.4**	155.4	155.4
MEDS Equity Units	8.75%	2005		**—**	460.0	460.0
Industrial Development Bonds	5.25%	2027		**128.3**	128.3	128.3
First Mortgage Bonds	6.08% - 8.80%	2008 - 2028		**95.0**	95.0	153.2
Authority Financing Notes	Variable	2027 - 2028		**66.0**	66.0	66.0
Other Subsidiary Debt				**—**	—	145.1
Ravenswood Master Lease & Capital Leases		2005 - 2022		**423.0**	424.1	425.3
Subtotal				**3,945.4**	4,454.3	5,638.2
Unamortised interest rate hedge and debt discount				**(30.4)**	(55.2)	(69.2)
Derivative impact on debt				**18.8**	35.7	43.5
Less: current maturities				**13.0**	16.1	1.5
Total Long-Term Debt				**3,920.8**	4,418.7	5,611.0
Total Capitalization				**$ 8,384.9**	$ 8,333.2	$ 9,365.2

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, 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 8 November 2000, KeySpan acquired Eastern Enterprises (''Eastern''), a Massachusetts business trust, and the parent of several gas utilities operating in Massachusetts. Also on 8 November 2000, Eastern acquired EnergyNorth, Inc. (''ENI''), the parent of a gas utility operating in central New Hampshire. KeySpan Corporation will be referred to in these notes to the Consolidated Financial Statements as ''KeySpan,'' ''we,'' ''us'' and ''our.''

On 25 February 2006, KeySpan entered into an Agreement and Plan of Merger (the ''Merger Agreement''), with National Grid PLC, a public limited company incorporated under the laws of England and Wales (''Parent'') and National Grid US8, Inc., a New York Corporation (''Merger Sub''), pursuant to which Merger Sub will merge with and into KeySpan (the ''Merger''), with KeySpan continuing as the surviving company. Pursuant to the Merger Agreement, at the effective time of the Merger, each outstanding share of common stock, par value $0.01 per share of KeySpan (the ''Shares''), other than shares owned by KeySpan, shall be cancelled and shall be converted into the right to receive $42.00 in cash, without interest.

Consummation of the Merger is subject to various closing conditions, including but not limited to the satisfaction or waiver of conditions regarding the receipt of requisite regulatory approvals and the adoption of the Merger Agreement by the stockholders of KeySpan and the Parent. Assuming receipt or waiver of the foregoing, it is currently anticipated that the Merger will be consummated in early 2007. However, no assurance can be given that the Merger will occur, or, the timing of its completion.

KeySpan's core businesses are engaged in gas distribution, electric services and generation and other energy related activities. KeySpan's gas distribution operations are conducted by our six regulated gas utility subsidiaries: The Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York (''KEDNY'') and KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island (''KEDLI'') distribute gas to customers in the Boroughs of Brooklyn, Staten Island, a portion of the Borough of Queens in New York City, and the counties of Nassau and Suffolk on Long Island and the Rockaway Peninsula in Queens, respectively; Boston Gas Company, Colonial Gas Company and Essex Gas Company, each doing business as KeySpan Energy Delivery New England (''KEDNE''), distribute gas to customers in southern, eastern and central Massachusetts; and EnergyNorth Natural Gas, Inc., d/b/a KeySpan Energy Delivery New England distributes gas to customers in central New Hampshire. Together, these companies distribute gas to approximately 2.6 million customers throughout the Northeast.

We own, lease and operate electric generating plants on Long Island and in New York City. Under contractual arrangements, we provide electric 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''). On 16 February 2006, KeySpan and LIPA entered into agreements to extend, amend and restate these contractual arrangements. See Note 11 ''2006 LIPA Settlement'' for a discussion of the settlement.

Our other subsidiaries are involved in gas production; gas storage; liquefied natural gas storage; retail electric marketing; appliance service; fibre optic services; and engineering and consulting services. We also invest in, and participate in the development of natural gas pipelines; electric generation, and other energy-related projects. (See Note 2, ''Business Segments'' for additional information on each operating segment.)

At 31 December 2005, KeySpan was a holding company under the Public Utility Holding Company Act of 1935, as amended (''PUHCA 1935''). In August 2005, the Energy Policy Act of 2005 (the ''Energy Act'') was enacted. The Energy Act is a broad energy bill that places an increased emphasis on the production of energy and promotes the development of new technologies and alternative energy sources and provides tax credits to companies that produce natural gas, oil, coal, electricity and renewable energy. For KeySpan, one of the more significant provisions of the Energy Act is the repeal of PUHCA 1935, which became effective on 8 February 2006, and the transfer of certain holding company oversight from

the Securities and Exchange Commission (''SEC'') to the Federal Energy Regulatory Commission (''FERC'') pursuant to the Public Utility Holding Company Act of 2005 (''PUHCA 2005'').

Pursuant to PUHCA 2005, the SEC no longer has jurisdiction over our holding company activities, other than those associated with the registration and issuance of our securities under the federal securities laws. FERC now 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 Public Service Commission of the State of New York (''NYPSC''), the Massachusetts Department of Telecommunications and Energy (''MADTE'') 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.

Pursuant to NYPSC orders, the ability of KEDNY and KEDLI to pay dividends to KeySpan is conditioned upon maintenance of a utility capital structure with debt not exceeding 55 per cent. and 58 per cent., respectively, of total utility capitalization. In addition, the level of dividends paid by both utilities may not be increased from current levels if a 40 basis point penalty is incurred under the customer service performance program.

B. Basis of Presentation

The Consolidated Financial Statements presented herein reflect the accounts of KeySpan and its subsidiaries. Most of our subsidiaries are fully consolidated in the financial information presented, except for certain subsidiary investments in the Energy Investments segment which are accounted for on the equity method as we do not have a controlling voting interest or otherwise have control over the management of such companies. All intercompany transactions have been eliminated. Certain reclassifications were made to conform prior period financial statements to current period financial statement presentation. For the years ended December 31, 2004 and 2003 we have reclassified the operations of KeySpan's mechanical contracting subsidiaries, which are part of the Energy Services segment, as discontinued operations on the Consolidated Statement of Income and Consolidated Balance Sheet. For all periods presented, KeySpan revised and has separately disclosed the operating, investing and financing portions of the cash flows attributable to its discounted operations, which in prior periods were reported on a combined basis as a single amount (See Note 10 ''Energy Services— Discontinued Operations'' for additional details regarding these operations).

The preparation of financial statements in conformity with generally accepted accounting principles (''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 MADTE. 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.

Four of our six regulated gas utilities (KEDNY, KEDLI, Boston Gas Company and EnergyNorth Natural Gas, Inc.) and our Long Island based electric generation subsidiaries are subject to the provisions of Statement of Financial Accounting Standards (''SFAS'') 71, ''Accounting for the Effects of Certain Types of Regulation.'' This statement recognises 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.

In separate merger related orders issued by the MADTE, the base rates charged by Colonial Gas Company and Essex Gas Company have been frozen at their current levels for ten-year periods ending 2009 and 2008, respectively. Due to the length of these base rate freezes, the Colonial and Essex Gas companies had previously discontinued the application of SFAS 71.

The following table presents our net regulatory assets at 31 December 2005, 2004 and 2003.

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Regulatory Assets			
Regulatory tax asset	$ 33.4	$ 39.5	$ 60.7
Property and other taxes	53.8	58.8	51.4
Environmental costs	454.7	272.6	296.9
Postretirement benefits	109.3	110.6	106.7
Costs associated with the KeySpan/LILCO transaction	27.3	39.1	50.6
Derivative financial instruments	30.9	20.1	6.9
Other	9.8	14.7	5.2
Total Regulatory Assets	$ 719.2	$ 555.4	$ 578.4
Regulatory Liabilities	(245.3)	(73.9)	(104.1)
Net Regulatory Assets	473.9	481.5	474.3
Removal Costs Recovered	(516.4)	(496.5)	(450.0)
	$ (42.5)	$ (15.0)	$ 24.3

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 $11.3 million, $37.7 million and $53.4 million at 31 December 2005, 31 December 2004 and 31 December 2003, respectively are reflected in accounts receivable on the Consolidated Balance Sheet. Deferred gas costs are subject to current recovery from customers. We estimate that full recovery of our regulatory assets will not exceed 9 years.

Rate regulation is undergoing significant change as regulators and customers seek lower prices for utility service and greater competition among energy service providers. In the event that regulation significantly changes the opportunity to recover costs in the future, all or a portion of our regulated operations may no longer meet the criteria for the application of SFAS 71. In that event, a write-down of all or a portion of our existing regulatory assets and liabilities could result. If we were unable to continue to apply the provisions of SFAS 71 for any of our rate regulated subsidiaries, we would apply the provisions of SFAS 101, ''Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement 71.'' We estimate that the write-off of all net regulatory assets at 31 December 2005, before consideration of removal costs recovered, could result in a charge to net income of $308.0 million after-tax or $1.81 per share, which would be classified as an extraordinary item. In management's opinion, the regulated subsidiaries that are currently subject to the provisions of SFAS 71 will continue to be subject to SFAS 71 for the foreseeable future.

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 and are generally included in rates in the following month. 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 8 ''Hedging, Derivative Financial Instruments and Fair Values'' for additional information on these derivatives.)

In December 2005, Boston Gas received a MADTE order permitting regulatory recovery of the 2004 gas cost component of bad debt write-offs. This was approved for full recovery as an exogenous cost effective 1 November 2005. In addition, effective 1 January 2006 Boston Gas is permitted 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. We have reflected both of these favourable recovery mechanisms in our 31 December 2005 Allowance for Doubtful Accounts reserve requirement and related expense. Boston Gas also plans to request full recovery, as an exogenous cost, of the 2005 gas cost component of bad debt write-offs beginning 1 November 2006.

Electric Services

Electric revenues are primarily derived from: (i) billings to LIPA for management of LIPA's transmission and distribution (''T&D'') system, electric generation, and procurement of fuel, and (ii): subsidiaries that own, lease and operate the 2,200 megawatt (''MW'') Ravenswood electric generation facility (''Ravenswood Facility'') and the 250 MW combined cycle generating facility located at the Ravenswood facility site (''Ravenswood Expansion'').

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.

KeySpan manages the day-to-day operations, maintenance and capital improvements of the T&D system under the 1998 MSA. KeySpan's billings to LIPA are based on certain agreed upon terms. In addition, KeySpan earns a $10 million annual management fee. Annual service incentives or penalties exist under the 1998 MSA if certain targets are achieved or not achieved. In addition, we can earn certain incentives for budget underruns associated with the day-to-day operations, maintenance and capital improvements of LIPA's T&D system. These incentives provide for KeySpan to (i) retain 100 per cent. on the first $5 million in annual budget underruns, and (ii) retain 50 per cent. of additional annual underruns up to 15 per cent. of the total cost budget, thereafter all savings accrue to LIPA. With respect to cost overruns, KeySpan will absorb the first $15 million of overruns, with a sharing of overruns above $15 million. There are certain limitations on the amount of cost sharing of overruns.

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.

KeySpan also procures and manages fuel supplies on behalf of LIPA, under the 1998 EMA, to fuel the generating facilities under contract to it and perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs. In exchange for these services KeySpan earns an annual fee of $1.5 million. In addition, we arrange for off-system sales on behalf of LIPA of excess output from the generating facilities and other power supplies either owned or under contract to LIPA. LIPA is entitled to two-thirds of the profit from any off-system energy sales. 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 1998 EMA is expected to be in effect through 2013 for the procurement of fuel supplies and through 2006 for off-system arrangement services.

On 1 February 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 15 December 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''. Each of the 2006 LIPA agreements will become effective as of 1 January 2006 upon all of the 2006 LIPA Agreements receiving the required governmental approvals; otherwise none of the 2006 LIPA Agreements will become effective. See Note 11, ''2006 LIPA Settlement'' for additional details on these agreements.

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 each. Under the PPAs, LIPA pays a monthly capacity fee, which guarantees 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.

Ravenswood Facilities

In addition, electric revenues are derived from our investment in the 2,200 MW Ravenswood electric generation facility (''Ravenswood Facility''), (which KeySpan acquired in June 1999). KeySpan has an arrangement with a variable interest entity through which we lease a portion of the Ravenswood Facility. Further, in May 2004 KeySpan completed construction of a 250 MW combined cycle generating facility located at the Ravenswood facility site (''Ravenswood Expansion''). To finance the Ravenswood Expansion, KeySpan entered into a leveraged lease financing arrangement. Collectively the Ravenswood Facility and Ravenswood Expansion will be referred to as the Ravenswood Generating Station. (See Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies'' for a description of the financing arrangements associated with the Ravenswood Generating Station.) We realise revenues from our investment in the Ravenswood Generating Station through the sale, at wholesale, of energy, capacity, and ancillary services to the New York Independent System Operator (''NYISO''). Energy and ancillary services are sold through a bidding process into the NYISO energy markets on a day ahead or real time basis.

Energy Services

Revenues earned by our Energy Services segment for service and maintenance contracts associated with small commercial and residential appliances are recognised as earned or over the life of the service contract, as appropriate. Revenues earned for engineering services are derived from services rendered under fixed price and cost-plus contracts and generally are recognised on the percentage-of-completion method. Fibre optic service revenue is recognised upon delivery of service access. We have unearned

revenue recorded in deferred credits and other liabilities—other on the Consolidated Balance Sheet totalling $29.3 million, $28.5 million and $23.8 million as of 31 December 2005, 31 December 2004 and 31 December 2003, respectively. These balances represent primarily unearned revenues for service contracts and are generally amortised to income over a one year period.

KeySpan completed its sale of its mechanical contracting companies in the first quarter of 2005, and therefore, no longer has revenues from mechanical contracting operations. (See Note 10 ''Energy Services—Discontinued Operations'' for additional details on the mechanical contracting companies.)

Gas Exploration and Production

Natural gas and oil revenues earned by our gas exploration and production activities are recognised 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. During 2004 KeySpan disposed of its interest in The Houston Exploration Company (''Houston Exploration''), an independent natural gas and oil exploration company. KeySpan continues to maintain, on a significantly smaller scale, gas exploration and production activities. (See Note 2 ''Business Segments'' for a discussion on the disposition of Houston Exploration and KeySpan's remaining gas exploration activities.)

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 capitalised interest for the year ended 31 December 2005 ranged from 1.80 per cent. to 7.02 per cent.. Capitalised interest for 2005, 2004 and 2003 was $1.4 million, $7.4 million and $13.5 million, respectively.

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 31 December 2005, 2004 and 2003, KeySpan had costs recovered in excess of costs incurred totalling $516.4 million, $496.5 million and $450.0 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 were as follows:

	Year Ended December 31,		
	2005	2004	2003
Electric	3.75%	3.87%	3.81%
Gas	3.72%	3.55%	3.37%

We also had $416.3 million of other property at 31 December 2005, consisting of assets held primarily by our corporate service subsidiary of $290.0 million and $96.0 million in Energy Services 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 and fibre optic cable and related electronics and have service lives ranging from seven to 40 years.

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 capitalised. 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 Exploration and Production Property—Depletion

KeySpan maintains gas exploration and production activities through its two wholly-owned subsidiaries—KeySpan Exploration and Production, LLC (''KeySpan Exploration'') and Seneca-Upshur Petroleum, Inc. (''Seneca-Upshur''). At 31 December 2005, these subsidiaries had net exploration and production property in the amount of $75.0 million. These assets are accounted for under the full cost method of accounting. Under the full cost method, costs of acquisition, exploration and development of natural gas and oil reserves plus asset retirement obligations are capitalised 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 capitalised costs (net of accumulated depletion) less deferred taxes exceed the present value (using a 10 per cent. 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 SEC guidelines, we have included estimated future cash flows from our hedging program in ceiling test calculations.

As of 31 December 2005, we estimated that our capitalised costs did not exceed the ceiling test limitation. We used an average wellhead price of $10.43 per MCF, adjusted for derivative instruments.

As a result of the disposition of Houston Exploration in 2004, during 2004 KeySpan calculated the ceiling test on KeySpan Exploration and Production's and Seneca-Uphsur's assets independently of Houston Exploration's assets. Based on a report furnished by an independent reservoir engineer during the second quarter of 2004, it was determined that the remaining proved undeveloped oil reserves held in the joint venture required a substantial investment in order to develop. Therefore, KeySpan and Houston Exploration elected not to develop these oil reserves. As a result, in the second quarter of 2004, we recorded a $48.2 million non-cash impairment charge to write down our wholly-owned gas exploration and production subsidiaries' assets. This charge was recorded in depreciation, depletion and amortization on the Consolidated Statement of Income.

As of December 31, 2004, we estimated, using an average wellhead price adjusted for derivative instruments of $6.45 per MCF, that the capitalized costs did not exceed the ceiling test limitation.

As of December 31, 2003, KeySpan calculated the ceiling test on KeySpan Exploration and Production's and Houston Exploration's assets. We estimated, using a wellhead price of $5.79 per MCF, that the capitalized costs did not exceed the ceiling test limitation for that period.

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, there are significant downward revisions in our estimated proved reserves or we have unsuccessful drilling results.

Houston Exploration, for 2004 and 2003, capitalised interest related to their unevaluated natural gas and oil properties, as well as some properties under development which were not being amortised. For years ended 31 December 2004 and 2003, capitalised interest was $3.4 million and $7.3 million, respectively.

G. Goodwill and Other Intangible Assets

The balance of goodwill and other intangible assets was $1.7 billion at 31 December 2005 and 31 December 2004 and $1.8 billion at 31 December 2003, representing primarily the excess of acquisition cost over the fair value of net assets acquired. Goodwill and other intangible assets reflect 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 per cent. or less in energy-related investments, which are accounted for under the equity method.

The table below summarises the goodwill and other intangible assets balance for each segment at 31 December 2005, 2004 and 2003:

	At December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Operating Segment			
Gas Distribution	$1,436.9	$1,436.9	$1,436.9
Energy Services	65.2	65.8	172.9
Energy Investments and other	164.2	174.9	199.9
	$1,666.3	$1,677.6	$1,809.7

As prescribed in SFAS 142 ''Goodwill and Other Intangible Assets,'' KeySpan is required to compare the fair value of a reporting unit to its carrying amount, including goodwill. This evaluation is required to be performed at least annually, unless facts and circumstances indicated that the evaluation should be performed at an interim period during the year. At 31 December 2005, KeySpan had $1.7 billion of recorded goodwill and has concluded that the fair value of the business units that have recorded goodwill exceed their carrying value.

In 2003, KeySpan updated its review of the carrying value of goodwill associated with the Energy Services segment. KeySpan employed a combination of two methodologies in determining the fair value for its investment in the Energy Services segment, a market valuation approach and an income valuation approach. A third party specialist was engaged to assist with the valuation and evaluate the reasonableness of key assumptions employed. Under the market valuation approach, KeySpan compared relevant financial information relating to the companies included in the Energy Services segment to the corresponding financial information for a peer group of companies in the specialty trade-contracting sector of the construction industry. Under the income valuation approach, the fair value of a firm is obtained by discounting the sum of (i) the expected future cash flows to a firm; and (ii) the terminal value of a firm. As a result of this valuation, management determined that the fair value of the assets adequately exceeded their carrying value and no impairment charge was necessary.

During 2004, KeySpan conducted an evaluation of the carrying value of goodwill recorded in its Energy Services segment. As a result of this evaluation, KeySpan recorded a non-cash goodwill impairment charge of $108.3 million ($80.3 million after tax, or $0.50 per share) in 2004. This charge was recorded as follows: (i) $14.4 million as an operating expense on the Consolidated Statement of Income reflecting the write-down of goodwill on Energy Services segment's continuing operations; and (ii) $93.9 million as discontinued operations reflecting the impairment on the mechanical contracting companies. (See Note 10 to the Consolidated Financial Statements ''Energy Services—Discontinued Operations'' for further details.)

At the end of 2004, KeySpan entered into an agreement to sell its then 50 per cent. interest in Premier Transmission Limited (''Premier''). This investment was accounted for under the equity method of accounting in the Energy Investments segment. In the fourth quarter of 2004 KeySpan recorded a partial pre-tax non-cash impairment charge of $26.5 million - $18.8 million after-tax or $0.12 per share. The impairment charge reflected the difference between the anticipated cash proceeds from the sale of Premier compared to its carrying value at that time and was recorded as a reduction to goodwill.

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 and interest rate risk, as well as to hedge cash flow variability associated with a portion of our peak electric energy sales. Whenever hedge positions are in effect, we are exposed to credit risk in the event of non-performance by counter-parties to derivative contracts, as well as non-performance 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. Our currently outstanding derivative instruments do not qualify as energy trading contracts as defined by current accounting literature.

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 other comprehensive income on the Consolidated Balance Sheet, while the ineffective portion of such changes in fair value is recognised in earnings. Unrealised gains and losses (on such cash flow hedges) that are recorded as 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 utilise derivative financial instruments to reduce cash flow variability associated with the purchase price for a portion of our future natural gas purchases. Our strategy is to minimise fluctuations in firm gas sales prices to our regulated firm gas sales customers in our New York and New England service territories. Since these derivative instruments are being employed to support our gas sales prices to regulated firm gas sales customers, the accounting for these derivative instruments is subject to SFAS 71. Therefore, changes in the market value of these derivatives are recorded as regulatory assets or regulatory liabilities on our Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers during the appropriate winter heating season consistent with regulatory requirements.

Physically-Settled Commodity Derivative Instruments

Certain of our contracts for the physical purchase of natural gas were assessed as no longer being exempt from the requirements of SFAS 133 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 a weather normalization adjustment. 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 minimise 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 recognised 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.

I. Equity Investments

Certain subsidiaries own as their principal assets, investments (including goodwill), representing ownership interests of 50 per cent. or less in energy-related businesses that are accounted for under the equity method. None of these current investments are publicly traded.

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 amortised 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 amortised 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 years ended 31 December 2005, 2004 and 2003, excise taxes collected and paid were $65.8 million, $73.3 million, $90.5 million, respectively.

K. Subsidiary Common Stock Issuances to Third Parties

We follow an accounting policy of income statement recognition for parent company gains or losses from issuances of common stock by subsidiaries to unaffiliated third parties.

L. Foreign Currency Translation

We followed the principles of SFAS 52, ''Foreign Currency Translation,'' for recording our investments in foreign affiliates. Under this statement, all elements of the financial statements are translated by using a current exchange rate. Translation adjustments result from changes in exchange rates from one reporting period to another. At 31 December 2004 and 2003, the foreign currency translation adjustment was included on the Consolidated Balance Sheet. The functional currency for our foreign affiliates was their local currency. At 31 December 2005, SFAS 52 was not applicable to KeySpan since we completed the sale of our remaining foreign investment in the first quarter of 2005.

M. Earnings Per Share

Basic earnings per share (''EPS'') is calculated by dividing earnings for common stock by the weighted average number of shares of common stock outstanding during the period. No dilution for any potentially anti-dilutive securities is included. Diluted EPS assumes the conversion of all potentially dilutive securities and is calculated by dividing earnings for common stock, as adjusted, by the sum of the weighted average number of shares of common stock outstanding plus all potentially dilutive securities.

At 31 December 2005 and 2003, we had approximately 4.6 million and 2.0 million, respectively, options outstanding to purchase KeySpan common stock that were not used in the calculation of diluted EPS since the exercise price associated with these options were greater than the average per share market price of Keyspan's common stock. In addition, there were approximately 384,000 performance shares not used in the calculation of diluted EPS since these shares would not have been issued if 31 December 2005 were the end of the performance period. In 2003, we had 85,676 shares of convertible preferred stock outstanding that could have been converted into 221,153 shares of common stock. These shares were redeemed in 2004.

Under the requirements of SFAS 128, ''Earnings Per Share'' our basic and diluted EPS are as follows:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars, Except Per Share Amounts)		
Earnings for common stock	$ 388.0	$ 458.1	$ 380.9
Houston Exploration dilution	—	—	(0.3)
Preferred stock dividend	—	—	0.5
Earnings for common stock—adjusted	$ 388.0	$ 458.1	$ 381.1
Weighted average shares outstanding (000)	169,940	160,294	158,256
Add dilutive securities:			
Options	861	983	755
Convertible preferred stock	—	—	221
Total weighted average shares outstanding—assuming dilution	170,801	161,277	159,232
Basic earnings per share	$ 2.28	$ 2.86	$ 2.41
Diluted earnings per share	$ 2.27	$ 2.84	$ 2.39

N. Stock Options and Other Stock Based Compensation

Stock options are issued to all KeySpan officers and certain other management employees as approved by the Board of Directors. These options generally vest over a three-to-five year period and have exercise periods between five to ten years. Up to approximately 21 million shares have been authorised for the issuance of options and approximately 3.7 million of these shares were available for issuance at 31 December 2005. Under a separate plan, Houston Exploration had issued stock options to its key employees. KeySpan and Houston Exploration adopted the prospective method of transition in accordance with SFAS 148 ''Accounting for Stock-Based Compensation—Transition and Disclosure.'' Accordingly, compensation expense has been recognised by employing the fair value recognition provisions of SFAS 123 ''Accounting for Stock-Based Compensation'' for grants awarded after 1 January 2003.

KeySpan continues to apply APB Opinion 25, ''Accounting for Stock Issued to Employees,'' and related Interpretations in accounting for grants awarded prior to 1 January 2003. Prior to the disposition of Houston Exploration, Houston Exploration also applied APB Opinion 25, and related Interpretations in accounting for grants awarded prior to 1 January 2003. Accordingly, no compensation cost has been recognised for these fixed stock option plans in the Consolidated Financial Statements since the exercise prices and market values were equal on the grant dates. Had compensation cost for these plans been determined based on the fair value at the grant dates for awards under the plans consistent with SFAS 123, our net income and earnings per share would have decreased to the pro-forma amounts indicated below:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars, Except Per Share Amounts)		
Earnings available for common stock:			
As reported	$ 388.0	$ 458.1	$ 380.9
Add: recorded stock-based compensation expense, net of tax	7.0	9.1	3.7
Deduct: total stock-based compensation expense, net of tax	(8.9)	(12.4)	(9.4)
Pro-forma earnings	$ 386.1	$ 454.8	$ 375.2
Earnings per share:			
Basic—as reported	$ 2.28	$ 2.86	$ 2.41
Basic—pro-forma	$ 2.27	$ 2.84	$ 2.37
Diluted—as reported	$ 2.27	$ 2.84	$ 2.39
Diluted—pro-forma	$ 2.26	$ 2.82	$ 2.36

All grants are estimated on the date of the grant using the Black-Scholes option-pricing model. The following table presents the weighted average fair value, exercise price and assumptions used for the periods indicated:

	Year Ended December 31,		
	2005	2004	2003
Fair value of grants issued	$ 6.15	$ 5.47	$ 4.26
Dividend yield	4.64%	4.74%	5.49%
Expected volatility	22.63%	23.48%	24.26%
Risk free rate	4.10%	3.22%	3.16%
Expected lives	6.4 years	6.5 years	6 years
Exercise price	$ 39.25	$ 37.54	$ 32.40

A summary of the status of our fixed stock option plans and changes is presented below for the periods indicated:

	Year Ended December 31,					
	2005		2004		2003	
Fixed Options	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Outstanding at beginning of period	10,540,946	$ 32.61	10,320,743	$ 31.39	9,524,900	$ 30.74
Granted during the year	1,451,650	$ 39.25	1,602,850	$ 37.54	1,650,450	$ 32.40
Exercised	(1,400,190)	$ 30.65	(1,150,464)	$ 28.05	(664,902)	$ 23.64
Forfeited	(149,351)	$ 36.32	(232,183)	$ 35.18	(189,705)	$ 34.63
Outstanding at end of period	10,443,055	$ 33.74	10,540,946	$ 32.61	10,320,743	$ 31.39
Exercisable at end of period	5,673,084	$ 31.55	5,523,259	$ 30.39	5,365,545	$ 28.76

Remaining Contractual Life	Options Outstanding at December 31, 2005	Weighted Average Exercise Price	Range of Exercise Price	Options Exercisable at December 31, 2005	Weighted Average Exercise Price	Range of Exercise Price
1 years	148,000	$ 30.50	30.50	148,000	$ 30.50	30.50
2 years	230,410	$ 32.54	$ 19.15 - 32.63	230,410	$ 32.54	$ 19.15 - 32.63
3 years	844,625	$ 27.96	$ 24.73 - 29.38	844,625	$ 27.96	$ 24.73 - 29.38
4 years	392,848	$ 26.97	$ 21.99 - 27.06	392,847	$ 26.97	$ 21.99 - 27.06
5 years	998,887	$ 22.68	$ 22.50 - 32.76	998,887	$ 22.68	$ 22.50 - 32.76
6 years	1,657,075	$ 39.50	$ 39.50	1,313,025	$ 39.50	$ 39.50
7 years	1,944,811	$ 32.66	$ 32.66	1,054,195	$ 32.66	$ 32.66
8 years	1,286,493	$ 32.40	$ 32.40	415,856	$ 32.40	$ 32.40
9 years	1,502,756	$ 37.54	$ 37.54	275,239	$ 37.54	$ 37.54
10 years	1,437,150	$ 39.25	$ 39.25	—	$ 39.25	$ 39.25
	10,443,055			5,673,084		

Since 2003, KeySpan provides long-term incentive compensation for officers consisting of 50 per cent. stock options and 50 per cent. performance shares. Performance shares are awarded based upon the attainment of overall corporate performance goals and better aligns incentive compensation with overall corporate performance. These performance shares are measured over a three year period by comparing KeySpan's cumulative total shareholder return to the S&P Utilities Group. The award ''cliff'' vests after each 3 year period.

During 2005, it became apparent to management that the 2003 performance share award would not be achieved and the 2004 performance share award would not be achieved at the level of expense being recorded. Since these awards meet the definition of a performance condition not achieved under SFAS 123, KeySpan reversed the previously recognised expense for the 2003 award and one half of previously recognised expense for the 2004 award amounting to $3.8 million ($2.5 million after tax). For the 2005 award, it is too early to predict whether the performance condition will be achieved and therefore none of the expense recorded to date for the 2005 performance share award has been reversed.

In December 2004, the FASB issued SFAS 123R ''Share-Based Payment'' which superseded SFAS 123. The effective date of SFAS 123R is the first quarter of 2006. Under this standard, we will be prohibited

from reversing any previously recorded expense for the portion of the 2004 and 2005 performance share awards currently deemed attainable. This is due to the fact that the condition of our current performance share awards will be viewed as market conditions under SFAS 123R.

O. Recent Accounting Pronouncements

On 14 July 2005, the Financial Accounting Standards Board (''FASB'') issued an Exposure Draft ''Accounting for Uncertain Tax Positions,'' that would interpret SFAS 109, ''Accounting for Income Taxes.'' This proposal seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement requirements related to accounting for income taxes. Specifically, the proposal would require that a tax position meet a ''probable recognition threshold'' for the benefit of an uncertain tax position to be recognised in the financial statements. The proposal would require recognition in the financial statements of the best estimate of the effect of a tax position only if that position is probable of being sustained on audit by the appropriate taxing authorities, based solely on the technical merits of the position.

The proposed effective date has been delayed until the first fiscal year ending after 1 January 2007. KeySpan is currently evaluating this Exposure Draft, and at this time cannot determine the impact, if any, that the potential requirements of this Exposure Draft may have on its results of operations, financial position or cash flows.

In March 2005, the FASB issued FASB Interpretation No. 47 (''FIN 47'') ''Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143.'' FIN 47 clarifies that the term conditional asset retirement obligation as used in SFAS No. 143 ''Accounting for Asset Retirement Obligations'', refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Accordingly, an entity is required to recognise a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. An entity shall recognise the cumulative effect of initially applying FIN 47 as a change in accounting principle. KeySpan implemented FIN 47 in December 2005. See Note 1 Item P below and Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies'' for further information on FIN 47.

In 2004, the FASB issued FASB Staff Position (''FSP'') 106-2 ''Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.'' This guidance clarified the accounting and disclosure requirements for employers with postretirement benefit plans that have been affected by the passage of the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the ''Medicare Act''). The Act introduced two new features to Medicare that an employer needs to consider in measuring its obligation and net periodic postretirement benefit costs.

KeySpan's retiree health benefit plan currently includes a prescription drug benefit that is provided to retired employees. KeySpan implemented the requirements of FSP 106-2 in 2004 and determined that the savings associated with the Medicare Act reduced KeySpan's retiree health care costs by approximately $10 million in 2004. However, KEDLI and Boston Gas Company are subject to certain deferral accounting requirements mandated by the NYPSC and MADTE, respectively for pension costs and other postretirement benefit costs. Further, in accordance with our service agreements with LIPA, variations between pension costs and other postretirement benefit costs incurred by KeySpan compared to those costs recovered through rates charged to LIPA are deferred subject to recovery from or refund to LIPA. As a result of these various requirements, approximately $7 million of savings attributable to the implementation of FSP 106-2 and the Medicare Act was deferred and used to offset increases in overall pension and postretirement benefit costs, with the remaining approximately $3 million recorded as a reduction to 2004 postretirement expense. The implementation of FSP 106-2 and the Medicare Act had no immediate impact on KeySpan's cash flow.

In January 2005, the Department of Health and Human Services/Centres for Medicare and Medicaid Services (''CMS'') released final regulations with regard to the implementation of the major provisions of the Medicare Act. KeySpan reviewed the new provisions and believes that the new guidance will not have a material impact on its results of operations, financial position, or cash flows.

In December 2004 the FASB issued SFAS 123 (revised 2004) ''Share-Based Payment.'' This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement revises certain provisions of SFAS 123 ''Accounting for Stock-Based Compensation'' and supersedes APB Opinion 25 ''Accounting for Stock Issued to Employees.'' The fair-value-based method in this Statement is similar to the fair-value-based method in SFAS 123 in most respects. However, the following are key differences between the two: entities are required to measure liabilities incurred to employees in share-based payment transactions at fair value as compared to using the intrinsic method allowed under SFAS 123; entities are required to estimate the number of instruments for which the requisite service is expected to be rendered, as compared to accounting for forfeitures as they occur under SFAS 123; and incremental compensation cost for a modification of the terms or conditions of an award are also measured differently under this Statement compared to Statement 123. This Statement also clarifies and expands SFAS 123's guidance in several areas. The effective date of this Statement is the beginning of the first fiscal year beginning after 15 June 2005. KeySpan adopted the prospective method of transition for stock options in accordance with SFAS 148 ''Accounting for Stock-Based Compensation—Transition and Disclosure.'' Accordingly, compensation expense has been recognised by employing the fair value recognition provisions of SFAS 123 for grants awarded after 1 January 2003. KeySpan believes that implementation of this Statement will not have a material impact on its results of operations or financial position and no impact on its cash flows.

P. Impact of Cumulative Effect of Change in Accounting Principles

As previously discussed, KeySpan implemented FIN 47, effective 31 December 2005. FIN 47 required KeySpan to record a liability and corresponding asset representing the present value of conditional asset retirement obligations associated with the retirement of tangible, long-lived assets on the date the obligations were incurred. At year-end, we recorded a $45.6 million liability and corresponding asset representing the present value of conditional asset retirement obligations associated with the retirement of tangible, long-lived assets on the date the obligations were incurred. For the $45.6 million initial asset recorded, approximately $4.3 million represents asset retirement costs that have been deferred on the Consolidated Balance Sheet and will be depreciated over the remaining life of the underlying associated assets lives. The remaining $41.3 million represented cumulative accretion and depreciation expense associated with the liability and asset from the dates the various obligations would have been recorded had this Interpretation been in effect at the time the obligations were incurred.

Of the $41.3 million recorded, $11.3 million ($6.6 million, after-tax), was recorded as a cumulative change in accounting principle on the Consolidated Statement of Income. The remaining $30.0 million was attributable to the Gas Distribution segment and was recorded as a reduction to removal cost recovered. For asset retirement costs incurred in the Gas Distribution segment, KeySpan is recovering these costs from utility customers and has been expensing a like amount through its depreciation expense. A portion of this depreciation expense represents removal costs not yet incurred. The $30 million recorded to removal cost recovered is for purposes of reclassifying a portion of this reserve to the asset retirement obligation. (See Note 7, ''Contractual Obligations, Financial Guarantees and Contingencies—Asset Retirement Obligations'' for further details.)

KeySpan has an arrangement with a variable interest entity through which it leases a portion of the 2,200-megawatt Ravenswood electric generation facility. On 31 December 2003, KeySpan adopted FASB Interpretation No. 46 (''FIN 46''). This pronouncement required KeySpan to consolidate its variable interest entity, which had a fair market value of $425 million at the inception of the lease, June 1999. As a result, in 2003 KeySpan recorded a $37.6 million after-tax charge, or $0.23 per share, cumulative change in accounting principle on the Consolidated Statement of Income, representing approximately four and a half years of depreciation. (See Note 7, ''Contractual Obligations, Financial Guarantees and Contingencies—Variable Interest Entity'' for a detailed description of the impact of the adoption of this standard.)

Under Accounting Principle Board Opinion No. 20 (''APB 20''), the pro-forma impact of the retroactive application resulting from the adoption of a change in accounting principle is to be disclosed as follows:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars, Except Per Share Amounts)		
Earnings for common stock	$ 388.0	$ 458.1	$ 380.9
Add back: Cumulative effect of a change in accounting principle	6.6	—	37.4
Earnings for common stock before cumulative effect of a change in accounting principle	394.6	458.1	418.3
Less: FIN 47 Accretion expense, net of taxes	(0.5)	(0.4)	(0.4)
Add: FIN 47 Depreciation expense, net of taxes	(0.2)	(0.2)	(0.1)
Less: FIN 46 Depreciation expense, net of taxes	—	—	(9.5)
Pro-forma earnings	$ 393.9	$ 457.5	$ 408.3
Earnings per share before cumulative change in accounting principle:			
Basic—as reported	$ 2.32	$ 2.86	$ 2.64
Basic—pro-forma	$ 2.32	$ 2.85	$ 2.58
Diluted—as reported	$ 2.31	$ 2.84	$ 2.62
Diluted—pro-forma	$ 2.31	$ 2.84	$ 2.56
Earnings per share for common stock:			
Basic—as reported	$ 2.28	$ 2.86	$ 2.41
Basic—pro-forma	$ 2.32	$ 2.85	$ 2.58
Diluted—as reported	$ 2.27	$ 2.84	$ 2.39
Diluted—pro-forma	$ 2.31	$ 2.84	$ 2.56

In addition to the above disclosure, FIN 47 requires disclosure of the pro-forma impact of the liability for the asset retirement obligation for the beginning of the earliest year presented and at the end of all years presented as if this Interpretation had been applied during all periods effected. The disclosure is as follows:

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Asset retirement obligation—January 1	$ 44.9	$ 42.5	—
Accretion	2.5	2.4	—
Asset retirement obligation—December 31	$ 47.4	$ 44.9	$ —

Q. Accumulated Other Comprehensive Income

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

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Foreign currency translation adjustments	$ —	$ 5.0	$ 26.5
Unrealized (losses) on marketable securities	(0.9)	(0.4)	(7.5)
Premium on derivative instruments	—	—	(3.4)
Accrued unfunded pension obligation	(63.5)	(59.8)	(51.9)
Unrealized (losses)/gain on derivative financial instruments	(10.4)	0.9	(23.6)
Accumulated other comprehensive income	$ (74.8)	$ (54.3)	$ (59.9)

Note 2. Business Segments

We have four reportable segments: Gas Distribution, Electric Services, Energy Services and Energy Investments.

The Gas Distribution segment consists of our six gas distribution subsidiaries. KEDNY provides gas distribution services to customers in the New York City Boroughs of Brooklyn, Staten Island and a portion of the Borough of Queens. KEDLI provides gas distribution services to customers in the Long Island counties of Nassau and Suffolk and the Rockaway Peninsula of Queens County. The remaining gas distribution subsidiaries, collectively doing business as 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 long-term service contracts having remaining terms that range from one to seven years and power purchase agreements having remaining terms that range from seven to 21 years. On 1 February 2006, KeySpan and LIPA agreed to extend, amend and restate these contractual arrangements. (See Note 11, ''2006 LIPA Settlement'' for a further discussion of these agreements.) The Electric Services segment also includes 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''. All of the energy, capacity and ancillary services related to the Ravenswood Generating Station are sold to the NYISO energy markets. To finance the purchase and/or construction of the Ravenswood Generating Station, KeySpan entered into leasing arrangement for each facility. The Electric Services segment also conducts retail marketing of electricity to commercial customers. (See Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies'' for further details on the leasing arrangements.)

The Energy Services segment includes companies that provide energy-related services to customers located primarily within the Northeastern United States. 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, consulting and fibre optic services to commercial, institutional and industrial customers.

In January and February of 2005, KeySpan sold its mechanical contracting subsidiaries. The operating results and financial position of these companies, which were previously consolidated within the Energy Services segment, have been reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

In regard to the January 2005 transactions, KeySpan received proceeds of approximately $16 million, including approximately $5 million to be paid within a three year period. In addition, KeySpan retained a portion of its previously incurred surety indemnity support obligations related to certain performance and payment bonds issued for the benefit of KeySpan's former subsidiaries prior to closing. In June 2005, the balance to be paid over a three year period was fully collected on a present value basis and a significant portion of the performance bonds were replaced without any remaining indemnification obligation on the part of KeySpan. The current estimated cost to complete projects supported by the remaining indemnity obligations associated with the January 2005 transactions is approximately $0.2 million. The buyers have agreed to complete the projects for which such indemnity obligations were incurred and to indemnify and hold KeySpan harmless with respect to its liabilities in connection with such bonds.

In connection with the February 2005 transaction, KeySpan paid or contributed approximately $26 million to a former subsidiary prior to closing the sale transaction in exchange for, among other things, the disposition of outstanding shares in the former subsidiary and the settlement of intercompany advances and replacement of a performance and payment bond issued for the benefit of its former subsidiary with respect to a pending project, which bond had been supported by a $150 million indemnity obligation of KeySpan. In addition, KeySpan received from its former subsidiary an indemnity bond issued by a third party surety 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 the remaining bonded projects of its former subsidiary as of the closing. As of 31 December 2005, the total cost to complete such remaining bonded projects is estimated to be approximately $40 million. The aforementioned guarantees are reflected in Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies.'' KeySpan's former subsidiary has also agreed to complete the projects for which such indemnity obligations were incurred and indemnify and hold KeySpan harmless with respect to any liabilities in connection with such bonds.

In the fourth quarter of 2004, KeySpan's investment in its mechanical contracting subsidiaries was written-down to an estimated fair value. During 2004, KeySpan recorded a non-cash goodwill impairment charge of $108.3 million ($80.3 million after tax, or $0.50 per share) associated with its mechanical contracting operations and certain remaining operations. In addition, an impairment charge of $100.3 million ($72.1 million after-tax or $0.45 per share) was also recorded to reduce the carrying value of the remaining assets of the mechanical contracting companies. (See Note 10 ''Energy Services—Discontinued Operations'' for additional details regarding these charges.) During the first six months of 2005, operating losses were incurred through the dates of sale of these companies of $4.1 million after-tax, including but not limited to costs incurred for employee related benefits. Partially offsetting these losses was a gain of $2.3 million associated with the related divestitures, reflecting the difference between the fair value estimates and the financial impact of the actual sale transactions. The net income impact of the operating losses and the disposal gain was a loss of $1.8 million, or $0.01 per share for the twelve months ended 31 December 2005.

The Energy Investments segment consists of our gas exploration and production investments, as well as certain other domestic energy-related investments. KeySpan's gas exploration and production activities include our wholly-owned subsidiaries Seneca Upshur Petroleum, Inc. (''Seneca-Upshur'') and KeySpan Exploration and Production, LLC (''KeySpan Exploration''). Seneca-Upshur is engaged in gas exploration and production activities primarily in West Virginia. KeySpan Exploration is engaged in a joint venture with The Houston Exploration Company (''Houston Exploration''), an independent natural gas and oil exploration company located in Houston, Texas.

During the first five months of 2004, our gas exploration and production investments also included a 55 per cent. equity interest in Houston Exploration, the operations of which were fully consolidated in KeySpan's Consolidated Financial Statements. On 2 June 2004, KeySpan exchanged 10.8 million shares of common stock of Houston Exploration for 100 per cent. of the stock of Seneca-Upshur, previously a wholly owned subsidiary of Houston Exploration. This transaction reduced our interest in Houston Exploration from 55 per cent. to the then current level of 23.5 per cent.. Effective 1 June 2004, Houston Exploration's earnings and our ownership interest in Houston Exploration were accounted for on the equity method of accounting. This transaction resulted in a gain to KeySpan of $150.1 million. The deconsolidation of Houston Exploration required the recognition of certain deferred taxes on our remaining investment resulting in a net deferred tax expense of $44.1 million. Therefore, the net gain on the share exchange less the deferred tax provision was $106 million, or $0.66 per share.

In November 2004, KeySpan sold its remaining 23.5 per cent. interest in Houston Exploration (6.6 million shares) and received cash proceeds of approximately $369 million. KeySpan recorded a pre-tax gain of $179.6 million which is reflected in other income and (deductions) on the Consolidated Statement of Income. The after-tax gain was $116.8 million or $0.73 per share.

Asset transactions regarding our investment in Houston Exploration were also recorded in 2003. In February 2003, we reduced our ownership interest in Houston Exploration from 66 per cent. to approximately 55 per cent. following the repurchase, by Houston Exploration, of three million shares of common stock owned by KeySpan. We realised net proceeds of $79 million in connection with this repurchase. KeySpan realised a gain of $19 million on this transaction, which is reflected in other income and (deductions) on the Consolidated Statement of Income. Income taxes were not provided, since this transaction was structured as a return of capital. The per share gain on this transaction was $0.12.

Houston Exploration's revenues, which are reflected in KeySpan's Consolidated Statement of Income in fiscal years 2004 and 2003, were $268.1 million, and $495.3 million, respectively. Houston Exploration's operating income, including KeySpan's share of equity earnings, was $138.5 million and $196.3 million in fiscal years 2004 and 2003, respectively.

The Energy Investments segment is also engaged in pipeline development activities. KeySpan and Duke Energy Corporation each own a 50 per cent. interest in the Islander East Pipeline Company, LLC (''Islander East''). 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. Once in service, the pipeline is expected to transport up to 260,000 DTH daily to the Long Island and New York City energy markets. Further, KeySpan has a 21 per cent. interest in the Millennium Pipeline project which is expected to transport up to 525,000 DTH of natural gas a day from Corning to Ramapo, New York, where it will connect to an existing pipeline. Additionally, subsidiaries in this segment hold a 20 per cent. equity interest in the Iroquois Gas Transmission System LP, a pipeline that transports Canadian gas supply to markets in the Northeastern United States. These subsidiaries 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.

Through its wholly owned subsidiary, KeySpan LNG, LP, KeySpan owns a liquefied natural gas storage and receiving facility in Providence, Rhode Island, the operations of which are fully consolidated.

During the first quarter of 2004, we also had an approximate 61 per cent. investment in certain midstream natural gas assets in Western Canada through KeySpan Energy Canada Partnership (''KeySpan Canada''). These assets included 14 processing plants and associated gathering systems that produced approximately 1.5 BCFe of natural gas daily and provided associated natural gas liquids fractionation. These operations were fully consolidated in KeySpan's Consolidated Financial Statements. On 1 April 2004, KeySpan and KeySpan Facilities Income Fund (the ''Fund''), which previously owned a 39.09 per cent. interest in KeySpan Canada, consummated a transaction whereby the Fund sold 15.617 million units of the Fund and acquired an additional 35.91 per cent. interest in KeySpan Canada from KeySpan. As a result of this transaction, KeySpan's ownership of KeySpan Canada decreased to 25 per cent.. KeySpan recorded a gain of $22.8 million ($10.1 million after-tax, or $0.06 per share) at the time of this transaction. Effective 1 April 2004 KeySpan Canada's earnings and our ownership interest in KeySpan Canada were accounted for on the equity method of accounting.

In July 2004, the Fund issued an additional 10.7 million units, the proceeds of which were used to fund the acquisition of the midstream assets of Chevron Canada Midstream Inc. This transaction had the effect of further diluting KeySpan's ownership of KeySpan Canada to 17.4 per cent.. KeySpan continued to account for its investment in KeySpan Canada on the equity basis of accounting since it still exercised significant influence over this entity.

In December 2004, KeySpan sold its remaining 17.4 per cent. interest in KeySpan Canada to the Fund and received net proceeds of approximately $119 million and recorded a pre-tax gain of approximately $35.8 million, which is reflected in other income and (deductions) on the Consolidated Statement of Income. The after-tax gain was approximately $24.7 million, or $0.15 per share.

Asset transactions regarding our investment in KeySpan Canada were also recorded in 2003. In 2003, we sold a portion of our interest in KeySpan Canada through the Fund. The Fund acquired a 39.1 per cent. ownership interest in KeySpan Canada through an indirect subsidiary, and then issued 17 million trust units to the public through an initial public offering. Additionally, we sold our 20 per cent. interest in Taylor NGL LP that owns and operates two extraction plants in Canada to AltaGas Services, Inc. Net proceeds of $119.4 million from the two sales, plus proceeds of $45.7 million drawn under a credit facility made available to KeySpan Canada, were used to pay down existing KeySpan Canada credit facilities of $160.4 million. A pre-tax loss of $30.3 million was recognised on the transactions and is included in other income and (deductions) on the Consolidated Statement of Income. These transactions produced a tax expense of $3.8 million as a result of certain United States partnership tax rules and resulted in an after-tax loss of $34.1 million, or $0.22 per share.

KeySpan Canada's revenues, which are reflected in KeySpan's Consolidated Statement of Income in fiscal years 2004 and 2003, were $25.2 million and $90.3 million, respectively. KeySpan Canada's operating income, including KeySpan's share of equity earnings, was $16.5 million and $29.7 million, respectively.

In the first quarter of 2005, KeySpan sold its 50 per cent. interest in Premier Transmission Limited (''Premier''), a gas pipeline from southwest Scotland to Northern Ireland. On 25 February 2005, KeySpan entered into a Share Sale and Purchase Agreement with BG Energy Holdings Limited and Premier Transmission Financing Public Limited Company (''PTFPL''), pursuant to which all of the outstanding shares of Premier were to be purchased by PTFPL. On 18 March 2005, the sale was completed and generated cash proceeds of approximately $48.1 million. In the fourth quarter of 2004, KeySpan recorded a pre-tax non-cash impairment charge of $26.5 million reflecting the difference between the anticipated cash proceeds from the sale of Premier compared to its carrying value. The final sale of Premier resulted in a pre-tax gain of $4.1 million reflecting the difference from earlier estimates; this gain was recorded in the first quarter of 2005.

In the fourth quarter of 2003, we completed the sale of our 24.5 per cent. interest in Phoenix Natural Gas Limited for $96 million and recorded a pre-tax gain of $24.7 million in other income and (deductions) on the Consolidated Statement of Income. The after-tax gain was $16.0 million, or $0.10 per share.

The accounting policies of the segments are the same as those used for the preparation of the Consolidated Financial Statements. Our segments are strategic business units that are managed separately because of their different operating and regulatory environments. Operating results of our segments are evaluated by management on an operating income basis. For fiscal years 2004 and 2003, the operating data of Houston Exploration has been separately displayed. The reportable segment information is as follows:

	Gas Distribution	Electric Services	Energy Services	Other Investments	Eliminations	Consolidated
			(In Millions of Dollars)			
Year Ended December 31, 2005						
Unaffiliated revenue	5,390.1	2,042.7	191.2	38.0	—	7,662.0
Intersegment revenue	—	4.6	10.8	5.0	(20.4)	—
Depreciation, depletion and amortization	277.0	91.7	7.6	6.8	13.4	396.5
Gain on sales of property	0.1	1.2	—	0.1	0.2	1.6
Income from equity investments	—	—	—	15.1	—	15.1
Operating income	565.7	342.3	(2.7)	20.6	(18.1)	907.8
Interest income	0.9	0.8	0.2	2.8	7.6	12.3
Interest charges	178.2	71.7	18.4	1.8	(0.8)	269.3
Total assets	10,052.5	2,348.0	199.0	341.9	871.2	13,812.6
Equity method investments	—	—	—	106.7	—	106.7
Construction expenditures	410.3	88.8	7.4	23.6	9.4	539.5

Eliminating items include intercompany interest income and expense and the elimination of certain intercompany accounts as well as activities of our corporate and administrative subsidiaries.

Electric Services revenues from LIPA and the NYISO of $2.0 billion for the year ended 31 December 2005 represents approximately 26 per cent. of our consolidated revenues during that period.

	Gas Distribution	Electric Services	Energy Services	Houston Exploration	Other Investments	Eliminations	Consolidated
			(In Millions of Dollars)				
Year Ended December 31, 2004							
Unaffiliated revenue	4,407.3	1,738.7	182.4	268.1	54.0	—	6,650.5
Intersegment revenue	—	—	11.5	—	4.9	(16.4)	—
Depreciation, depletion and amortization	276.5	88.2	7.5	104.6	59.7	15.3	551.8
Gain on sales of property	—	2.0	—	—	5.0	—	7.0
Income from equity investments	—	—	—	20.7	25.8	—	46.5
Operating income	579.6	289.8	(48.3)	138.5	(33.8)	9.5	935.3
Interest income	2.2	9.9	—	3.5	3.0	(9.2)	9.4
Interest charges	176.8	72.9	19.4	3.5	3.9	54.8	331.3
Total assets	8,908.8	2,144.3	246.6	—	701.3	1,363.1	13,364.1
Equity method investments	—	—	—	—	107.1	—	107.1
Construction expenditures	414.5	150.3	13.7	146.5	13.7	11.6	750.3

Eliminating items include intercompany interest income and expense, the elimination of certain intercompany accounts, as well as activities of our corporate and administrative subsidiaries.

Electric Services revenues from LIPA and the NYISO of $1.7 billion for the year ended 31 December 2004 represents approximately 25 per cent. of our consolidated revenues during that period.

	Gas Distribution	Electric Services	Energy Services	Houston Exploration	Other Investments	Eliminations	Consolidated
	(In Millions of Dollars)						
Year Ended December 31, 2003							
Unaffiliated revenue	4,161.3	1,606.0	158.9	495.3	114.0	—	6,535.5
Intersegment revenue	—	0.1	7.5	—	5.0	(12.6)	—
Depreciation, depletion and amortization	259.9	67.2	7.1	204.1	19.1	14.3	571.7
Gain on sales of property	15.1	—	—	—	—	—	15.1
Income from equity investments	—	—	—	—	19.1	0.1	19.2
Operating income	574.3	269.9	(33.0)	196.3	42.2	(2.1)	1,047.6
Interest income	1.2	4.6	1.1	—	1.0	(2.2)	5.7
Interest charges	203.7	44.2	15.8	8.5	7.5	28.0	307.7
Total assets	8,457.5	2,511.1	407.5	1,530.9	915.4	817.8	14,640.2
Equity method investments	—	—	—	—	97.0	—	97.0
Construction expenditures	419.6	256.5	7.0	295.9	18.1	12.3	1,009.4

Eliminating items include intercompany interest income and expense and the elimination of certain intercompany accounts as well as activities of our corporate and administrative subsidiaries.

Electric Services revenues from LIPA and the NYISO of $1.5 billion for the year ended 31 December 2003 represents approximately 22 per cent. of our consolidated revenues during that period.

Note 3. Income Tax

KeySpan files a consolidated federal income tax return. A tax sharing agreement between the holding company and its subsidiaries provides for the allocation of a realised tax liability or asset 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:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Current income tax	$ 206.6	$ 201.9	$ (99.8)
Deferred income tax	32.7	123.6	381.1
Total income tax	$ 239.3	$ 325.5	$ 281.3

At 31 December 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:

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Reserves not currently deductible	$ 28.4	$ 23.9	$ 34.3
State income tax	(20.6)	(19.0)	(56.2)
Property related differences	(1,080.8)	(1,080.0)	(1,049.2)
Regulatory tax asset	(24.5)	(21.4)	(21.2)
Employess benefits and compensation	(64.4)	(16.6)	—
Property taxes	(84.1)	(99.1)	(98.1)
Other items—net	88.1	88.1	(85.2)
Net deferred tax liability	$(1,157.9)	$(1,124.1)	$(1,275.6)

KeySpan is currently in discussions with the Internal Revenue Service (''IRS'') at the Appeals level with regard to LILCO's tax returns for the tax years ending 31 December 1996 through March 31, 1999 and KeySpan's and the Brooklyn Union Gas Company's tax returns for the years ending September 30, 1997 through December 31, 1998. The primary issue relates to the valuation of the transferred assets in the KeySpan/LILCO combination. Additionally, the IRS has recently commenced the examination of KeySpan's tax returns for the year ended 2002 and 2003. At this time, we cannot predict the result of

these audits. However, KeySpan has evaluated the potential outcomes based on the issues raised and progress of the discussions to date. KeySpan believes that it has adequately provided for the additional tax, if any, which may result.

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

The table below sets forth the reasons for such differences:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Computed at the statutory rate	$ 223.3	$ 329.1	$ 247.6
Adjustments related to:			
Tax credits	(1.4)	(2.2)	—
Removal costs	(2.9)	(0.6)	(6.6)
Accrual to return adjustments	6.7	(10.7)	0.5
Sale of subsidiary stock	—	(22.5)	—
Minority interest in Houston Exploration	—	12.9	20.0
State income tax, net of Federal benefit	29.0	24.8	28.5
Contribution of land	(3.8)	—	—
Dividends paid to employee benefit plan	(3.9)	(3.6)	—
Other items—net	(7.7)	(1.7)	(8.7)
Total income tax	$ 239.3	$ 325.5	$ 281.3
Effective income tax rate[1]	38%	35%	40%

(1) Reflects both federal as well as state income taxes.

The American Jobs Creation Act of 2004, signed into law on 22 October 2004 provides for a special one-time tax deduction, or dividend received deduction (''DRD'') of 85 per cent. of qualifying foreign earnings that are repatriated in 2004 or 2005. We currently estimate that KeySpan has repatriated dividends of approximately $9.5 million of earnings under this provision and received, as a result, a tax benefit of $2.8 million.

As of 31 December 2005 KeySpan had $285 million of state tax net operating loss carryforwards which, if fully utilised at current rates, will yield tax credits of approximately $25 million. These credits will expire between 2011 and 2022.

Note 4. Post-retirement Benefits

Pension Plans: The following information represents the consolidated results for our non-contributory defined benefit pension plans which cover substantially all employees. Benefits are typically based on age, 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 MADTE, respectively for pension costs and other postretirement benefit costs.

The calculation of net periodic pension cost is as follows:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Service cost, benefits earned during the period	$ 56.5	$ 52.9	$ 47.5
Interest cost on projected benefit obligation	148.5	144.2	138.3
Expected return on plan assets	(173.1)	(158.2)	(130.6)
Net amortization and deferral	74.1	63.3	67.0
Special termination benefits	2.2	—	—
Total pension cost	$ 108.2	$ 102.2	$ 122.2

The following table sets forth the pension plans' funded status at 31 December 2005, 31 December 2004 and 31 December 2003:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Change in benefit obligation:			
Benefit obligation at beginning of period	$(2,520.1)	$(2,343.2)	$(2,080.2)
Service cost	(56.6)	(52.9)	(47.5)
Interest cost	(148.5)	(144.2)	(138.3)
Amendments	(0.1)	(2.3)	(3.1)
Actuarial loss	(117.9)	(114.6)	(192.6)
Benefits paid	130.4	137.1	118.5
Special termination benefits	(2.2)	—	—
Benefit obligation at end of period	$(2,715.0)	(2,520.1)	(2,343.2)
Change in plan assets:			
Fair value of plan assets at beginning of period	2,028.9	1,855.2	1,544.5
Actual return on plan assets	166.7	164.2	335.7
Employer contribution	148.3	146.6	93.5
Benefits paid	(130.4)	(137.1)	(118.4)
Fair value of plan assets at end of period	2,213.5	2,028.9	1,855.3
Funded status	(501.5)	(491.2)	(487.9)
Unrecognized net loss from past experience different from that assumed and from changes in assumptions	672.1	612.1	557.2
Unrecognized prior service cost	48.2	57.7	64.9
Net prepaid pension cost reflected on consolidated balance sheet	$ 218.8	$ 178.6	$ 134.2

	Year Ended December 31,		
	2005	2004	2003
Assumptions:			
Obligation discount	5.75%	6.00%	6.25%
Asset return	8.50%	8.50%	8.50%
Average annual increase in compensation	4.00%	4.00%	4.00%

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

	Pension Benefits
	(In Millions of Dollars)
2006	$ 132.2
2007	$ 134.1
2008	$ 137.7
2009	$ 141.4
2010	$ 146.0
Years 2011 - 2015	$ 839.3

Unfunded Pension Obligation: At 31 December 2005 the accumulated benefit obligation was in excess of pension assets. As prescribed by SFAS 87 ''Employers' Accounting for Pensions,'' KeySpan had a $257.3 million minimum liability at 31 December 2005, for this unfunded pension obligation. As permitted under current accounting guidelines, these accruals can be offset by a corresponding debit to a long-term asset up to the amount of accumulated unrecognised prior service costs. Any remaining amount is to be recorded in accumulated other comprehensive income on the Consolidated Balance Sheet.

Therefore, at year-end, we had a long-term asset in deferred charges other of $41.2 million, representing the amount of unrecognised prior service cost and a debit to accumulated other comprehensive income of $97.8 million, or $63.6 million after-tax. The remaining amount of $118.3 million was recorded as a contractual receivable from LIPA of $103.8 million and a regulatory asset of $14.5 million, representing the amounts that could be recovered from LIPA and the Boston Gas ratepayer in accordance with our service and rate agreements if the underlying assumptions giving rise to this minimum liability were realised and recorded as pension expense. Boston Gas has received approval from the MADTE to defer as a regulatory asset the amount of its current and future minimum pension liability to reflect its ability to recover in rates its actual pension liability.

At 31 December 2005 the projected benefit obligation, accumulated benefit obligation and value of assets for plans with accumulated benefit obligations in excess of plan assets were $1.4 billion, $1.3 billion and $997 million, respectively.

At 31 December 2004, the accumulated benefit obligation was also in excess of pension assets. As a result, we had a minimum liability of $255.9 million, a long-term asset in deferred charges other of $49.7 million, and a debit to other comprehensive income of $91.9 million, or $59.8 million after-tax. The remaining amount of $114.3 million was recorded as a contractual receivable from LIPA of $100.1 million and a regulatory asset of $14.2 million.

At 31 December 2004 the projected benefit obligation, accumulated benefit obligation and value of assets for plans with accumulated benefit obligations in plan assets were $1.3 billion, $1.2 billion and $881 million, respectively.

At December 31, 2003, the accumulated benefit obligation was in excess of pension assets. As a result, we had a minimum liability of $244.4 million, a long-term asset in deferred charges other of $55.3 million, and a debit to other comprehensive income of $79.9 million, or $51.9 million after-tax. The remaining amount of $109.2 million was recorded as a contractual receivable from LIPA of $95.8 million and a regulatory asset of $13.4 million.

At December 31, 2003 the projected benefit obligation, accumulated benefit obligation and value of assets for plans with accumulated benefit obligations in plan assets were $1.2 billion, $1.1 billion and $794 million, respectively.

At the end of each year, we will re-measure the accumulated benefit obligation and pension assets, and adjust the accrual and deferrals as appropriate.

Other Post-retirement Benefits: The following information represents the consolidated results for our contributory medical and prescription drug programs and non-contributory life insurance programs 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:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Service cost, benefits earned during the period	$ 24.4	$ 19.7	$ 18.8
Interest cost on accumulated postretirement benefit obligation	75.7	70.2	69.8
Expected return on plan assets	(36.1)	(33.9)	(27.5)
Net amortization and deferral	59.9	41.0	35.8
Special termination benefit	1.7	—	—
Other post-retirement cost	$ 125.6	$ 97.0	$ 96.9

The following table sets forth the plans' funded status at 31 December 2005, 31 December 2004 and 31 December 2003:

	Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Change in benefit obligation:			
Benefit obligation at beginning of period	$(1,336.7)	$(1,267.6)	$(1,056.9)
Impact due to Medicare subsidy	—	60.6	—
Service cost	(24.4)	(19.7)	(18.8)
Interest cost	(75.7)	(70.2)	(69.8)
Plan participants' contributions	(3.4)	(1.9)	(1.8)
Amendments	3.2	27.4	35.4
Actuarial (loss)	(38.3)	(119.9)	(209.4)
Benefits paid	62.7	54.6	53.7
Special termination benefit	(1.7)	—	—
Benefit obligation at end of period	(1,414.3)	(1,336.7)	(1,267.6)
Change in plan assets:			
Fair value of plan assets at beginning of period	464.0	438.4	361.2
Actual return on plan assets	29.1	38.8	85.6
Employer contribution	35.8	39.5	43.6
Plan participants' contributions	3.4	1.9	1.7
Benefits paid	(62.7)	(54.6)	(53.7)
Fair value of plan assets at end of period	469.6	464.0	438.4
Funded status	(944.7)	(872.7)	(829.2)
Unrecognized net loss from past experience different from that assumed and from changes in assumptions	557.5	576.8	573.3
Unrecognized prior service cost	(97.5)	(106.5)	(89.0)
Accrued post-retirement cost reflected on consolidated balance sheet	$ (484.7)	$ (402.4)	$ (344.9)

	Year Ended December 31,		
	2005	2004	2003
Assumptions:			
Obligation discount	5.75%	6.00%	6.25%
Asset return	8.50%	8.50%	8.50%
Average annual increase in compensation	4.00%	4.00%	4.00%

The measurement of plan liabilities also assumes a health care cost trend rate of 9.5 per cent. grading down to 4.75 per cent. over six years, and 4.75 per cent. thereafter. A 1 per cent. increase in the health care cost trend rate would have the effect of increasing the accumulated postretirement benefit obligation as of 31 December 2005 by $173.1 million and the net periodic health care expense by $14.9 million. A 1 per cent. decrease in the health care cost trend rate would have the effect of decreasing the accumulated postretirement benefit obligation as of 31 December 2005 by $151.1 million and the net periodic health care expense by $12.6 million.

At 31 December 2005, KeySpan had a contractual receivable from LIPA of $297.4 million representing pension and postretirement benefits associated with the electric business unit employees recorded in deferred charges other on the Consolidated Balance Sheet. LIPA has been reimbursing us for costs related to the postretirement benefits of the electric business unit employees in accordance with the LIPA Agreements.

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

	Gross Benefit Payments	Subsidiary Receipts Expected(**)
	(In Millions of Dollars)	
2006	$ 65.9	$ 3.5
2007	$ 70.6	$ 3.9
2008	$ 74.9	$ 4.3
2009	$ 79.6	$ 4.7
2010	$ 83.9	$ 5.0
Years 2011 - 2015	$ 469.3	$ 28.1

(**) 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 31 December 2005, 2004 and 2003 by asset category, for both the pension and other postretirement benefit plans are as follows:

	Pension			OPEB		
Asset Category	**2005**	**2004**	**2003**	**2005**	**2004**	**2003**
Equity securities	65%	64%	61%	70%	72%	68%
Debt securities	27%	28%	31%	23%	23%	26%
Cash and equivalents	3%	3%	2%	2%	—	2%
Venture capital	5%	5%	6%	5%	5%	4%
Total	100%	100%	100%	100%	100%	100%

The long-term rate of return on assets (pre-tax) is assumed to be 8.5 per cent. 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 for our Plans is greater than 8.5 per cent..

Our master trust investment allocation policy target for the assets of the pension and other postretirement benefit plans is 70 per cent. equity and 30 per cent. fixed income.

During 2003, KeySpan conducted an asset and liability study projecting asset returns and expected benefit payments over a ten-year period. Based on the results of the study, KeySpan 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 2006, KeySpan is expected to contribute approximately $90 million to its pension plans and approximately $30 million to its other postretirement benefit plans.

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. 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 per cent. discount on the purchase of KeySpan common stock in the Plan. The matching contributions were in KeySpan's common stock until January 2006. The matching contributions are now determined at election of KeySpan employees. For the years ended 31 December 2005, 2004 and 2003, we recorded an expense of $15.2 million, $14.7 million, and $11.2 million, respectively.

Note 5. Capital Stock

Common Stock: Currently we have 450,000,000 shares of authorised common stock. At 31 December 2005, we had 10.5 million shares, or $303.9 million of treasury stock outstanding. During 2005, we issued 1.4 million shares out of treasury for the dividend reinvestment feature of our Investor Program,

the Employee Discount Stock Purchase Plan, the 401(k) Plan and the Long-Term Incentive Compensation Plan.

On 16 May 2005, KeySpan issued 12.1 million shares of common stock, in association with the MEDS Equity Units conversion, at an issuance price of $37.93 per share pursuant to the terms of the forward purchase contract. KeySpan received proceeds of approximately $460 million from the equity conversion. The number of shares issued was dependent on the average closing price of our common stock over the 20 day trading period ending on the third trading day prior to 16 May 2005. (See Note 6 ''Long-Term Debt and Commercial Paper'' for further details on the MEDS Equity Units.)

Preferred Stock: We have the authority to issue 100,000,000 shares of preferred stock with the following classifications: 16,000,000 shares of preferred stock, par value $25 per share; 1,000,000 shares of preferred stock, par value $100 per share; and 83,000,000 shares of preferred stock, par value $.01 per share.

At 31 December 2004 we had 553,000 shares outstanding of 7.07 per cent. Mandatory Redeemable Preferred Stock Series B par value $100 redeemable in 2005; and 197,000 shares outstanding of 7.17 per cent. Mandatory Redeemable Preferred Stock Series C par value $100 redeemable in 2008.

In May 2005, $55.3 million of 7.07 per cent. Series B preferred stock was redeemed on its scheduled redemption date. Additionally, also in May 2005, KeySpan called for the optional redemption of $19.7 million of 7.17 per cent. Series C of Preferred Stock due 2008. KeySpan no longer has preferred stock outstanding.

In July 2004, KeySpan redeemed 83,268 shares of preferred stock 6.00% Series A par value $100 that were previously issued in a private placement. KeySpan redeemed these shares at a 2% premium and incurred a cash expenditure of $8.5 million.

Note 6. Long-Term Debt And Commercial Paper

Notes Payable: KEDLI had $125 million of Medium-Term Notes at 6.90 per cent. due 15 January 2008, and $400 million of 7.875 per cent. medium-term notes due 1 February 2010, outstanding at 31 December 2005, 2004 and 2003, each of which is guaranteed by KeySpan.

During 2005, KeySpan redeemed $500 million 6.15 per cent. Notes due 2006. We applied the provisions of SFAS 145 ''Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections'' and recorded an expense of $20.9 million associated with call premiums and wrote-off $1.3 million of previously deferred financing costs. Further, KeySpan accelerated the amortisation of approximately $11.2 million of previously unamortised benefits associated with an interest rate swap on these bonds. The accelerated amortisation was recorded as a reduction to interest expense on the Consolidated Statement of Income. In addition, during the first quarter of 2005, $15 million of 8.87 per cent. notes of a KeySpan subsidiary were redeemed at maturity.

Further, in association with the MEDS Equity Units conversion, KeySpan converted $460 million of MEDS Equity Units into $467.2 million of medium and long term bonds. (For further details on the MEDS Equity Units see ''MEDS Equity Units'' below.) As a result of the aforementioned transactions, at 31 December 2005 KeySpan had $2.4 billion of notes outstanding with interest rates ranging from 4.65 per cent. to 9.75 per cent. that mature in 2006-2035.

KeySpan had $2.66 billion of medium and long term notes outstanding at December 31, 2003 of which $1.65 billion of these notes were associated with the acquisition of Eastern and ENI. These notes were issued in three series as follows: $700 million, 7.25% Notes due 2005; $700 million, 7.625% Notes due 2010 and $250 million, 8.00% Notes due 2030. During 2004, KeySpan redeemed the $700 million, 7.25% Notes due 2005 series. We applied the provisions of SFAS 145 ''Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections'' and recorded an expense of $48.9 million reflecting call premiums of $40.9 million and the write-off of $8.0 million of previously deferred financing costs. The call premiums are reflected in other income and (deductions) while the write-off of previously deferred financing costs have been reflected in interest expense on the Consolidated Statement of Income. Therefore, at December 31, 2004 KeySpan has $1.96 billion of notes remaining having interest rates ranging from 4.65% to 9.75% that mature in 2005-2033.

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 31 December 2005, $640.5 million of GFRBs were outstanding. The interest rate on the variable rate series due through 1 December 2026 is reset weekly and ranged from 1.40 per cent. to 2.95 per cent. during the year ended 31 December 2005, at which time the rate was 2.85 per cent.

In November 2005, KEDNY, issued $137 million of tax-exempt GFRBs through the NYSERDA in the following series: (i) $82 million of 4.70 per cent. GFRB, 2005 Series A (the ''Series A Bonds''); and (ii) $55 million GFRB, 2005 Series B (the ''Series B Bonds''). The interest rate on the Series B bonds is re-set every seven days through an auction process and at 31 December 2005 the interest rate on these bonds was 3.15 per cent. KEDNY used the proceeds from this issuance to redeem the following three series: (i) $41 million Adjustable Rate GFRB Series 1989 A due February 2024; (ii) $41 million Adjustable Rate GFRB Series 1989 B due February 2024; and (iii) $55 million 5.60 per cent. GFRB Series 1993 C due June 2025. KEDNY incurred $3.7 million in call premiums and financing fees, all of which have been deferred for future rate recovery.

In December 2005, KEDNY converted $50 million of fixed rate GFRBs (5.64 per cent. GFRB Series D1 and D2 due 2026) into variable rate debt. The interest rate on these bonds is reset, through an auction process, every seven days. At 31 December 2005 the interest rate was 3.00 per cent.

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 31 December 2005, $155.4 million of these promissory notes remained outstanding. 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 recognised statistical rating agencies. At 31 December 2005, KeySpan was in compliance with this requirement.

MEDS Equity Units: At 31 December 2004, KeySpan had $460 million of MEDS Equity Units outstanding at 8.75 per cent. consisting of a three-year forward purchase contract for our common stock and a six-year note. The purchase contract required us, three years from the date of issuance of the MEDS Equity Units, 16 May 2005, to issue and the investors to purchase, a number of shares of our common stock based on a formula tied to the market price of our common stock at that time. The 8.75 per cent. coupon was composed of interest payments on the six-year note of 4.9 per cent. and premium payments on the three-year equity forward contract of 3.85 per cent.

In 2005, KeySpan was required to remarket the note component of the Equity Units between February 2005 and May 2005 and reset the interest rate to the then current market rate of interest; however, the reset interest rate could not be set below 4.9 per cent. In March 2005, KeySpan remarketed the note component of $394.9 million of the Equity Units at the reset interest rate of 4.9 per cent. through their maturity date of May 2008. The balance of the notes ($65.1 million) were held by the original MEDS equity holders in accordance with their terms and not remarketed. KeySpan then exchanged $300 million of the remarketed notes for $307.2 million of new 30 year notes bearing an interest rate of 5.8 per cent. Therefore, KeySpan now has $160 million of 4.9 per cent. notes outstanding with a maturity date of May 2008 and $307.2 million of 5.8 per cent. notes outstanding with a maturity date of April 2035 that are classified as medium and long term notes.

On 16 May 2005 KeySpan issued 12.1 million shares of common stock, at an issuance price of $37.93 per share, pursuant to the terms of the financial purchase contract described above. KeySpan received proceeds of approximately $460 million from the equity conversion. The number of shares issued was dependent on the average closing price of our common stock over the 20 day trading period ending on the third trading day prior to 16 May 2005.

Industrial Development Revenue Bonds: At 31 December 2005 KeySpan had outstanding $128.3 million of tax-exempt bonds with a 5.25 per cent. coupon maturing in June 2027. Fifty-three 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 (''Colonial''), Essex Gas Company (''Essex''), ENI and their respective subsidiaries, had outstanding $153.2 million of first mortgage bonds at 31 December 2003. These bonds are secured by KEDNE 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.

During 2004, KeySpan redeemed $58.2 million of these bonds, representing all previously outstanding bonds of Essex and ENI. KeySpan incurred call premiums of $13.6 million associated with this redemption, of which $5.0 million was expensed. The remaining amount of the call premiums have been deferred for future regulatory recovery. Further, KeySpan wrote-off $0.2 million of previously deferred financing costs. The call premiums are reflected in other income and (deductions) while the write-off of previously deferred financing costs have been reflected in interest expense on the Consolidated Statement of Income for the twelve months ended December 31, 2004. At December 31, 2005, $95.0 million of these bonds remain outstanding and have interest rates ranging from 6.08 per cent. to 8.80 per cent. and maturities that range from 2008-2028.

Authority Financing Notes: Certain of our electric generation subsidiaries can issue tax-exempt bonds through the NYSERDA. At 31 December 2005, $41.1 million of Authority Financing Notes 1999 Series A Pollution Control Revenue Bonds due 1 October 2028 were outstanding. The interest rate on these notes is reset based on an auction procedure. The interest rate during 2005 ranged from 1.40 per cent. to 2.85 per cent., through 31 December 2005, at which time the rate was 3.00 per cent.

We also have outstanding $24.9 million variable rate 1997 Series A Electric Facilities Revenue Bonds due 1 December 2027. The interest rate on these bonds is reset weekly and ranged from 1.47 per cent. to 3.42 per cent. for the year ended 31 December 2005, at which time the rate was 3.42 per cent.

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 18 June 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, or 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 per cent. of capitalisation) and equity of $12.7 million (3 per cent. of capitalisation). 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.

We have classified the Master Lease as $412.3 million of long-term debt 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.'' Further, we have an asset on the Consolidated Balance Sheet for an amount substantially equal to the fair market value of the leased assets at the inception of the lease, less depreciation since that date, or approximately $322.8 million. Under the terms of our credit facilities, the Master Lease is considered debt in the ratio of debt-to-total capitalisation. (See Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies'' for additional information regarding the leasing arrangement associated with the Master Lease Agreement.)

Commercial Paper and Revolving Credit Agreements: In June 2005, KeySpan closed on a $920 million revolving credit facility for five years due 24 June 2010, which was syndicated among 15 banks, and an amended $580 million revolving credit facility due 24 June 2009. These facilities replaced an existing $660 million, three-year facility due June 2006, and a five-year $640 million facility due June 2009. The two credit facilities, which now total $1.5 billion—$920 million for five years through 2010, and $580 million for the amended facility through 2009, will 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 0.07 per cent. based on our credit rating of A3 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 per cent., or the Federal Funds Effective Rate plus 0.5 per cent. 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 capitalisation ratio of no more than 65 per cent. 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 31 December 2005, KeySpan's consolidated indebtedness was 50.7 per cent. of its consolidated capitalisation 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 per cent. 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 31 December 2005, we had cash and temporary cash investments of $124.5 million. During 2005, we repaid $254.6 million of commercial paper and, at 31 December 2005, $657.6 million of commercial paper was outstanding at a weighted average annualised interest rate of 4.38 per cent. At 31 December 2005, KeySpan had the ability to issue up to an additional $842 million, 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 6.0 per cent.

Debt Maturity: The following table reflects the maturity schedule for our debt repayment requirements, including capitalized leases and related maturities, at 31 December 2005:

	Long-Term Debt	Capital Leases	Total
	(In Millions of Dollars)		
Repayments:			
2006	$ 12.0	$ 1.0	$ 13.0
2007	—	1.1	1.1
2008	305.0	1.1	306.1
2009	412.3	1.2	413.5
2010	1,110.0	1.3	1,111.3
Thereafter	2,095.4	5.1	2,100.5
	$ 3,934.7	$ 10.8	$ 3,945.5

Note 7. Contractual Obligations, Financial Guarantees and Contingencies

Lease Obligations: Lease costs included in operating expense were $76.5 million in 2005 including, the lease of KeySpan's Brooklyn headquarters of $14.1million. Further, in March 2005, KeySpan renegotiated the lease of the Brooklyn headquarters. The original agreement was to expire in 2012. The current lease will expire in 2025. Yearly lease expense is approximately $11.7 million. In May 2004 KeySpan entered into a leveraged lease financing arrangement associated with the Ravenswood Expansion. The yearly operating lease expense is approximately $17 million per year. (See the caption below ''Sale/Leaseback Transaction'' for further details of this lease.) Lease costs also include leases for other buildings, office equipment, vehicles and power operated equipment. Lease costs for the year ended 31 December 2004 and 2003 were $67.7 million and $82.1 million, respectively. As previously mentioned, the Master Lease is consolidated and, as a result, lease payments are reflected as 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 $100.6 million per year over the next five years and $652.4 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: As mentioned, KeySpan has an arrangement with an unaffiliated variable interest financing entity through which we lease 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 18 June 1999 for approximately $597 million. In order to reduce the initial cash requirements, we entered into the Master Lease with the variable interest entity that acquired a portion of the facility, or three steam generating units, directly from Consolidated Edison and leased it to our subsidiary. The variable interest entity acquired the property for $425 million, financed with debt of $412.3 million (97 per cent. of capitalisation) and equity of $12.7 million (3 per cent. of capitalisation). 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 substantially equal the monthly interest expense on such debt securities. Interest expense for the year ended 31 December 2005 was $29.7 million.

The term of the Master Lease extends through 20 June 2009. On all future semi-annual payment dates, we have the right to: (i) purchase the facility for the original acquisition cost of $425 million, plus the present value of the lease payments that would otherwise have been paid through June 2009; or (ii) terminate the Master Lease and dispose of the facility. In June 2009, when the Master Lease terminates, we may purchase the facility in an amount equal to the original acquisition cost, subject to adjustment, or surrender the facility to the lessor. If we elect not to purchase the property, the Ravenswood Facility will be sold by the lessor. We have guaranteed to the lessor 84 per cent. of the residual value of the original cost of the property.

We have classified the Master Lease as $412.3 million of long-term debt on the Consolidated Balance Sheet based on our current status as primary beneficiary. Further, we have an asset on the Consolidated Balance Sheet for an amount substantially equal to the fair market value of the leased assets at the inception of the lease, less depreciation since that date, or approximately $322.8 million.

If our subsidiary that leases the Ravenswood Facility was not able to fulfil its payment obligations with respect to the Master Lease payments, then the maximum amount KeySpan would be exposed to under its current guarantees would be $425 million plus the present value of the remaining lease payments through 20 June 2009.

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 generated cash proceeds of $385 million, before transaction costs, which approximates the fair market value of the facility, as determined by a third-party appraiser. 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''. The lease has an initial term of 36 years and the yearly operating lease expense is approximately $17 million per year. Lease payments will fluctuate from year to year, but are substantially paid over the first 16 years. The future minimum cash lease payments under this lease is approximately $152 million over the next five years and $417 million, in the aggregate, for all years thereafter. The sale/leaseback transaction resulted in a pre-tax gain of approximately $6 million which has been deferred and is being amortised over the life of the lease.

Asset Retirement Obligations: On 31 December 2005, KeySpan implemented FIN 47 ''Accounting for Conditional Asset Retirement Obligations''. FIN 47 was issued to clarify that the term conditional asset obligation used in SFAS 143 ''Accounting for Asset Retirement Obligations'' refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Previously, KeySpan adopted SFAS 143 on 1 January 2003. SFAS 143 required us to record a liability and corresponding asset representing the present value of legal obligations associated with the retirement of tangible, long-lived assets that existed at the inception of the obligation.

At 31 December 2005 the following asset retirement obligations were recorded on the Consolidated Balance Sheet at their estimated present values:

		December 31,		
		2005	2004	2003
		(In Millions of Dollars)		
Asset Retirement Obligations				
Asbestos removal	(i)	$ 3.5	$ —	$ —
Tanks removal and cleaning	(ii)	6.9	—	—
Main—cutting, purging and capping	(iii)	30.6	—	—
Wells—plug and capping	(iv)	0.2	—	—
KeySpan LNG tank demolition	(v)	2.1	—	—
Waste water treatment pond removal	(vi)	1.4	—	—
Fiber network removal	(vii)	0.8	—	—
Exploration wells-plug and capping	(viii)	1.9	1.9	—
Total Asset Retirement Obligations		$ 47.4	$ 1.9	$ —

(i) Asbestos-containing materials was deemed to 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 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 per cent. 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 barrel Liquefied Natural Gas (''LNG'') tank and ancillary facilities located in Providence, RI under a 30 year contract with New England Gas Company. 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 per cent. probability as allowed 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 11 May 2003.

(vii) KeySpan Communications has portions of its fibre optic network (underground and above ground) that are required to be removed upon termination of various agreements.

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

Financial Guarantees: KeySpan has issued financial guarantees in the normal course of business, primarily on behalf of its subsidiaries, to various third party creditors. At 31 December 2005, 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:

		Amount of Exposure	Expiration Dates
		(In Millions of Dollars)	
Guarantees for Subsidiaries			
Medium-Term Notes—KEDLI	(i)	$ 525.0	2008 - 2010
Industrial Development Revenue Bonds	(ii)	128.3	2027
Ravenswood—Master Lease	(iii)	425.0	2009
Ravenswood—Sale/leaseback	(iv)	403.5	2019
Surety Bonds	(v)	76.0	2005 - 2008
Commodity Guarantees and Other	(vi)	83.2	2005 - 2009
Letters of Credit	(vii)	73.0	2006 - 2010
		$ 1,714.0	

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

(i) KeySpan has fully and unconditionally guaranteed $525 million to holders of Medium-Term Notes issued by KEDLI. These notes are due to be repaid on 15 January 2008 and 1 February 2010. KEDLI is required to comply with certain financial covenants under the debt agreements. The face values of these notes are included in long-term debt on the Consolidated Balance Sheet.

(ii) KeySpan has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to $128 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 values 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 extends through 20 June 2009. The Master Lease is classified as $412.3 million long-term debt on the Consolidated Balance Sheet.

(iv) KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, the lessee under the sale/leaseback transaction associated with the 250 MW 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.

(v) KeySpan has agreed to indemnify the issuers of various surety and performance bonds associated with certain construction projects being performed by certain current or 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 31 December 2005, the total cost to complete such remaining bonded projects is estimated to be approximately $40.2 million.

(vi) KeySpan has guaranteed commodity-related payments for subsidiaries within the Energy Services segment, as well as for KeySpan Ravenswood, LLC. 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 31 December 2005.

(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.

Fixed Charges Under Firm Contracts: Our utility subsidiaries and the Ravenswood Generating Station 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 $492.7 million. We are liable for these payments regardless of the level of service we require from third parties. Such charges associated with gas distribution operations are currently recovered from utility customers through the gas adjustment clause.

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.

KeySpan and certain of its current and former officers and directors were named as defendants in a shareholder derivative action asserting claims on behalf of KeySpan based upon breach of fiduciary duty. The complaint, which was filed in the New York State Supreme Court for the County of Kings on 9 February 2005, also relates to the 2001 Roy Kay-related losses and alleges that KeySpan's directors and certain senior officers breached their fiduciary duties when they placed their own personal interests above the interests of KeySpan by using material non-public information (the fraud at Roy Kay) to sell securities at artificially inflated prices. On 3 January 2006, the parties entered into a settlement agreement to settle the action for a nominal sum of $250,000 for plaintiff's counsel fees and for KeySpan to implement certain corporate governance practices. The settlement agreement is subject to court approval, the timing of which cannot be predicted. While KeySpan denies any wrongdoing, we believe the settlement is in the best interest of KeySpan and its shareholders.

KeySpan subsidiaries, along with several other parties, have been named as defendants in numerous proceedings filed by plaintiffs claiming various degrees of injury from asbestos exposure at generating facilities formerly owned by LILCO and others. In connection with the May 1998 transaction with LIPA, costs incurred by KeySpan for liabilities for asbestos exposure arising from the activities of the generating facilities previously owned by LILCO are recoverable from LIPA through the PSA between LIPA and KeySpan.

KeySpan is unable to determine the outcome of the outstanding asbestos proceedings, but does not believe that such outcome, if adverse, will have a material effect on its financial condition, results of operation or cash flows. KeySpan believes that its cost recovery rights under the 1998 and 2006 PSA, its indemnification rights against third parties and its insurance coverage (above applicable deductible limits) cover its exposure for asbestos liabilities generally.

Other Contingencies: We derive a substantial portion of our revenues in our Electric Services segment from a series of agreements with LIPA pursuant to which we manage LIPA's transmission and distribution system and supply the majority of LIPA's customers' electricity needs. KeySpan and LIPA have entered into agreements to extend, amend, and restate these contractual arrangements. See Note 11 ''2006 LIPA Settlement'' for a further discussion of these agreements.

LIPA completed its strategic review initiative that it had undertaken in connection with among other reasons, its option under the Generation Purchase Rights Agreement. As part of its review, LIPA engaged a team of advisors and consultants, held public hearings and explored its strategic options, including continuing its existing operations, municipalising, privatizing, selling some, but not all of its assets, becoming a regulator of rates and services, or merging with one or more utilities. Upon completion of its strategic review, LIPA determined that it would continue its existing operations, as part

of its settlement with KeySpan and the renegotiated 2006 LIPA Agreements noted above. The 2006 LIPA Agreements are subject to governmental approvals, and if such governmental approvals are not received then LIPA may revisit its strategic review alternatives.

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 Phase I, II and III NOx reduction requirements established under the Ozone Transport Commission memorandum of understanding and forthcoming requirements under the Clean Air Interstate Rule (''CAIR'') designed to address both ozone and particulate matter. 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 the emission reductions required. KeySpan is developing its compliance strategy in response to the implementation of the CAIR rule, which is expected in 2009. Since detailed requirements under the CAIR rule have not yet been fully articulated, it is not possible to definitively estimate capital expenditures that may be required to meet these regulatory mandates. Although, it is anticipated that NOx control equipment may be required at one or more of the KeySpan's Long Island facilities at a cost between $25 to $35 million, such amounts are recoverable from LIPA pursuant to the 1998 PSA or if applicable, the 2006 PSA.

Water: Additional capital expenditures associated with the renewal of the surface water discharge permits for our power plants will likely be required by the Department of Environmental Conservation (''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 satisfy these evolving regulatory requirements. It is not possible at this time to predict the extent of such capital investments but these upgrades are expected to cost up to $60 million, however, such amounts are recoverable from LIPA pursuant to the 1998 PSA or if applicable, the 2006 PSA. The Ravenswood Generating Station may also require upgrades at a cost of up to $15 million. 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: During 2005, KeySpan undertook an extensive review of all its current and former properties that are or may be subject to environmental cleanup activities. As a result of this study, we adjusted reserve balances for estimated manufactured gas plant (''MGP'') related environmental cleanup activities. Through various rate orders issued by the NYPSC, MADTE and NHPUC, costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers and, as a result, adjustments to these reserve balances do not impact earnings.

New York Sites: Within the State of New York we have identified 43 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 us, have been identified to the NYPSC and the DEC for inclusion on appropriate site inventories. Administrative Orders on Consent (''ACO'') or Voluntary Cleanup Agreements (''VCA'') have been executed with the DEC to address the investigation and remediation activities associated with certain sites and one waterway. In March 2005, KeySpan withdrew its previously filed applications under the DEC's Brownfield Cleanup Program (''BCP'') because of the uncertainty associated with contribution suits which we may need to bring against other parties who impacted these sites for their share of remedial cost. As a result of the December 2004 Cooper Industries v. Aviall Services, Inc. decision by the United States Supreme Court and the emerging case law in New York, KeySpan continues to evaluate how to proceed with respect to participation in the BCP or alternative DEC remediation programs.

We have identified 28 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 27 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 $60.9 million.

The remaining 15 sites have been identified as being associated with the historical operations of KEDLI. Expenditures incurred to date by us with respect to KEDLI MGP-related activities total $51.8 million. One

site has been fully investigated and requires no further action. The remaining sites will be investigated and, if necessary, remediated under the conditions of ACOs, VCAs or BCAs.

We presently estimate the remaining cost of our KEDNY and KEDLI MGP-related environmental remediation activities will be $355.3 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 to date by us with respect to these MGP-related activities total $112.7 million.

With respect to remediation costs, the KEDNY rate plan provides, among other things, that if the total cost of investigation and remediation varies from that which is specifically estimated for a site under investigation and/or remediation, then KEDNY will retain or absorb up to 10 per cent. of the variation. The KEDLI rate plan also provides for the recovery of investigation and remediation costs but with no consideration of the difference between estimated and actual costs. At 31 December 2005, we have reflected a regulatory asset of $388.0 million for our KEDNY/KEDLI MGP sites. In October 2003, KEDNY and KEDLI filed a joint petition with the NYPSC seeking rate treatment for additional environmental costs that may be incurred in the future. That petition is still pending.

We are 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. We are 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 $1.7 million, which amount has been accrued by us. Expenditures incurred to date total $3.3 million.

New England Sites: Within the Commonwealth of Massachusetts and the State of New Hampshire, we are aware of 74 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 64 of these sites. A subsidiary of National Grid USA (''National Grid''), 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 three sites each. 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.

We presently estimate the remaining cost of these Massachusetts KEDNE MGP-related environmental cleanup activities will be $15.5 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 8 November 2000, the date KeySpan acquired Eastern Enterprises, with respect to these MGP-related activities total $27.9 million.

In 2004, Boston Gas Company reached settlements with certain insurance carriers for recovery of a portion of previously incurred environmental expenditures. Under a previously issued MADTE rate order, insurance and third-party recoveries, after deducting legal fees, are shared between Boston Gas and its firm gas customers. As a result of these settlements, in 2004 Boston Gas Company recorded a $5.0 million benefit to operations and maintenance expense.

We 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. At four of these sites we have entered into cost sharing agreements with other parties who share responsibility for remediation of these sites. EnergyNorth also has entered into an agreement with the United States Environmental Protection Agency (''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.

We presently estimate the remaining cost of EnergyNorth MGP-related environmental cleanup activities will be $31.5 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 8 November 2000, with respect to these MGP-related activities total $17.0 million.

By rate orders, the MADTE and the NHPUC provide for the recovery of site investigation and remediation costs and, accordingly, at 31 December 2005, we have reflected a regulatory asset of $66.7 million for the KEDNE MGP sites. As previously mentioned, Colonial Gas Company and Essex Gas Company are not subject to the provisions of SFAS 71 and therefore have recorded no regulatory asset. However, rate orders currently in effect for these subsidiaries provide for the recovery of investigation and remediation costs.

KeySpan New England LLC Sites: We are aware of three non-utility sites associated with KeySpan New England, LLC, a successor company to Eastern Enterprises, for which we 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, 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 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 has been executed on favourable terms to KeySpan and the Beazer lawsuit has been discontinued.

In 2004, KeySpan reached a settlement with insurance carriers regarding cost recovery for expenses at one of the above noted sites and recorded an $11.6 million reduction to operating expenses. We presently estimate the remaining cost of our environmental cleanup activities for the three non-utility sites will be approximately $19.7 million, which amount has been accrued by us 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 8 November 2000, with respect to these sites total $13.1 million.

We believe 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. And 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. On 14 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 on 6 December 2005, the jury returned a verdict in favour 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. On 5 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 on 25 October 2004, the jury returned a verdict in favour of EnergyNorth, finding that EnergyNorth was entitled to recover against London Market Insurers. The precise amount of the recovery will depend on the allocation calculations which the court has yet to apply to this case. We anticipate that London Market Issuers will appeal this verdict. On 15 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 favour on all issues. Century filed an appeal with the First Circuit Court of Appeals and oral argument on Century's appeal was on 13 January 2006. A jury trial in the Nashua MGP action commenced against the London Market Insurers and Century Indemnity on 1 November 2005 and on 14 November 2005, the jury returned a verdict in favour of KeySpan finding that London and Century was obligated to indemnify EnergyNorth for response costs incurred at the site. We anticipate that the carriers will appeal this verdict. The outcome of these proceedings 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 Eastern Action''). Eastern sought to have the court compel the Insurers to defend Eastern in connection with the Massachusetts DEP's Notice of Responsibility (''NOR''). In 2004, the Court granted KeySpan's unopposed motion for leave to file a Second Amended Complaint in the Eastern Action to seek a declaratory ruling that the insurers have a duty to indemnify KeySpan 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 Eastern Action. The outcome of this proceeding cannot yet be determined.

Note 8. Hedging, Derivative Financial Instruments and Fair Values

Financially-Settled Commodity Derivative Instruments—Hedging Activities: From time to time, KeySpan subsidiaries have utilised 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, gas exploration and production activities and its electric generating facilities at the Ravenswood site.

Derivative financial instruments are employed by our gas distribution operations to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases for our regulated firm gas sales customers. The accounting for these derivative instruments is subject to SFAS 71. See the caption below ''Firm Gas Sales Derivative Instruments—Regulated Utilities'' for a further discussion of these derivatives. During 2005 our gas distribution operations employed certain derivative instruments associated with large-volume customers that were not subject to SFAS 71. Those derivative financial instruments settled by year-end.

Seneca-Upshur utilises OTC natural gas swaps to hedge the cash flow variability associated with forecasted sales of a portion of its natural gas production. At 31 December 2005, Seneca-Upshur has hedge positions in place for approximately 85 per cent. of its estimated 2005 through 2008 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 2008. The fair value of these derivative instruments at 31 December 2005 was a liability of $21.8 million. The estimated amount of losses associated with such derivative instruments that are reported in other comprehensive income and that are expected to be reclassified into earnings over

the next twelve months is $9.2 million, or approximately $6.0 million after-tax. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial at 31 December 2005.

The Ravenswood Generating Station uses derivative financial instruments to hedge the cash flow variability associated with the purchase of natural gas or fuel oil that will be consumed during the generation of electricity. The Ravenswood Generating Station also hedges the cash flow variability associated with a portion of electric energy sales.

With respect to price exposure associated with fuel purchases for the Ravenswood Generating Station, KeySpan employed the use of financially-settled oil swap contracts to hedge the cash flow variability for a portion of forecasted purchases of fuel oil that was consumed by the Ravenswood Generating Station. We use market quoted forward prices to value oil swap contracts. The maximum length of time over which we have hedged cash flow variability associated with forecasted purchases of fuel oil is through June 2006. The fair value of these derivative instruments at 31 December 2005 was $0.3 million, which is reported in other comprehensive income and is expected to be reclassified into earnings within the next twelve months. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial at 31 December 2005.

We have also engaged in the use of cash-settled swap instruments to hedge the cash flow variability associated with a portion of forecasted electric energy sales from the Ravenswood Generating Station. Our hedging strategy is to hedge at least 50 per cent. of forecasted on-peak summer season electric energy sales and a portion of forecasted electric energy sales for the remainder of the year. The maximum length of time over which we have hedged cash flow variability is through August 2006. To accomplish our stated hedging strategy, KeySpan employs financially-settled electric-power swap contracts with offsetting financially-settled oil swap contracts and OTC natural gas swaps. We use market quoted forward prices to value the electric-power swap contracts. The fair value of these derivative instruments at 31 December 2005 was $9.5 million all of which is expected to be reclassified into earnings within the next twelve months. We use market quoted forward prices to value the oil swap contracts. The fair value of these derivative instruments at 31 December 2005 was a liability of $6.6 million all of which is expected to be reclassified into earnings within the next twelve months. We use market quoted forward prices to value the gas swap contracts. The fair value of these derivative instruments at 31 December 2005 was $0.5 million all of which is expected to be reclassified into earnings within the next twelve months. The after-tax benefit of these derivative instruments is anticipated to be $2.2 million. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial at 31 December 2005.

The above noted derivative financial instruments are cash flow hedges that qualify for hedge accounting 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, and are not considered held for trading purposes as defined by current accounting literature. Accordingly, we carry the fair value of our derivative instruments on the Consolidated Balance Sheet as either a current or deferred asset or liability, as appropriate, and defer the effective portion of unrealised 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 are reflected as a component of either revenue or fuel and purchased power depending on the hedged transaction. Hedge ineffectiveness, which was negligible for the year ended 31 December 2005, 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.

Firm Gas Sales 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 minimise 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, changes in the fair value of these derivatives have been recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. At 31 December 2005, these derivatives had a fair value of $157.6 million and are reflected as a current asset of $131.6 million and a deferred asset of $26.0 million, with offsetting

positions in regulatory liabilities and deferred credits of $146.5 million and $11.1 million, respectively on the Consolidated Balance Sheet.

Physically-Settled Commodity Derivative Instruments: 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 be exempted as normal purchases and sales. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities are not exempt as normal purchases from the requirements of 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. Therefore, changes in the market value of these contracts have been recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet. At 31 December 2005, these derivatives had a fair value of $18.4 million and are reflected as a deferred asset of $49.2 million and a regulatory asset of $30.9 million with offsetting positions in regulatory liabilities, current liabilities, and deferred credits of $28.9 million, 30.6 million and $20.6 million, respectively on the Consolidated Balance Sheet.

The table below summarizes the fair value of the above outstanding derivative instruments at 31 December 2005 and 31 December 2004, and the related line item on the Consolidated Balance Sheet. Fair value is the amount at which derivative instruments could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale.

	December 31, 2005	December 31, 2004
	(In Millions of Dollars)	
Gas Contracts:		
Other current assets	$ 132.1	$ —
Other deferred charges	75.2	21.7
Regulatory asset	30.9	20.1
Other current liability	(39.8)	—
Other deferred liabilities	(44.3)	(43.9)
Regulatory liability	(175.4)	(7.4)
Oil Contracts:		
Other current assets	0.5	0.3
Other deferred charges	—	7.5
Other current liability	(6.8)	—
Electric Contracts:		
Other current assets	10.2	0.3
Other current liability	(0.7)	—
	$ (18.1)	$ (1.4)

At 31 December, 2003, KeySpan's derivative positions were recorded in the following asset line items: $3.4 million in other current assets; $15.6 million in deferred assets; and $6.9 million in regulatory assets. KeySpan also had the following offsetting liability positions: $35.6 million in accounts payable and other liabilities; $11.6 million in deferred liabilities; and $14.9 million in regulatory liabilities. A significant portion of these derivative positions reflect the activity of Houston Exploration, which was subsequently sold. All other derivative positions were settled prior to 31 December, 2005.

Financially-Settled Commodity Derivative Instruments that Do Not Qualify for Hedge Accounting: KeySpan subsidiaries also have employed a limited number of financial derivatives that do not qualify for hedge accounting treatment under SFAS 133. During 2004, we purchased a series of call options on the spread between the price of heating oil and the price of natural gas to further complement our hedging strategy regarding sales to certain large-volume customers. As stated, these positions settled prior to year end. In addition, the Ravenswood Generating Station sold a three year option for 30-day peaking gas service. The 30-day peaking gas service is for the following three winter seasons: October 2004 - March 2005, October 2005 - March 2006 and October 2006 - March 2007. For each of these winter seasons, the counterparty can call on the Ravenswood Generating Station to supply no more than 30,000 Mdth of a gas a day for no more than 30 days. We recorded a $0.8 million gain in other income and deductions on the Consolidated Statement of Income to reflect the change in the market value associated with this derivative instrument for the twelve months ended 31 December 2005.

Interest Rate Derivative Instruments: In January 2005, KeySpan redeemed $500 million of outstanding debt—6.15 per cent. Notes due 2006, and accelerated the amortization of approximately $11.2 million of previously unamortized benefits associated with an interest rate swap on these notes that was previously settled. The accelerated amortization was recorded as a reduction to interest expense. (See Note 6 ''Long-term Debt and Commercial Paper'' for additional details regarding the debt redemption.) There were no interest rate derivative instruments outstanding at 31 December 2005.

In 2003, we entered into interest rate swap agreements in which we swapped $250 million of 7.25% fixed rate debt to floating rate debt. Under the terms of the agreements, we received the fixed coupon rate associated with these bonds and paid our swap counterparties a variable interest rate based on LIBOR, that was reset on a semi-annual basis. These swaps were designated as fair-value hedges and qualified for ''short-cut'' hedge accounting treatment under SFAS 133. In the first quarter of 2004, we paid our counterparty an average interest rate of 6.44%, and as a result, we realized interest savings of $0.5 million.

On April 7, 2004 we terminated these swap agreements and received $1.2 million from our swap counterparties, of which $0.7 million represented accrued swap interest. The difference between the termination settlement amount and the amount of accrued interest, $0.5 million, was being recorded as a reduction to interest expense over the remaining life of the bonds. In August 2004, we redeemed these bonds and recorded the remaining benefit.

KeySpan had a leveraged lease financing arrangement associated with the Ravenswood Expansion. In May 2004, the facility was acquired by a lessor from our subsidiary, KeySpan Ravenswood, LLC, and simultaneously leased back to that subsidiary. In connection with this sale/leaseback transaction, KeySpan utilized a $275 million treasury lock (at 4.2 per cent.) to hedge the 10-year US Treasury component of the underlying notes issued by the lessor to purchase the facility. The treasury lock was in effect for a five-week period during which time the 10-year US Treasury increased 70 basis points. KeySpan did not designate this derivative instrument as a hedge for accounting purposes. The treasury lock settled in May 2004 and KeySpan received cash proceeds of $12.6 million which was recorded in other income and (deductions) in the Consolidated Statement of Income. (See Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies'' for additional information regarding the sale/ leaseback transaction).

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.

In 2005, 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 2005/2006 winter heating season—November 2005 through March 2006. These put options will pay KeySpan up to $40,000 per heating degree day when the actual temperature is below 4,169 heating degree days, or approximately 5 per cent. warmer than normal, based on the most recent 20-year average for normal weather. The maximum amount KeySpan will receive on these purchased put options is $16 million. The net premium cost for these options is $1.2 million and will be amortized over the heating season. Since weather was near normal during the fourth quarter of 2005, there was no earnings impact associated with these derivative instruments other than the premium cost for purchasing the options. 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.

In 2004, 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 2004/2005 winter heating season—November 2004 through March 2005. These put options would have paid KeySpan up to $40,000 per heating degree day when the actual temperature was below 4,130 heating degree days, or approximately 5 per cent. warmer than normal, 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 $1.6 million and was amortized over the heating season. Since weather was colder than normal during the first quarter of 2005, there was no earnings impact associated with these derivative instruments other than the premium cost for purchasing the options.

In 2003, we entered into heating-degree day call and put options to mitigate the effect of fluctuations from normal weather on KEDNE's financial position and cash flows for the 2003/2004 winter heating

season—November 2003 through March 2004. With respect to sold call options, KeySpan was required to make a payment of $27,500 per heating degree day to its counterparties when actual weather experienced during this time frame was above 4,440 heating degree days, which equates to approximately 2% colder than normal weather, based on the then most recent 20-year average for normal weather. The maximum amount KeySpan was required to pay on its sold call options was $5.5 million. With respect to purchased put options, KeySpan was to receive a $27,500 per heating degree day payment from its counterparties when actual weather was below 4,266 heating degree days, or approximately 2% warmer than normal. The maximum amount KeySpan was to receive on its purchased put options was $11 million. The net premium cost for these options was $0.4 million. During the first quarter of 2004, weather, as measured in heating degree-days, was 9.4% colder than normal and, as a result $4.1 million was recorded as a reduction to revenues.

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 31 December 2005, KeySpan has received $13.2 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. Further, KeySpan has paid $8.9 million in margin calls to its counterparties. This amount has been recorded as an accounts receivable on the 31 December 2005 Consolidated Balance Sheet.

We believe that our credit risk related to the above mentioned derivative financial instruments is no greater than the risk associated with the primary contracts which they hedge and that the elimination of a portion of the price risk reduces volatility in our reported results of operations, financial position and cash flows and lowers overall business risk.

Long-term Debt: The following tables depict the fair values and carrying values of KeySpan's long-term debt at 31 December 2005, 2004 and 2003.

Fair Values of Long-Term Debt

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
First Mortgage Bonds	$ 114.1	$ 115.8	$ 178.4
Notes	2,692.1	2,571.8	3,893.2
Gas Facilities Revenue Bonds	651.3	666.9	683.3
Authority Financing Notes	66.0	66.0	66.0
Promissory Notes	156.6	159.8	158.8
MEDS Equity Units	—	480.0	495.9
Master Lease	430.5	460.9	474.9
Tax Exempt Bonds	130.8	135.0	129.6
	$ 4,241.4	$ 4,656.2	$ 6,080.1

Carrying Values of Long-Term Debt

	December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
First Mortgage Bonds	$ 95.0	$ 95.0	$ 153.2
Notes	2,437.2	2,485.0	3,456.4
Gas Facilities Revenue Bonds	640.5	640.5	648.5
Authority Financing Notes	66.0	66.0	66.0
Promissory Notes	155.4	155.4	155.4
MEDS Equity Units	—	460.0	460.0
Master Lease	412.3	412.3	412.3
Tax Exempt Bonds	128.3	128.3	128.3
	$ 3,934.7	$ 4,442.5	$ 5,480.1

Our subsidiary debt was carried at an amount approximating fair value because interest rates are based on current market rates. All other financial instruments included in the Consolidated Balance Sheet such as cash, commercial paper, accounts receivable and accounts payable, are also stated at amounts that approximate fair value.

Note 9. Gas Exploration and Production Property—Depletion

As described in Note 2 ''Business Segments,'' during much of 2003 and 2004 KeySpan's investment in gas exploration and production activities consisted of its ownership interest in Houston Exploration, as well as KeySpan's wholly-owned subsidiary KeySpan Exploration and Production, which is still engaged in a joint drilling program with Houston Exploration. Further, KeySpan's investment in these activities also includes its wholly-owned subsidiary Seneca-Upshur. These assets are accounted for under the full cost method of accounting. Under the full cost method, costs of acquisition, exploration 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 as to the existence of proved reserves. Properties are depleted and charged to operations using the unit of production method.

To the extent that such capitalized costs (net of accumulated depletion) less deferred taxes exceed the present value (using a 10 per cent. 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 prices increase. The ceiling test is calculated using natural gas and oil prices in effect as of the balance sheet date, adjusted for outstanding derivative instruments, held flat over the life of the reserves.

As a result of the June 2004 stock transaction discussed in Note 2 ''Business Segments'', KeySpan accounted for its investment in Houston Exploration on the equity method from June 2004 through 19 November 2004. Therefore, we were required to calculate a ceiling test on KeySpan Exploration and Production's and Seneca-Upshur's assets independently of Houston Exploration's assets in the second quarter of 2004. Based on a report furnished by an independent reservoir engineer at that time, it was determined that the remaining proved undeveloped oil reserves held in the joint venture required a substantial investment in order to develop. Therefore, KeySpan and Houston Exploration elected not to develop these oil reserves. As a result, in the second quarter of 2004, KeySpan recorded a $48.2 million non-cash impairment charge to write down its wholly-owned gas exploration and production subsidiaries' assets. This charge was recorded in depreciation, depletion and amortization on the Consolidated Statement of Income.

Note 10. Energy Services—Discontinued Operations

In 2004, the Energy Services segment experienced significantly lower operating profits and cash flows than originally projected. At a meeting held on 2 November 2004, KeySpan's Board of Directors authorized management to begin the process of disposing of a significant portion of its ownership interests in certain companies within the Energy Services segment—specifically those companies engaged in mechanical contracting activities. In January and February of 2005, KeySpan sold its mechanical contracting investments. The operating results and financial position of these companies, are reflected as discontinued operations on the Consolidated Statement of Income, Consolidated Balance Sheet and Consolidated Statement of Cash Flows.

In regard to the January 2005 transactions, KeySpan received proceeds of approximately $16 million, including approximately $5 million to be paid within a three year period. In addition, KeySpan retained its previously incurred indemnity support obligations related to certain surety, performance and payment bonds issued for the benefit of KeySpan's former subsidiaries prior to closing. In June 2005, the balance to be paid over the three year period was fully collected on a present value basis and a significant portion of the performance bonds were replaced without any remaining indemnification obligation on the part of KeySpan. The current estimated cost to complete projects supported by such indemnity obligations is approximately $0.2 million. The buyers have agreed to complete the projects for which such indemnity obligations were incurred and to indemnify and hold KeySpan harmless with respect to its liabilities in connection with such bonds.

In connection with the February 2005 transaction, KeySpan paid or contributed approximately $26 million to its former subsidiary prior to closing the sale transaction in exchange for, among other

things, the disposition of outstanding shares in the former subsidiary and the settlement of intercompany advances and replacement of a performance and payment bond issued for the benefit of its former subsidiary with respect to a pending project, which bond had been supported by a $150 million indemnity obligation of KeySpan. In addition, KeySpan received from its 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 the remaining bonded projects of its former subsidiary as of the closing. As of 31 December 2005, the total cost to complete such remaining bonded projects is estimated to be approximately $40 million. The aforementioned guarantees are reflected in Note 7 ''Contractual Obligations, Financial Guarantees and Contingencies''. KeySpan's former subsidiary has also agreed to complete the projects for which such indemnity obligations were incurred and to indemnify and hold KeySpan harmless with respect to its liabilities in connection with such bonds.

In anticipation of these sales and in connection with the preparation of the third quarter and fourth quarter 2004 financial statements, KeySpan conducted an evaluation of the carrying value of these investments, including recorded goodwill. Further, we evaluated the carrying value of goodwill for the entire Energy Services segment. As noted, KeySpan records goodwill on purchased transactions, representing the excess of acquisition cost over the fair value of net assets acquired.

As a result of these evaluations, KeySpan recorded a non-cash goodwill impairment charge of $108.3 million ($80.3 million after tax, or $0.50 per share) in 2004. This charge was recorded as follows: (i) $14.4 million as an operating expense on the Consolidated Statement of Income reflecting the write-down of goodwill on Energy Services segment's continuing operations; and (ii) $93.9 million ($67.8 million after-tax) as discontinued operations reflecting the impairment on the mechanical contracting companies.

In addition, an impairment charge of $100.3 million ($72.1 million after-tax or $0.45 per share) was also recorded in 2004 to reduce the carrying value of the remaining assets of the mechanical contracting companies. This charge is reflected in discontinued operations on the Consolidated Statement of Income to reflect the estimated loss on disposal.

KeySpan employed a combination of two methodologies in determining the estimated fair value for its investment in the Energy Services segment, a market valuation approach and an income valuation approach. Under the market valuation approach, KeySpan utilized a range of near-term potential realizable values for the mechanical contracting businesses. Under the income valuation approach, the fair value was obtained by discounting the sum of (i) the expected future cash flows and (ii) the terminal value. KeySpan utilized certain significant assumptions in this valuation, specifically the weighted-average cost of capital, short and long-term growth rates and expected future cash flows. Approximately $65 million of goodwill remains in this segment.

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

	December 31, 2004	December 31, 2003
	(In Millions of Dollars)	
Property	$ 8.7	8.6
Current assets	$ 42.9	181.8
Goodwill	$ —	$ 92.7
Current liabilities	$ 64.2	$ 82.0

	For the Year Ended December 31,		
	2005	2004	2003
	(In Millions of Dollars)		
Revenues	$ 33.8	$ 338.7	$ 379.6
Less:			
Operating expenses	40.2	364.9	385.5
Goodwill impairment	—	108.3	—
	(6.4)	(134.5)	(5.9)
Income taxes (benefit)	(2.3)	(55.5)	(4.0)
Operating income (loss)	(4.1)	(79.0)	(1.9)
Gain (Loss) on disposal, net of tax	2.3	(72.0)	—
Net (Loss)	$ (1.8)	$ (151.0)	$ (1.9)

Note 11. 2006 LIPA Settlement

LIPA is a corporate municipal instrumentality and a political subdivision of the State of New York. On 28 May 1998, certain of LILCO's business units were merged with KeySpan and LILCO's common stock and remaining assets were acquired by LIPA. At the time of this transaction, 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 28 May 1998 and are collectively referred to as the 1998 LIPA Agreements.

On 1 February 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 15 December 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''. Each of the 2006 LIPA Agreements will become effective as of 1 January 2006 upon all of the 2006 LIPA Agreements receiving the required governmental approvals; otherwise none of the 2006 LIPA Agreements will become effective.

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 will increase from approximately $50 million to approximately $200 million. These credits and attributes may be used to satisfy KeySpan's previously incurred indemnity obligation to LIPA for any federal income tax liability that may result from the settlement of a pending Internal Revenue Service (''IRS'') audit for LILCO's tax year ended 31 March 1999. In recognition of these items, as well as for the modification and extension of the 1998 MSA and the elimination of the GPRA, upon effectiveness of the Settlement Agreement KeySpan will record a contractual asset in the amount of approximately $160 million, of which approximately $110 million will be attributed to the right to utilize such additional tax credits and attributes and approximately $50 million will be amortized over the eight year term of the 2006 MSA. In order to compensate LIPA for the foregoing, KeySpan will pay LIPA $69 million in cash and will settle 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 15 December 2005. As part of the 2006 settlement between KeySpan and LIPA, the parties entered into the 2006 Option Agreement whereby LIPA has the option during the period 1 January 2006 to 31 December 2006 to purchase only 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. The 2006 Option Agreement replaces the GPRA, the expiration of which has been stayed pending effectiveness of the 2006 LIPA Agreements. In the event such agreements do not become effective by reason of failure to secure the requisite governmental approvals, the GPRA will be reinstated for a period of 90 days. 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 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 will remain unchanged for three years and then increase annually by 1.7 per cent., plus inflation. The variable component, which will comprise no more than 20 per cent. 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 per cent. 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. Subject to certain limitations, KeySpan will be able to retain all operational efficiencies realized during the term of the 2006 MSA.

LIPA will continue 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.

Note 12. Subsequent Events

On 25 February 2006, KeySpan entered into an Agreement and Plan of Merger (the ''Merger Agreement''), with National Grid PLC, a public limited company incorporated under the laws of England and Wales (''Parent'') and National Grid US8, Inc., a New York Corporation (''Merger Sub''), pursuant to which Merger Sub will merge with and into KeySpan (the ''Merger''), with KeySpan continuing as the surviving company. Pursuant to the Merger Agreement, at the effective time of the Merger, each outstanding share of common stock, par value $0.01 per share of KeySpan (the ''Shares''), other than shares owned by KeySpan, shall be cancelled and shall be converted into the right to receive $42.00 in cash, without interest.

Consummation of the Merger is subject to various closing conditions, including but not limited to the satisfaction or waiver of conditions regarding the receipt of requisite regulatory approvals and the adoption of the Merger Agreement by the stockholders of KeySpan and the Parent. Assuming receipt or waiver of the foregoing, it is currently anticipated that the Merger will be consummated in early 2007. However, no assurance can be given that the Merger will occur, or, the timing of its completion.

Financial Swap Agreement for In-City Unforced Capacity

Currently, the NYISO's New York City local reliability rules require that 80 per cent. of the electric capacity needs of New York City be provided by ''in-City'' generators. On 6 February 2006, the NYISO Operating Committee increased the ''in-City'' generator requirement to 83 per cent. beginning in May 2006 through the period ending on April 2007, based in part on the statewide reserve margin of 118 per cent. set by the New York State Reliability Council. On 16 February 2006, an appeal was filed with the NYISO Management Committee requesting that the 6 February decision be rejected and that the In-City requirement be increased to a larger percentage than 83 per cent. A vote on this appeal is expected to occur at the NYISO Management Committee meeting scheduled for 28 February 2006.

Our Ravenswood Generating Station is an ''in-City'' generator. As the electric infrastructure in New York City and the surrounding areas continues to change and evolve and the demand for electric power increases, the ''in-City'' generator requirement could be further modified. Construction of new transmission and generation facilities may cause significant changes to the market for sales of capacity, energy and ancillary services from our Ravenswood Generating Station. Recently 500 MW of capacity came on line and it is anticipated that another 500MW of new capacity may be available during 2006 as a result of the completion of an in-City generation project currently under construction. We can not, however, be certain as to when the new power plant will be in operation or the nature of future New York City energy, capacity or ancillary services market requirements or design.

Notwithstanding the foregoing, KeySpan continues to believe that New York City represents a strong capacity market and has entered into an International SWAP Dealers Association Master Agreement for a fixed for float unforced capacity financial swap (the ''Agreement'') with Morgan Stanley Capital Group Inc. (''Morgan Stanley'') dated as of 18 January 2006. The Agreement has a three year term beginning 1 May 2006, (assuming a condition to effectiveness has been satisfied by such date). 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 will occur on a monthly basis based on the In-City Unforced Capacity price determined by the relevant New York Independent System Operator Spot Demand Curve Auction Market (''Floating Price''). For each monthly settlement period, the price difference will equal 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. KeySpan believes that the average annual monthly capacity market price will settle above the Fixed Price. This derivative instrument will not qualify for hedge accounting treatment under SFAS 133 and will be subject to mark-to-market accounting treatment.

Note 13. KeySpan Gas East Corporation Summary Financial Data

KEDLI is a wholly owned subsidiary of KeySpan. KEDLI was formed on 7 May 1998 and on 28 May 1998 acquired substantially all of the assets related to the gas distribution business of LILCO. KEDLI provides gas distribution services to customers in the Long Island counties of Nassau and Suffolk and the Rockaway peninsula of Queens county. KEDLI established a program for the issuance, from time to time, of up to $600 million aggregate principal amount of Medium-Term Notes, which will be fully and unconditionally guaranteed by the parent, KeySpan Corporation. On 1 February 2000, KEDLI issued $400 million of 7.875 per cent. Medium-Term Notes due 2010. In January 2001, KEDLI issued an additional $125 million of Medium- Term Notes at 6.9 per cent. due January 2008. The following condensed financial statements are required to be disclosed by SEC regulations and set forth those of KEDLI, KeySpan Corporation as guarantor of the Medium-Term Notes and our other subsidiaries on a combined basis.

KeySpan Gas East Corporation

Statement of Income

	Year Ended December 31, 2005				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
Revenues	0.6	1,432.9	6,229.1	(0.6)	7,662.0
Operating Expenses					
Purchased gas	—	963.0	2,634.3	—	3,597.3
Fuel and purchased power	—	—	752.1	—	752.1
Operations and maintenance	22.0	133.5	1,462.4	—	1,617.9
Intercompany expense	—	4.8	(4.2)	(0.6)	—
Depreciation and amortisation	—	76.9	319.7	—	396.6
Operating taxes	0.1	65.9	341.0	—	407.0
Total Operating Expenses	22.1	1,244.1	5,505.3	(0.6)	6,770.9
Gain on sale of property	—	—	1.6	—	1.6
Income from equity investments	—	—	15.1	—	15.1
Operating Income (Loss)	(21.5)	188.8	740.5	—	907.8
Interest charges	(144.5)	(61.9)	(83.9)	21.0	(269.3)
Other income and (deductions)	523.8	2.9	(81.3)	(446.0)	(0.6)
Total Other Income and (Deductions)	379.3	(59.0)	(165.2)	(425.0)	(269.9)
Income Taxes (Benefit)	(32.4)	48.2	223.5	—	239.3
Earnings from Continuing Operations	390.2	81.6	351.8	(425.0)	398.6
Discontinued Operations	—	—	(1.8)	—	(1.8)
Culmulative Change in Accounting Principal	—	(0.2)	(6.4)	—	(6.6)
Net Income	$ 390.2	$ 81.4	$ 343.6	$ (425.0)	$ 390.2

KeySpan Gas East Corporation

Statement of Income

	Year Ended December 31, 2004				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
Revenues	0.6	1,124.4	5,526.1	(0.6)	6,650.5
Operating Expenses					
Purchased gas	—	664.9	1,999.6	—	2,664.5
Fuel and purchased power	—	—	540.3	—	540.3
Operations and maintenance	5.3	137.8	1,423.9	—	1,567.0
Intercompany expense	—	5.4	(5.4)	—	—
Depreciation and amortisation	—	79.9	471.9	—	551.8
Operating taxes	—	65.7	338.4	—	404.1
Goodwill Impairment	—	—	41.0	—	41.0
Total Operating Expenses	5.3	953.7	4,809.7	—	5,768.7
Gain on sale of property	—	—	7.0	—	7.0
Income from equity investments	—	—	46.5	—	46.5
Operating Income (Loss)	(4.7)	170.7	769.9	(0.6)	935.3
Interest charges	(204.5)	(61.5)	(267.7)	202.4	(331.3)
Other income and (deductions)	635.4	0.8	423.9	(723.9)	336.2
Total Other Income and (Deductions)	430.9	(60.7)	156.2	(521.5)	4.9
Income Taxes (Benefit)	(45.5)	35.8	335.2	—	325.5
Earnings from Continuing Operations	471.7	74.2	590.9	(522.1)	614.7
Discontinued Operations	—	—	(151.0)	—	(151.0)
Net Income	$ 471.7	$ 74.2	$ 439.9	$ (522.1)	$ 463.7

KeySpan Gas East Corporation

Statement of Income

	Year Ended December 31, 2003				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
Revenues	0.5	1,046.9	5,488.6	(0.5)	6,535.5
Operating Expenses					
Purchased gas	—	574.0	1,921.1	—	2,495.1
Fuel and purchased power	—	—	414.6	—	414.6
Operations and maintenance	11.3	137.2	1,474.1	—	1,622.6
Intercompany expense	5.3	3.6	(3.6)	(5.3)	—
Depreciation and amortisation	—	77.6	494.1	—	571.7
Operating taxes	—	77.5	340.7	—	418.2
Total Operating Expenses	16.6	869.9	4,641.0	(5.3)	5,522.2
Gain on sale of property	—	14.0	1.1	—	15.1
Income from equity investments	0.1	—	19.1	—	19.2
Operating Income (Loss)	(16.0)	191.0	867.8	4.8	1,047.6
Interest charges	(209.5)	(63.0)	(299.4)	264.2	(307.7)
Other income and (deductions)	621.1	(8.6)	54.3	(699.4)	(32.6)
Total Other Income and (Deductions)	411.6	(71.6)	(245.1)	(435.2)	(340.3)
Income Taxes (Benefit)	(28.7)	40.8	269.2	—	281.3
Earnings from Continuing Operations	424.3	78.6	353.5	(430.4)	426.0
Discontinued Operations	—	—	(1.9)	—	(1.9)
Cumulative Change in Accounting Principle	—	—	(37.4)	—	(37.4)
Net Income	$ 424.3	$ 78.6	$ 314.2	$ (430.4)	$ 386.7

KeySpan Gas East Corporation

Balance Sheet

	December 31, 2005				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
ASSETS					
Current Assets					
Cash and temporary cash investments	79.6	3.5	41.4		124.5
Accounts receivable, net	0.6	149.9	822.2		972.7
Other current assets	4.0	368.9	1,550.0		1,922.9
	84.2	522.3	2,413.6	—	3,020.1
Investments and Other	4,571.0	0.7	128.2	(4,457.5)	242.4
Property					
Gas	—	—	7,275.9		7,275.9
Other	—	2,111.3	981.5		3,092.8
Accumulated depreciation and depletion	—	(400.6)	(2,631.2)		(3,031.8)
	—	1,710.7	5,626.2	—	7,336.9
Intercompany Accounts Receivable	2,813.6	44.6	95.6	(2,953.8)	—
Deferred Charges	482.5	316.1	2,414.6		3,213.2
Total Assets	7,951.3	2,594.4	10,678.2	(7,411.3)	13,812.6
LIABILITIES AND CAPITALISATION					
Current Liabilities					
Accounts payable	36.4	149.7	900.9		1,087.0
Commercial paper	657.6	—	—		657.6
Other current liabilities	196.2	128.5	85.9		410.6
	890.2	278.2	986.8	—	2,155.2
Intercompany Accounts Payable	51.8	338.3	1,049.8	(1,439.9)	—
Deferred Credits and Other Liabilities					
Deferred income tax	27.2	330.6	800.1		1,157.9
Other deferred credits and liabilities	634.0	225.3	1,240.0		2,099.3
	661.2	555.9	2,040.1	—	3,257.2
CAPITALISATION					
Common shareholders' equity	4,485.4	897.0	3,539.3	(4,457.6)	4,464.1
Long-term debt	1,862.7	525.0	3,046.9	(1,513.8)	3,920.8
Total Capitalisation	6,348.1	1,422.0	6,586.2	(5,971.4)	8,384.9
Minority Interest in Consolidated Companies			15.3		15.3
Total Liabilities and Capitalisation	$ 7,951.3	$ 2,594.4	$ 10,678.2	$ (7,411.3)	$ 13,812.6

KeySpan Gas East Corporation

Balance Sheet

	December 31, 2004				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
ASSETS					
Current Assets					
Cash and temporary cash investments	580.7	(0.9)	342.2	—	922.0
Accounts receivable, net	0.8	223.6	1,087.6	—	1,312.0
Other current assets	4.5	146.5	650.7	—	801.7
Assets of discontinued operations	—	—	42.9		42.9
	586.0	369.2	2,123.4	—	3,078.6
Investments and Other	4,567.3	2.0	169.1	(4,465.5)	272.9
Property					
Gas	—	1,998.5	4,872.7	—	6,871.2
Other	—	—	2,987.8	—	2,987.8
Accumulated depreciation and depletion	—	(334.5)	(2,465.3)	—	(2,799.8)
Property of discontinued operations	—	—	8.7		8.7
	—	1,664.0	5,403.9	—	7,067.9
Intercompany Accounts Receivable	2,485.7	—	1,292.2	(3,777.9)	—
Deferred Charges	381.3	221.4	2,342.0	—	2,944.7
Total Assets	8,020.3	2,256.6	11,330.6	(8,243.4)	13,364.1
LIABILITIES AND CAPITALISATION					
Current Liabilities					
Accounts payable	48.4	111.5	746.7	—	906.6
Commercial paper	912.2	—	—	—	912.2
Other current liabilities	294.7	167.2	(62.6)	—	399.3
Liabilities of discontinued operations	—	—	64.2		64.2
	1,255.3	278.7	748.3	—	2,282.3
Intercompany Accounts Payable	—	101.3	2,147.8	(2,249.1)	—
Deferred Credits and Other Liabilities					
Deferred income tax	(83.2)	298.1	909.2	—	1,124.1
Other deferred credits and liabilities	534.5	112.0	964.4	—	1,610.9
	451.3	410.1	1,873.6	—	2,735.0
Capitalisation					
Common shareholders' equity	3,940.5	815.6	3,604.2	(4,465.5)	3,894.8
Preferred stock	19.7	—	—	—	19.7
Long-term debt	2,353.5	650.9	2,943.1	(1,528.8)	4,418.7
Total Capitalisation	6,313.7	1,466.5	6,547.3	(5,994.3)	8,333.2
Minority Interest in Consolidated Companies	—	—	13.6	—	13.6
Total Liabilities and Capitalisation	$ 8,020.3	$ 2,256.6	$ 11,330.6	$ (8,243.4)	$ 13,364.1

KeySpan Gas East Corporation

Balance Sheet

	December 31, 2003				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
ASSETS					
Current Assets					
Cash and temporary cash investments	97.6	1.6	104.2	—	203.4
Accounts receivable, net	3.3	209.2	1,068.1	—	1,280.5
Other current assets	3.3	136.0	582.3	—	721.6
Assets of discontinued operations	—	—	181.8		181.8
	104.1	346.7	1,936.5	—	2,387.3
Investments and Other	4,475.9	1.1	153.5	(4,382.0)	248.6
Property					
Gas	—	1,899.4	4,622.9	—	6,522.3
Other	—	—	6,132.6	—	6,132.6
Accumulated depreciation and depletion	—	(355.4)	(3,413.8)	—	(3,769.1)
Property of discontinued operations	—	—	8.6		8.6
	—	1,544.0	7,350.3	—	8,894.3
Intercompany Accounts Receivable	3,105.6	—	1,274.3	(4,379.9)	—
Deferred Charges	374.1	237.9	2,498.0	—	3,110.0
Total Assets	8,059.7	2,129.7	13,212.6	(8,761.9)	14,640.2
LIABILITIES AND CAPITALISATION					
Current Liabilities					
Accounts payable	125.9	165.6	774.0	—	1,065.5
Commercial paper	481.9	—	—	—	481.9
Other current liabilities	129.2	21.1	72.6	—	222.9
Liabilities of discontinued operations	—	—	82.0		82.0
	737.0	186.8	928.6	—	1,852.3
Intercompany Accounts Payable	—	116.2	2,679.1	(2,795.3)	—
Deferred Credits and Other Liabilities					
Deferred income tax	(48.1)	256.9	1,066.7	—	1,275.6
Other deferred credits and liabilities	532.1	136.7	968.8	—	1,637.6
	484.0	393.6	2,035.5	—	2,913.2
Capitalisation					
Common shareholders' equity	3,707.8	782.2	3,562.7	(4,382.0)	3,670.7
Preferred stock	83.5	—	—	—	83.5
Long-term debt	3,047.5	650.9	3,497.2	(1,584.6)	5,611.0
Total Capitalisation	6,838.7	1,433.1	7,059.9	(5,966.6)	9,365.2
Minority Interest in Consolidated Companies	—	—	509.5	—	509.5
Total Liabilities and Capitalisation	$ 8,059.7	$ 2,129.7	$ 13,212.6	$ (8,761.9)	$ 14,640.2

KeySpan Gas East Corporation

Statement of Cash Flows

	Year Ended December 31, 2005			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
	(In Millions of Dollars)			
Operating Activities				
Net Cash (Used in) Provided by Continuing Operating Activities	(327.7)	168.5	562.5	403.3
Investing Activities				
Capital expenditures	—	(113.3)	(426.2)	(539.5)
Cost of removal	—	(2.6)	(25.2)	(27.8)
Proceeds from sale of property and investments	—	(2.1)	49.1	47.0
Derivative margin call	—	—	(8.9)	(8.9)
Net Cash (Used in) Continuing Investing Activities	—	(118.0)	(411.2)	(529.2)
Financing Activities				
Treasury stock issued	41.2	—	—	41.2
Common stock issued associated with MEDS conversion	460.0	—	—	460.0
Issuance (payment) of debt, net	(754.6)	—	(15.0)	(769.6)
Redemption of preferred stock	(75.0)	—	—	(75.0)
Common and preferred stock dividends paid	(308.4)	—	—	(308.4)
Dividend paid to parent	375.0	—	(375.0)	—
Other	(1.6)	—	(3.8)	(5.4)
Net intercompany accounts	90.0	(46.1)	(43.9)	—
Net Cash (Used in) Continuing Financing Activities	(173.4)	(46.1)	(437.7)	(657.2)
Net (Decreases) Increase in Cash and Cash Equivalents	(501.1)	4.4	(286.4)	(783.1)
Net Cash Flow from Discontinued Operations	—	—	(14.4)	(14.4)
Cash and Cash Equivalents at Beginning of Period	580.7	(0.9)	342.2	922.0
Cash and Cash Equivalents at End of Period	79.6	3.5	41.4	124.5

KeySpan Gas East Corporation

Statement of Cash Flows

	Year Ended December 31, 2004			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
	(In Millions of Dollars)			
Operating Activities				
Net Cash (Used in) Provided by Continuing Operating Activities	(88.7)	169.5	669.3	750.1
Investing Activities				
Capital expenditures	—	(108.7)	(641.6)	(750.3)
Cost of removal	—	(7.1)	(29.2)	(36.3)
Proceeds from sale of property and investments	—	—	1,021.3	1,021.3
Net Cash (Used in) Provided by Continuing Investing Activities	—	(115.8)	350.5	234.7
Financing Activities				
Treasury stock issued	33.4	—	—	33.4
Issuance (payment) of debt, net	(269.7)	—	(170.7)	(440.4)
Redemption of preferred stock	(8.5)	—	—	(8.5)
Net proceeds from sale/leaseback transaction	—	—	382.0	382.0
Common and preferred stock dividends paid paid	(291.1)	—	—	(291.1)
Gain on interest rate swap	12.7	—	—	12.7
Dividend paid to parent	447.6	(40.0)	(407.6)	—
Other	27.6	—	8.5	36.1
Net intercompany accounts	619.8	(16.2)	(603.6)	—
Net Cash Provided by (Used in) Continuing Financing Activities	571.8	(56.2)	(791.4)	(275.8)
Net Increase (Decrease) in Cash and Cash Equivalents	483.1	(2.5))	228.4	709.0
Net Cash Flow from Discontinued Operations	—	—	9.6	9.6
Cash and Cash Equivalents at Beginning of Period	97.6	1.6	104.2	203.4
Cash and Cash Equivalents at End of Period	580.7	(0.9)	342.2	922.0

KeySpan Gas East Corporation

Statement of Cash Flows

	Year Ended December 31, 2003			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
	(In Millions of Dollars)			
Operating Activities				
Net Cash (Used in) Provided by Continuing Operating Activities	(547.5)	164.5	1,606.4	1,223.4
Investing Activities				
Capital expenditures	—	(130.3)	(879.1)	(1,009.4)
Cost of removal	—	(1.7)	(29.4)	(31.1)
Proceeds from the sale of property and subsidiary stock	—	15.1	294.6	309.7
Investments in subsidiaries	—	—	(211.3)	(211.3)
Issuance of note receiveable	(55.0)	—	—	(55.0)
Net Cash (Used in) Continuing Investing Activities	(55.0)	(116.9)	(825.2)	(997.1)
Financing Activities				
Proceeds from equity issuance	473.6	—	—	473.6
Treasury stock issued	96.7	—	—	96.7
Redemption of LIPA promissory notes	(447.0)	—		(447.0)
(Payment) issuance of debt, net	(133.8)	—	110.2	(23.6)
Redemption of preferred stock	—	—	(14.3)	(14.3)
Common and preferred stock dividends paid	(280.6)	—	—	(280.6)
Other	28.9	—	(13.9)	15.0
Net intercompany accounts	874.0	(52.6)	(821.4)	—
Net Cash Provided by (Used in) Continuing Financing Activities	611.8	(52.6)	(739.4)	(180.2)
Net (Decrease) Increase in Cash and Cash Equivalents	9.3	(5.0)	41.8	46.1
Net Cash from Discontinued Operations	—	—	(13.3)	(13.3)
Cash and Cash Equivalents at Beginning of Period	88.3	6.5	75.8	170.6
Cash and Cash Equivalents at End of Period	97.6	1.5	104.3	203.4

Note 14. Supplemental Gas and Oil Disclosures (Unaudited)

The following information includes amounts attributable to 100 per cent. of Houston Exploration and KeySpan Exploration and Production, LLC at 31 December 2003. Shareholders other than KeySpan had a minority interest of approximately 45 per cent. in Houston Exploration at 31 December 2003. Gas and oil operations, and reserves, were located in the United States in 2003. As a result of the disposition of Houston Exploration and the immateriality of KeySpan's ongoing gas exploration and production activities supplemental gas and oil disclosures are not required for 2005 or 2004.

Capitalized Costs Relating to Gas and Oil Producing Activities

	At December 31, 2003 (In Millions of Dollars)
Unproved properties not being amortized	$ 142.9
Properties being amortized—productive and nonproductive	2,429.9
Total capitalized costs	2,572.8
Accumulated depletion	(1,159.5)
Net capitalized costs	$ 1,413.3

Costs Incurred in Property Acquisition, Exploration and Development Activities

	At December 31, 2003 (In Millions of Dollars)
Acquisition of properties—	
Unproved properties	$ 61.5
Proved properties	171.3
Exploration	66.3
Development	170.5
Asset retirement obligation	31.8
Total costs incurred	$ 501.4

Costs included in development costs to develop proved undeveloped reserves for the year ended 31 December 2003 were $49.4 million.

Results of Operations from Gas and Oil Producing Activities(*)

	At December 31, 2003 (In Millions of Dollars)
Revenues	$ 497.9
Production and lifting costs	63.6
Shipping and handling costs	10.4
Depletion	205.1
Total expenses	279.1
Income before taxes	218.8
Income taxes	76.6
Results of operations	$ 142.2

(*) (Excluding corporate overhead and interest costs)

Summary of Production and Lifting Costs

	At December 31, 2003
	(In Millions of Dollars)
Pumping, gauging and other labor	$ 11.0
Compressors and other rental equipment	5.1
Property taxes and insurance	7.2
Transportation	2.3
Processing fees	2.4
Workover and well stimulation	5.2
Repairs, maintenance and supplies	3.7
Fuel and chemicals	3.1
Environmental, regulatory and other	7.6
Severance taxes	16.0
Total production and lifting costs	$ 63.6

For 31 December 2003 the gas and oil reserves information reflects Houston Exploration and KeySpan Exploration and Production, LLC. These estimates principally were prepared by independent petroleum consultants. Proved reserves are estimated quantities of natural gas and crude oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.

Reserve Quantity Information Natural Gas (MMcf)

	At December 31, 2003
Proved Reserves	
Beginning of year	614,734
Revisions of previous estimates	(32,433)
Extensions and discoveries	140,632
Production	(100,130)
Purchases of reserves in place	89,380
Proved reserves—End of year[1]	712,183
Proved developed reserves	
Beginning of year	435,629
End of Year[2]	488,012

(1) Includes minority interest of 318,417.

(2) Includes minority interest of 218,190.

Crude Oil, Condensate and Natural Gas Liquids (MBbls)

	At December 31, 2003
Proved reserves	
Beginning of Year	9,548
Revisions of previous estimates	(3,542)
Extension and discoveries	117
Production	(1,514)
Purchases of reserves in place	3,753
Proved reserves—End of year(1)	8,362
Proved developed reserves	
Beginning of year	2,413
End of year(2)	4,273

(1) Includes minority interest of 3,739.

(2) Includes minority interest of 1,910.

The standardized measure of discounted future net cash flows was prepared by applying year-end prices of gas and oil adjusted for the effects of KeySpan's hedging program to the proved reserves. The standardized measure does not purport, nor should it be interpreted, to present the fair value of gas and oil reserves. An estimate of fair value would also take into account, among other things, the recovery of reserves not presently classified as proved, anticipated future changes in prices and costs, and a discount factor more representative of the time value of money and the risks inherent in reserve estimates.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Gas and Oil Reserves

	At December 31, 2003
	(In Millions of Dollars)
Future cash flows	$ 4,375.8
Future costs—	
Production	(769.9)
Development	(378.6)
Future net inflows before income tax	3,227.3
Future income taxes	(853.4)
Future net cash flows	2,373.9
10% discount factor	(853.4)
Standardized measure of discounted future net cash flows(1)	$ 1,520.5

(1) Includes minority interest of $672,620.

Changes in Standardized Measure of Discounted Future Net Cash Flows from Proved Reserve Quantities

	At December 31, 2003
	(In Millions of Dollars)
Standardized measure—beginning of year	$ 1,103.9
Sales and transfers, net of production costs	(492.3)
Net change in sales and transfer prices, net of production costs	384.3
Extensions and discoveries and improved recovery, net of related costs	434.3
Changes in estimated future development costs	(9.4)
Development costs incurred during the period that reduced future development costs	81.0
Revisions of quantity estimates	(123.9)
Accretion of discount	142.3
Net change in income taxes	(236.5)
Net purchases of reserves in place	254.0
Changes in production rates (timing) and other	(17.2)
Standardized measure—end of year	$ 1,520.5

Average Sales Prices and Production Costs Per Unit

	Year Ended December 31, 2003
Average Sales Price(*)	
Natural gas ($/Mcf)	5.23
Oil, condensate and natural gas liquid ($/Bbl)	28.26
Production cost per equivalent Mcf ($)	0.58

(*) Represents the cash price received which excludes the effect of any hedging transactions.

Note 15. Summary of Quarterly Information (Unaudited)

The following is a table of financial data for each quarter of KeySpan's year ended 31 December 2005.

	Quarter Ended			
	3/31/2005	6/30/2005	9/30/2005	12/31/2005
	(In Millions of Dollars, Except Per Share Amounts)			
Operating Revenue	2,480.5	1,342.5	1,303.1	2,535.9
Operating Income	438.7	103.2	102.8	263.1
Earnings (loss) from continuing operations, less preferred stock dividends	234.4	18.0	22.6	121.4
Cumulative change in accounting principles, net of tax	—	—	—	(6.6)[(a)]
Earnings (loss) from discontinued operations	—	(1.8)	—	—
Earnings (loss) for common stock	234.4	16.2	22.6	114.8
Basic earnings per common share from continuing operations less preferred stock dividends	1.45	0.11	0.13	0.70
Basic earnings per common share from discontinued operations	—	(0.01)	—	—
Basic earnings per common share from cumulative change in accounting principles	—	—	—	(0.04)[(a)]
Basic earnings per common share	1.45	0.10	0.13	0.66
Diluted earnings per common share	1.44	0.09	0.13	0.65
Dividends declared	0.455	0.455	0.455	0.455

(a) Cumulative change in accounting principles for implementation of FASB Interpretation No. 47 (''FIN 47'') ''Accounting for Conditional Asset Retirement Obligations.''

The following is a table of financial data for each quarter of KeySpan's year ended 31 December 2004.

	Quarter Ended			
	3/31/2004	6/30/2004	9/30/2004	12/31/2004
	(In Millions of Dollars, Except Per Share Amounts)			
Operating Revenue	2,510.6	1,277.8	975.6	1,886.5
Operating Income	487.6	122.2[(a)]	87.6[(c)]	237.9[(e)]
Earnings (loss) from continuing operations, less preferred stock dividends	246.6	128.5[(a)(b)]	(30.1)[(c)(d)]	264.1[(e)(f)]
Earnings (loss) from discontinued operations[(g)]	(0.4)	0.8	(87.0)	(64.4)
Earnings (loss) for common stock	246.2	129.3	(117.1)	199.7
Basic earnings per common share from continuing operations less preferred stock dividends	1.54	0.81	(0.19)	1.64
Basic earnings per common share from discontinued operations	—	—	(0.54)	(0.40)
Basic earnings per common share	1.54	0.81	(0.73)	1.24
Diluted earnings per common share	1.53	0.80	(0.73)	1.23
Dividends declared	0.445	0.445	0.445	0.445

(a) KeySpan's wholly owned gas exploration and production subsidiaries recorded a non-cash impairment charge of $48.2 million ($31.1 million after-tax) or $0.19 per share to recognize the reduced valuation of proved reserves.

(b) In June 2004, KeySpan exchanged 10.8 million shares of common stock of Houston Exploration for 100 per cent. of the stock of Seneca Upshur Petroleum, Inc. We recorded a gain of $150.1 million and were required to record deferred tax expense of $44.1 million. The net gain on the share exchange less the deferred tax provision was $106 million or $0.66 per share. In April 2004, KeySpan recorded a gain of $22.8 million ($10.1 million after-tax) or $0.06 per share, resulting from the sale of 35.9 per cent. of our ownership interest in KeySpan Canada.

(c) KeySpan recorded a $14.4 million ($12.6 million after-tax) or $0.08 per share non-cash goodwill impairment charge associated with our continuing investments in the Energy Services segment.

(d) In August 2004, we redeemed approximately $758 million of outstanding debt and recorded a charge of $45.9 million ($29.3 million after-tax) or $0.18 per share representing call premiums incurred on this redemption.

(e) In December 2004, we recorded a $26.5 million ($18.8 million after-tax) or $0.12 per share non-cash impairment charge related to our 50 per cent. ownership interest in Premier Transmission Pipeline.

(f) In November 2004, KeySpan decided to sell its remaining 6.6 million shares in Houston Exploration and recorded a gain of $179.6 million ($116.8 million after-tax) or $0.73 per share. In December 2004, KeySpan sold its remaining interest in KeySpan Canada and recorded a gain of $35.8 million ($24.7 million after tax) or $0.15 per share.

(g) At 31 December 2004, KeySpan intended to sell a significant portion of its ownership interest in certain companies within the Energy Services segment, specifically those companies engaged in mechanical contracting activities. As a result, KeySpan recorded a loss in discontinued operations of $151.0 million, or $0.94 per share. This loss reflects $139.9 million after-tax impairment charges, which were recorded in the third and fourth quarters, and operating losses at $11.1 million.

The following is a table of financial data for each quarter of KeySpan's year ended 31 December 2003.

	Quarter Ended			
	3/31/2003	6/30/2003	9/30/2003	12/31/2003
	(In Millions of Dollars, Except Per Share Amounts)			
Operating Revenue	2,423.5	1,307.4	1,032.5	1,772.1
Operating Income	455.1	139.1	112.2	341.3
Earnings (loss) from continuing operations, less preferred stock dividends	240.7[(a)]	(7.1)[(b)]	13.4	173.2[(c)]
Cumulative change in accounting principles, net of tax	0.2	—	—	(37.6)[(d)]
Earnings (loss) from discontinued operations[(e)]	0.9	(0.3)	(2.3)	(0.2)
Earnings (loss) for common stock	241.8	(7.4)	11.1	135.4
Basic earnings per common share from continuing operations less preferred stock dividends	1.54	(0.05)	0.08	1.09
Basic earnings per common share from discontinued operations[(a)]	—	—	(0.01)	—
Basic earnings per common share from cumulative change in accounting principles	—	—	—	(0.24)
Basic earnings per common share	1.54	(0.05)	0.07	0.85
Diluted earnings per common share	1.53	(0.05)	0.07	0.84
Dividends declared	0.445	0.445	0.445	0.445

(a) In February 2003, we reduced our ownership interest in Houston Exploration from 66% to 56% following the repurchase, by Houston Exploration, of 3 million shares of stock owned by KeySpan. This transaction resulted in an after-tax gain of $19.0 million or $0.12 per share.

(b) In May 2003, we monetized 39% of our interest in KeySpan Canada, and sold our 20% interest in Taylor NGL LP, a company that owns and operates extraction plants in Canada. The transactions resulted in an after-tax loss of $34.1 million or $0.22 per share.

(c) In December 2003, we sold our 24.5% interest in Phoenix Natural Gas, a natural gas distribution business in Northern Ireland. KeySpan recognized an after-tax gain on the sale of $16.0 million per share or $.10 per share.

(d) As a result of the implementation of FASB Interpretation No. 46 ''Consolidation of Variable Interest Entities,'' in December 2003 KeySpan consolidated the Ravenswood Master Lease. KeySpan recorded a cumulative effect change in accounting principle of $37.6 million or $0.23 per share, related to ''catch-up'' depreciation of the facility since its acquisition in June 1999.

(e) In December 2004, KeySpan reflected certain Energy Services companies as discontinued. Amounts for each of the quarters in the year 2003 have been restated to reflect this presentation.

SECTION II: KEYSPAN'S UNAUDITED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED 31 MARCH 2006: US GAAP

1 Nature of financial information

The financial information set out in this Section II below has been extracted without material adjustment from the unaudited financial statements of KeySpan for the three months ended 31 March 2006 included in KeySpan's 2006 Form 10-Q as filed with the SEC.

KEYSPAN CORPORATION

CONSOLIDATED BALANCE SHEET

(Unaudited)

	March 31, 2006	December 31, 2005
	(In Millions of Dollars)	
ASSETS		
Current Assets		
Cash and temporary cash investments	**$ 313.1**	$ 124.5
Restricted cash	**5.2**	13.2
Accounts receivable	**1,200.9**	1,035.6
Unbilled revenue	**479.7**	685.6
Allowance for uncollectible accounts	**(83.1)**	(62.8)
Gas in storage, at average cost	**491.4**	766.9
Material and supplies, at average cost	**132.4**	140.5
Derivative contracts	**22.3**	142.8
Other	**116.9**	173.8
	2,678.8	3,020.1
Investments and Other	**252.1**	242.4
Property		
Gas	**7,352.5**	7,275.9
Electric	**2,518.3**	2,492.3
Other	**415.9**	416.3
Accumulated depreciation	**(2,979.7)**	(2,922.6)
Gas exploration and production, at cost	**184.7**	184.2
Accumulated depletion	**(110.2)**	(109.2)
	7,381.5	7,336.9
Deferred Charges		
Regulatory assets:		
Miscellaneous assets	**678.3**	688.3
Derivative contracts	**27.1**	30.9
Goodwill and other intangible assets	**1,666.3**	1,666.3
Derivative contracts	**34.0**	75.2
Other	**774.5**	752.5
	3,180.2	3,213.2
Total Assets	**$ 13,492.6**	$ 13,812.6

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION

CONSOLIDATED BALANCE SHEET
(Unaudited)

	March 31, 2006	December 31, 2005
	(In Millions of Dollars)	
LIABILITIES AND CAPITALIZATION		
Current Liabilities		
Accounts payable and other liabilities	**$ 767.6**	$ 1,087.0
Commercial paper	**496.8**	657.6
Current redemption of long-term debt	**13.5**	13.0
Taxes accrued	**329.9**	176.3
Dividends payable	**81.3**	81.1
Customer deposits	**37.9**	39.1
Interest accrued	**73.4**	53.8
Derivative contracts	**31.1**	47.3
	1,831.5	2,155.2
Deferred Credits and Other Liabilities		
Regulatory liabilities:		
Miscellaneous liabilities	**15.9**	69.9
Removal cost recovered	**529.7**	516.4
Derivative contracts	**31.0**	175.4
Asset retirement obligations	**48.1**	47.4
Deferred income tax	**1,144.0**	1,157.9
Postretirement benefits and other reserves	**1,192.4**	1,118.4
Derivative contracts	**23.1**	44.3
Other	**116.1**	127.5
	3,100.3	3,257.2
Commitments and Contingencies (See Note 6)	**—**	—
Capitalization		
Common stock—184,864 shares issued, 174,940 shares outstanding, stated at	**3,983.3**	3,975.9
Retained earnings	**993.7**	866.9
Other comprehensive (loss)	**(64.2)**	(74.8)
Treasury stock	**(287.3)**	(303.9)
Total common shareholders' equity	**4,625.5**	4,464.1
Long-term debt and capital leases	**3,920.0**	3,920.8
Total Capitalization	**8,545.5**	8,384.9
Minority Interest in Subsidiary Companies	**15.3**	15.3
Total Liabilities and Capitalization	**$ 13,492.6**	$ 13,812.6

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars, Except Per Share Amounts)	
Revenues		
Gas Distribution	$ 2,180.1	$ 2,025.5
Electric Services	424.8	400.4
Energy Services	48.4	44.5
Energy Investments	7.8	10.1
Total Revenues	2,661.1	2,480.5
Operating Expenses		
Purchased gas for resale	1,511.4	1,308.8
Fuel and purchased power	130.0	133.1
Operations and maintenance	406.0	387.2
Depreciation, depletion and amortization	110.3	106.1
Operating taxes	118.2	111.9
Total Operating Expenses	2,275.9	2,047.1
Income from equity investments	3.4	5.3
Gain on sale of property	0.5	—
Operating Income	389.1	438.7
Other Income and (Deductions)		
Interest charges	(66.2)	(60.0)
Gain on sale of investments	—	4.1
Cost of debt redemption	—	(20.9)
Other	11.4	9.1
Total Other Income and (Deductions)	(54.8)	(67.7)
Income Taxes		
Current	159.4	128.8
Deferred	(33.1)	6.5
Total Income Taxes	126.3	135.3
Earnings from continuing operations	208.0	235.7
Discontinued Operations		
Loss from discontinued operations, net of tax	—	(2.2)
Gain on disposal, net of tax	—	2.2
Loss from discontinued operations	—	—
Net Income	208.0	235.7
Preferred stock dividend requirements	—	1.3
Earnings for Common Stock	$ 208.0	$ 234.4
Basic Earnings Per Share:		
Continuing Operations, less preferred stock dividends	$ 1.19	$ 1.45
Discontinued Operations	—	—
Basic Earnings Per Share	$ 1.19	$ 1.45
Diluted Earnings Per Share		
Continuing Operations, less preferred stock dividends	1.18	$ 1.44
Discontinued Operations	—	—
Diluted Earnings Per Share	$ 1.18	$ 1.44
Average Common Shares Outstanding (000)	174,704	161,125
Average Common Shares Outstanding—Diluted (000)	176,953	162,245

See accompanying Notes to the Consolidated Financial Statements.

KEYSPAN CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars)	
Operating Activities		
Net income	**$ 208.0**	$ 235.7
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation, depletion and amortization	**110.3**	106.1
Deferred income tax	**(33.1)**	6.5
Income from equity investments	**(3.4)**	(5.3)
Amortization of financing fees / interest rate swap	**2.1**	(11.7)
(Gain) on sale of investment	**—**	(4.1)
Amortization of property taxes	**33.4**	28.3
Changes in assets and liabilities		
Accounts receivable	**12.3**	(262.3)
Materials and supplies, fuel oil and gas in storage	**283.5**	297.8
Accounts payable and other liabilities	**(308.1)**	(126.5)
Taxes accrued	**166.0**	85.7
Interest accrued	**19.6**	15.0
Environmental payments	**(10.0)**	(7.4)
Other	**63.3**	25.6
Net Cash Provided by Operating Activities	**543.9**	383.4
Investing Activities		
Construction expenditures	**(122.2)**	(111.8)
Cost of removal	**(6.7)**	(4.8)
Net proceeds from sale of property and investments	**—**	48.1
Net Cash Used in Investing Activities	**(128.9)**	(68.5)
Financing Activities		
Common/Treasury stock issued	**15.5**	24.3
Payment of commercial paper	**(160.8)**	(441.4)
Payment of long-term debt	**—**	(515.0)
Common stock dividends paid	**(81.1)**	(74.6)
Preferred stock dividends paid	**—**	(1.3)
Other	**—**	9.1
Net Cash Used in Financing Activities	**(226.4)**	(998.9)
Net Increase (Decrease) in Cash and Cash Equivalents	**188.6**	(684.0)
Cash Flow from Discontinued Operations—Operating	**—**	(4.4)
Cash Flow from Discontinued Operations—Investing	**—**	(10.6)
Cash and Cash Equivalents at Beginning of Period	**124.5**	922.0
Cash and Cash Equivalents at End of Period	**$ 313.1**	$ 223.0

Cash equivalents are short-term marketable securities purchased with maturities of three months or less that were carried at cost which approximates fair value.

See accompanying Notes to the Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

KeySpan Corporation (referred to in the Notes to the Financial Statements as ''KeySpan,'' ''we,'' ''us'' and ''our'') is a registered holding company under the Public Holding Company Act of 2005 (''PUHCA 2005''). 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, lease and operate electric generating plants in Nassau and Suffolk Counties on Long Island and in Queens County in New York City and are the largest electric generation operator in New York State. 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''). KeySpan's other operating subsidiaries are primarily involved in gas exploration and production; underground gas storage; liquefied natural gas storage; retail electric marketing; large energy-system ownership, installation and management; service and maintenance of energy systems; and engineering and consulting services. We also invest and participate in the development of natural gas pipelines, electric generation and other energy-related projects. (See Note 2 ''Business Segments'' for additional information on each operating segment.)

On February 25, 2006, KeySpan entered into an Agreement and Plan of Merger (the ''Merger Agreement''), with National Grid plc, a public limited company incorporated under the laws of England and Wales (''Parent'') and National Grid US8, Inc., a New York Corporation (''Merger Sub''), pursuant to which Merger Sub will merge with and into KeySpan (the ''Merger''), with KeySpan continuing as the surviving company and thereby becoming an indirect wholly-owned subsidiary of the Parent. Pursuant to the Merger Agreement, at the effective time of the Merger, each outstanding share of KeySpan common stock, par value $0.01 per share of KeySpan (the ''Shares''), other than treasury shares and shares held by the Parent and its subsidiaries, shall be canceled and shall be converted into the right to receive $42.00 in cash, without interest.

Consummation of the Merger is subject to various closing conditions, including but not limited to the receipt of requisite regulatory approvals and the adoption of the Merger Agreement by the stockholders of KeySpan and the Parent. Assuming receipt of all required approvals, it is currently anticipated that the Merger will be consummated in early 2007. However, no assurance can be given that the Merger will occur, or, the timing of its completion.

At December 31, 2005, KeySpan was a holding company under the Public Utility Holding Company Act of 1935, as amended (''PUHCA 1935''). In August 2005, the Energy Policy Act of 2005 (the ''Energy Act'') was enacted. The Energy Act is a broad energy bill that places an increased emphasis on the production of energy and promotes the development of new technologies and alternative energy sources and provides tax credits to companies that produce natural gas, oil, coal, electricity and renewable energy. For KeySpan, one of the more significant provisions of the Energy Act was the repeal of PUHCA 1935, which became effective on February 8, 2006. Since that time, the jurisdiction of the Securities and Exchange Commission (''SEC'') over certain holding company activities, including the regulation of our affiliate transactions and service companies, has been transferred to the Federal Energy Regulatory Commission (''FERC'') pursuant to PUHCA 2005. (For additional information on the Energy Act and PUHCA 2005 see KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7. Management's Discussion and Analyses of Financial Condition and Results of Operations— ''Regulation and Rate Matters.'')

1 BASIS OF PRESENTATION

In our opinion, the accompanying unaudited Consolidated Financial Statements contain all adjustments necessary to present fairly KeySpan's financial position as of March 31, 2006, and the results of operations for the three months ended March 31, 2006 and March 31, 2005, as well as cash flows for the three months ended March 31, 2006 and March 31, 2005. The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes included in KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005. The December 31, 2005 financial statement information has been derived from the 2005 audited financial statements. Income from interim periods may not be indicative of future results. Certain reclassifications were made to conform prior period financial statements to the current period financial statement presentation.

Consolidated earnings are seasonal in nature primarily due to the significant contributions to earnings of the gas distribution operations. As a result, we expect to earn most of our annual earnings in the first and fourth quarters.

Basic earnings per share (''EPS'') is calculated by dividing earnings available for common stock by the weighted average number of shares of common stock outstanding during the period. No dilution for any potentially dilutive securities is included. Diluted EPS assumes the conversion of all potentially dilutive securities and is calculated by dividing earnings available for common stock, as adjusted, by the sum of the weighted average number of shares of common stock outstanding plus all potentially dilutive securities.

Under the requirements of Statement of Financial Accounting Standards (''SFAS'') No. 128, ''Earnings Per Share'' our basic and diluted EPS are as follows:

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars, Except Per Share Amounts)	
Earnings for common stock	$ 208.0	$ 234.4
Weighted average shares outstanding (000)	174,704	161,125
Add dilutive securities:		
Options	2,249	1,120
Total weighted average shares outstanding—assuming dilution	176,953	162,245
Basic earnings per share	$ 1.19	$ 1.45
Diluted earnings per share	$ 1.18	$ 1.44

2 BUSINESS SEGMENTS

We have 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. 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 seven years and power purchase agreements having remaining terms that range from seven to 21 years. On February 1, 2006, KeySpan and LIPA agreed to extend, amend and restate these contractual arrangements. (See Note 10, ''2006 LIPA Settlement'' for a further discussion of these agreements.) The Electric Services segment also includes 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.'' All of the energy, capacity and ancillary services related to the Ravenswood Generating Station are sold to the New York Independent Systems Operator (''NYISO'') energy markets. To finance the purchase and/or construction of the Ravenswood Generating Station, KeySpan entered into a leasing arrangement for each facility. The Electric Services segment also conducts retail marketing of electricity to commercial customers. (See Note 6 ''Contractual Obligations, Financial Guarantees and Contingencies'' for further details on the leasing arrangements.)

The Energy Services segment includes companies that provide energy-related services to customers located primarily within the Northeastern United States. 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, consulting and fiber optic services to commercial, institutional and industrial customers.

In 2005, KeySpan sold its mechanical contracting subsidiaries. The operating results and financial position of these companies have been reflected as discontinued operations on the Consolidated Statement of Income and Consolidated Statement of Cash Flows for 2005.

The Energy Investments segment consists of our gas exploration and production investments, as well as certain other domestic energy-related investments. KeySpan's gas exploration and production 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 exploration and production activities primarily in West Virginia. KeySpan Exploration is engaged in a joint venture with The Houston Exploration Company (''Houston Exploration''), an independent natural gas and oil exploration company located in Houston, Texas. Houston Exploration, formerly a KeySpan subsidiary, was sold in 2004.

This segment is also engaged in pipeline development activities. KeySpan and Duke Energy Corporation each own a 50% interest in the Islander East Pipeline Company, LLC (''Islander East''). 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. Once in service, the pipeline is expected to transport up to 260,000 DTH daily to the Long Island and New York City energy markets. Further, during the first quarter of 2006, KeySpan increased its interest in the Millennium Pipeline Company LLC to 26.25% from 21%. The Millennium Pipeline Company LLC is the developer of the Millennium pipeline project, which is expected to transport up to 525,000 DTH of natural gas a day from Corning 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.

Through its wholly owned subsidiary, KeySpan LNG, KeySpan owns a 600,000 barrel liquefied natural gas storage and receiving facility in Providence, Rhode Island, the operations of which are fully consolidated.

In the first quarter of 2005, KeySpan sold its 50% interest in Premier Transmission Limited (''Premier''), a gas pipeline from southwest Scotland to Northern Ireland. The sale generated cash proceeds of approximately $48.1 million. In the fourth quarter of 2004, KeySpan reduced its carrying value in Premier to an amount approximating the anticipated cash proceeds from the sale. The final sale of Premier resulted in a pre-tax gain of $4.1 million reflecting the difference from earlier estimates; this gain was recorded in the first quarter of 2005.

The accounting policies of the segments are the same as those used for the preparation of the Consolidated Financial Statements. The segments are strategic business units that are managed separately because of their different operating and regulatory environments. Operating results of our segments are evaluated by management on an operating income basis. At March 31, 2006, the total assets of each reportable segment have not changed materially from those levels reported at December 31, 2005. The reportable segment information is as follows:

	Gas Distribution	Electric Services	Energy Services	Energy Investments	Eliminations	Consolidated
			(In Millions of Dollars)			
Three Months Ended March 31, 2006						
Unaffiliated revenue	2,180.1	424.8	48.4	7.8	—	2,661.1
Intersegment revenue	—	—	2.5	1.3	(3.8)	—
Operating Income	336.4	65.0	(0.4)	3.0	(14.9)	389.1
Three Months Ended March 31, 2005						
Unaffiliated revenue	2,025.5	400.4	44.5	10.1	—	2,480.5
Intersegment revenue	—	4.6	2.6	—	(7.2)	—
Operating Income	391.9	51.0	(2.8)	6.4	(7.8)	438.7

Eliminating items include intercompany interest income and expense, the elimination of certain intercompany accounts, as well as activities of our corporate and administrative areas.

Because of the nature of our Electric Services business, electric revenues are derived from two large customers—the NYISO and LIPA. Electric Services revenues from these customers of $422.7 million and $371.0 million for the three months ended March 31, 2006 and 2005, respectively, represent approximately 16% and 15%, respectively of our consolidated revenues in both periods.

3 COMPREHENSIVE INCOME

The table below indicated the components of comprehensive income:

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars)	
Net Income	$ 208.0	$ 235.7
Other comprehensive income (loss), net of tax		
Net (gains) on derivative instruments	(35.7)	(4.8)
Foreign currency translation adjustments	—	(5.0)
Unrealized gains (losses) on marketable securities	0.4	(1.8)
Unrealized gains (losses) on derivative financial instruments	45.9	(7.3)
Other comprehensive loss, net of tax	10.6	(18.9)
Comprehensive Income	$ 218.6	$ 216.8
Related tax (benefit) expense		
Net (gains) on derivative instruments	(19.2)	(0.5)
Foreign currency translation adjustments	—	(2.7)
Unrealized gains (losses) on marketable securities	0.2	(1.0)
Unrealized gains (losses) on derivative financial instruments	25.4	(6.7)
Total Tax (Benefit) Expense	$ 6.4	$ (10.9)

4 HEDGING AND DERIVATIVE FINANCIAL INSTRUMENT

Financially-Settled Commodity Derivative Instruments—Hedging Activities: 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, gas exploration and production activities and its electric generating facilities at the Ravenswood site.

Derivative financial instruments are employed by our gas distribution operations to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases for our regulated firm gas sales customers. The accounting for certain of these derivative instruments is subject to SFAS 71 ''Accounting for the Effects of Certain Types of Regulation.'' See the caption below ''Firm Gas Sales Derivative Instruments—Regulated Utilities'' for a further discussion of these derivatives. Certain derivative instruments employed by our gas distribution operations, however, are not subject to SFAS 71. Utility tariffs applicable to certain large-volume customers permit gas to be sold at prices established monthly, relative to a prevailing alternate fuel price, but limited to the cost of gas plus the rate for the highest consumption block otherwise applicable to our firm commercial customers. KEDNY uses over-the-counter (''OTC'') natural gas swaps, with offsetting positions in OTC fuel oil swaps of equivalent energy value, to hedge the cash-flow variability of specified portions of gas purchases and sales associated with these customers. The maximum length of time over which we have hedged cash flow variability associated with forecasted purchases and sales of natural gas is through October 2006. We use standard New York Mercantile Exchange (''NYMEX'') futures prices to value the gas and heating oil positions. At March 31, 2006, the fair value of gas swap contracts was a liability of $1.4 million; the fair value of the oil swap contracts was a liability of $1.7 million. The estimated amount of losses associated with such derivative instruments that are reported in other comprehensive income and that are expected to be reclassified into earnings over the next twelve months is $3.1 million, or $2.0 million after-tax. The ineffective portion of these derivatives for the three months ended March 31, 2006 was immaterial.

Our Energy Investments subsidiary, Seneca-Upshur, utilizes OTC natural gas swaps to hedge the cash flow variability associated with forecasted sales of a portion of its natural gas production. At March 31, 2006, Seneca-Upshur has hedge positions in place for approximately 85% of its estimated 2006 through 2008 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 2008. The fair value of these derivative instruments at March 31, 2006 was a liability of $14.0 million. The estimated amount of losses associated with such derivative instruments that are reported in other comprehensive income and that are expected to be reclassified into earnings over the next twelve months is $5.2 million, or approximately $3.4 million after-tax. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the three months ended March 31, 2006.

The Ravenswood Generating Station uses derivative financial instruments to hedge the cash flow variability associated with the purchase of natural gas or fuel oil that will be consumed during the generation of electricity. The Ravenswood Generating Station also hedges the cash flow variability associated with a portion of electric energy sales.

With respect to price exposure associated with fuel purchases for the Ravenswood Generating Station, KeySpan employs OTC natural gas swaps to hedge the cash flow variability for a portion of forecasted purchases of natural gas. We use market quoted forward prices to value these swap positions. The maximum length of time over which we have hedged cash flow variability associated with forecasted purchases of natural gas is through December 2006. The fair value of these derivative instruments at March 31, 2006, was a liability of $0.1 million. These derivative instruments, which are reported in other comprehensive income, are expected to be reclassified into earnings over the next twelve months.

We have also engaged in the use of cash-settled swap instruments to hedge the cash flow variability associated with a portion of forecasted electric energy sales from the Ravenswood Generating Station. Our hedging strategy is to hedge at least 50% of forecasted on-peak summer season electric energy sales and a portion of forecasted electric energy sales for the remainder of the year. The maximum length of time over which we have hedged cash flow variability is through October 2006. To accomplish our stated hedging strategy, KeySpan employs financially-settled electric-power swap contracts with offsetting financially-settled oil swap contracts and OTC natural gas swaps. We use market quoted forward prices to value the electric-power swap contracts. The fair value of these derivative instruments at March 31, 2006 was $19.6 million all of which is expected to be reclassified into earnings within the next twelve months. We use market quoted forward prices to value the oil swap contracts. The fair value of these derivative instruments at March 31, 2006, was a liability of $3.9 million all of which is expected to be reclassified into earnings within the next twelve months. We use market quoted forward prices to value the gas swap contracts. The fair value of these derivative instruments at March 31, 2006, was a liability of $0.2 million all of which is expected to be reclassified into earnings within the next twelve months. The after-tax benefit of these derivative instruments is anticipated to be $10.0 million. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the three months ended March 31, 2006.

The above noted derivative financial instruments are cash flow hedges that qualify for hedge accounting 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, and are not considered held for trading purposes as defined by current accounting literature. Accordingly, we carry the fair value of our derivative instruments on the Consolidated Balance Sheet as either a current or deferred asset or liability, as appropriate, and defer 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 are reflected as a component of either revenue or fuel and purchased power depending on the hedged transaction. Hedge ineffectiveness, which was negligible for the three months ended March 31, 2006, 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.

Firm Gas Sales 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 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, changes in the fair value of these derivatives have been recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. At March 31, 2006 the fair value of these derivative instruments was a liability of $14.1 million and are reflected as a current asset of $2.7 million, a deferred asset of $7.0 million, and a regulatory asset of $20.1 million, with offsetting positions in current liabilities, regulatory liabilities and deferred credits of $18.8 million, $7.9 million and $3.2 million, respectively on the Consolidated Balance Sheet.

Physically-Settled Commodity Derivative Instruments: 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 be exempted as normal purchases and sales. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities are not exempt as normal purchases from the requirements of 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. Therefore, changes in the market value of these contracts have been recorded as a regulatory asset or regulatory liability on the Consolidated Balance Sheet. At March 31, 2006, these derivatives had a net fair value of $16.8 million and are reflected as a deferred asset of $25.7 million and a regulatory asset of $7.0 million with offsetting positions in regulatory liabilities and deferred credits of $23.1 million and $9.5 million, respectively on the Consolidated Balance Sheet.

Further, certain contracts for the physical purchase of natural gas associated with the Ravenswood facility are not exempt as normal purchases from the requirements of SFAS 133. At March 31, 2006, the fair value of these contracts was a liability of $0.9 million and was recorded through earnings.

Financially-Settled Commodity Derivative Instruments that Do Not Qualify for Hedge Accounting: KeySpan subsidiaries also have employed a limited number of financial derivatives that do not qualify for hedge accounting treatment under SFAS 133. During the first quarter, we purchased a series of call options on the spread between the price of heating oil and the price of natural gas. The options cover the period February 2006 through October 2006 and further complement our hedging strategy noted above regarding sales to certain large-volume customers. As stated, we sell gas to certain large-volume customers at prices established monthly relative to a prevailing alternate fuel price, but limited to the cost of gas plus the tail block rate. Utility tariffs, however, establish an upper limit on the price KeySpan can charge for the sale of natural gas to these customers. These options are intended to limit KeySpan's exposure to spikes in heating oil prices. These options do not qualify for hedge accounting treatment under SFAS 133. We recorded a $0.7 million benefit in other income and deductions on the Consolidated Statement of Income to reflect the change in the market value associated with this derivative instrument for the first quarter of 2006.

Further, the Ravenswood facility has also employed a limited number of financial derivatives that do not qualify for hedge accounting treatment under SFAS 133 associated with the purchase of fuel oil. We recorded a $0.7 million expense in other income and deductions on the Consolidated Statement of Income to reflect the change in the market value associated with this derivative instrument for the first quarter of 2006.

On January 18, 2006, KeySpan entered into an International SWAP Dealers Association Master Agreement for a fixed for float unforced capacity financial swap (the ''Agreement'') with Morgan Stanley Capital Group Inc. (''Morgan Stanley''). The Agreement has a three year term beginning 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 will occur on a monthly basis based on the In-City Unforced Capacity price determined by the relevant New York Independent System Operator (''NYISO'') Spot Demand Curve Auction Market (''Floating Price''). For each monthly settlement period, the price difference will equal 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. KeySpan believes that the average annual monthly capacity market price will settle above the Fixed Price. This derivative instrument does not qualify for hedge accounting treatment under

SFAS 133 and is subject to mark-to-market accounting treatment; although currently there is no observable market reference to value this derivative instrument.

The table below summarizes the fair value of all of the above outstanding derivative instruments at March 31, 2006 and December 31, 2005, and the related line item on the Consolidated Balance Sheet. Fair value is the amount at which derivative instruments could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale.

	March 31, 2006	December 31, 2005
	(In Millions of Dollars)	
Gas Contracts:		
Other current assets	$ 2.7	$ 132.1
Other deferred charges	33.5	75.2
Regulatory asset	27.1	30.9
Other current liability	(25.6)	(39.8)
Other deferred liabilities	(22.4)	(44.3)
Regulatory liability	(31.0)	(175.4)
Oil Contracts:		
Other current assets	—	0.5
Other current liability	(5.6)	(6.8)
Other deferred liabilities	(0.7)	—
Electric Contracts:		
Other current assets	19.6	10.2
Other deferred charges	0.5	—
Other current liability	—	(0.7)
	$ (1.9)	$ (18.1)

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.

In 2005, 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 2005/2006 winter heating season—November 2005 through March 2006. These put options would have paid KeySpan up to $40,000 per heating degree day when the actual temperature was below 4,169 heating degree days, or approximately 5% warmer than normal, 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 $1.2 million and was amortized over the heating season. Weather for the first quarter of 2006 was approximately 8% warmer than normal in KeySpan's New England service territory; however for the entire primary winter heating season -November 2005 through March 2006—weather was slightly colder than normal. Therefore, there was no earnings impact associated with these weather derivatives, except for the amortization of the net premium cost. 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, 2006, KeySpan has received $5.2 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. At March 31, 2006, KeySpan has no outstanding margin calls to its counterparties.

We believe that our credit risk related to the above mentioned derivative financial instruments is no greater than the risk associated with the primary contracts which they hedge and that the elimination of a portion of the price risk reduces volatility in the reported results of operations, financial position and cash flows and lowers overall business risk.

5 RECENT ACCOUNTING PRONOUNCEMENTS

On March 31,2006, the Financial Accounting Standards Board (''FASB'') issued an Exposure Draft of proposed rules on employers' accounting for defined benefit pensions and other postretirement benefit plans that would require employers to fully recognize the plan's funded status on the balance sheet. If adopted as proposed, the new rules would be applied retroactively to prior financial statements presented and be effective for fiscal years ending after December 15, 2006. The new rules, if adopted as proposed, may significantly increase KeySpan's recorded pension and other postretirement liabilities and reduce its shareholders' equity. The comment period on this Exposure Draft ends on May 31, 2006. KeySpan is currently evaluating the Exposure Draft, and at this time cannot determine the full impact that the potential requirements of the Exposure Draft may have on its financial statements.

On July 14, 2005, the FASB issued an Exposure Draft ''Accounting for Uncertain Tax Positions,'' that would interpret SFAS 109, ''Accounting for Income Taxes.'' This proposal seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement requirements related to accounting for income taxes. KeySpan anticipates that implementation of this Exposure Draft in its proposed form will have minimal impact on its results of operations, financial position or cash flows.

In December 2004 the FASB issued SFAS 123 (revised 2004) ''Share-Based Payment.'' This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement revises certain provisions of SFAS 123 ''Accounting for Stock-Based Compensation'' and supersedes APB Opinion 25 ''Accounting for Stock Issued to Employees.'' The fair-value-based method in this Statement is similar to the fair-value-based method in SFAS 123 in most respects. However, the following are key differences between the two: entities are required to measure liabilities incurred to employees in share-based payment transactions at fair value as compared to using the intrinsic method allowed under SFAS 123; entities are required to estimate the number of instruments for which the requisite service is expected to be rendered, as compared to accounting for forfeitures as they occur under SFAS 123; and incremental compensation cost for a modification of the terms or conditions of an award are also measured differently under this Statement compared to Statement 123. This Statement also clarifies and expands SFAS 123's guidance in several areas. The effective date of this Statement is the beginning of the first fiscal year beginning after June 15, 2005. KeySpan adopted the prospective method of transition for stock options in accordance with SFAS 148 ''Accounting for Stock-Based Compensation—Transition and Disclosure.'' Accordingly, compensation expense has been recognized by employing the fair value recognition provisions of SFAS 123 for grants awarded after January 1, 2003. Therefore implementation of this Statement in January 2006 did not have a material impact on KeySpan's results of operations or financial position and no impact on its cash flows.

6 FINANCIAL GUARANTEES AND CONTINGENCIES

Variable Interest Entity: KeySpan has an arrangement with a variable interest entity through which we lease 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, or three steam generating units, directly from Consolidated Edison and leased it to our subsidiary. 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 our subsidiary, KeySpan Ravenswood, LLC, under the Master Lease. Monthly lease payments substantially equal the monthly interest expense on such debt securities.

The term of the Master Lease extends through June 20, 2009. On all future semi-annual payment dates, we have the right to: (i) either purchase the facility for the original acquisition cost of $425 million, plus the present value of the lease payments that would otherwise have been paid through June 2009; or (ii) terminate the Master Lease and dispose of the facility. In June 2009, when the Master Lease terminates, we may purchase the facility in an amount equal to the original acquisition cost, subject to adjustment, or surrender the facility to the lessor. If we elect not to purchase the property, the Ravenswood Facility will be sold by the lessor. We have guaranteed to the lessor 84% of the residual value of the original cost of the property.

We have classified the Master Lease as $412.3 million of long-term debt on the Consolidated Balance Sheet based on our current status as primary beneficiary. Further, we have an asset on the Consolidated Balance Sheet for an amount substantially equal to the fair market value of the leased assets at the inception of the lease, less depreciation since that date, or approximately $318.9 million.

If our subsidiary that leases the Ravenswood Facility, KeySpan Ravenswood LLC, was not able to fulfill its payment obligations with respect to the Master Lease payments, then the maximum amount KeySpan would be exposed to under its current guarantees would be $425 million plus the present value of the remaining lease payments through June 20, 2009.

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.''

Asset Retirement Obligations: KeySpan has various asset retirement obligations primarily associated with its gas distribution and electric generation activities. These obligations have remained substantially unchanged from December 31, 2005, except for accretion adjustments. 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; (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. At March 31, 2006, these obligations total $48.1 million. See KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Note 7 to the Consolidated Financial Statements ''Contractual Obligations, Financial Guarantees and Contingencies'' for additional information regarding these obligations.

Environmental Matters

New York Sites: Within the State of New York we have identified 43 historical manufactured gas plant (''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 us, have been identified to the New York State Public Service Commission (''NYPSC'') and the Department of Environmental Conservation (''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 with certain sites and one waterway. In March 2005, KeySpan withdrew its previously filed applications under the DEC's Brownfield Cleanup Program (''BCP'') because of the uncertainty associated with contribution suits which we may need to bring against other parties who impacted these sites for their share of remedial cost. As a result of the December 2004 Cooper Industries v. Aviall Services, Inc. decision by the United States Supreme Court and the emerging case law in New York, KeySpan continues to evaluate how to proceed with respect to participation in the BCP or alternative DEC remediation programs.

We have identified 28 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 27 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 $64.8 million.

The remaining 15 sites have been identified as being associated with the historical operations of KEDLI. One site has been fully investigated and requires no further action. Subject to the issues described above, 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 $53.7 million.

We presently estimate the remaining cost of our KEDNY and KEDLI MGP-related environmental remediation activities will be $349.6 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, the KEDNY and KEDLI rate plans generally provide for the recovery from customers of investigation and remediation costs of certain sites. At March 31, 2006, we have reflected a regulatory asset of $385.3 million for our KEDNY/KEDLI MGP sites. In October 2003, KEDNY and KEDLI filed a joint petition with the NYPSC seeking rate treatment for additional environmental costs that may be incurred at all of our New York MGP sites. That petition is still pending.

We are 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. We are 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 $1.6 million, which amount has been accrued by us. Expenditures incurred to date total $3.4 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. A subsidiary of National Grid USA (''National Grid''), 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 three sites each. 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.

We presently estimate the remaining cost of the Massachusetts KEDNE MGP-related environmental cleanup activities will be $12.2 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 date KeySpan acquired these subsidiaries, with respect to these MGP-related activities total $31.3 million.

We 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 we have entered into cost sharing agreements with other parties who share responsibility for remediation of these sites. EnergyNorth also has entered into an agreement with the United States Environmental Protection Agency (''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.

We presently estimate the remaining cost of EnergyNorth MGP-related environmental cleanup activities will be $30.9 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 date KeySpan acquired this subsidiary, with respect to these MGP-related activities total $17.6 million.

By rate orders, the Massachusetts Department of Telecommunications and Energy (''MADTE'') and the New Hampshire Public Utility Commission (''NHPUC'') provide for the recovery of site investigation and remediation costs and, accordingly, at March 31, 2006, we have reflected a regulatory asset of $64.6 million for the KEDNE MGP sites.

KeySpan New England, LLC Sites: We are aware of three non-utility sites associated with KeySpan New England, LLC, a successor company to Eastern Enterprises, for which we 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 have entered into a cost sharing agreement under which each company has 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 has been executed on favorable terms to KeySpan and the Beazer lawsuit has been discontinued.

We presently estimate the remaining cost of our environmental cleanup activities for these three non-utility sites will be approximately $19.4 million, which amount has been accrued by us 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 $13.4 million.

We believe 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.

See KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005 Note 7 to those Consolidated Financial Statements ''Contractual Obligations, Financial Guarantees and Contingencies'' for further information on environmental matters

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, or in KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, 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.

On March 20, 2006, a purported class action lawsuit was filed alleging breach of fiduciary duty against us and our directors. The complaint, which was filed in the New York State Supreme Court for the County of Kings, relates to the execution of the merger agreement with National Grid plc and alleges that the merger consideration which our stockholders will receive in connection with the proposed merger transaction is inadequate and unfair because the transaction value of $42.00 for each share of our common stock does not provide our stockholders with a meaningful premium over the market price of the common stock. We believe the lawsuit is without merit and we intend to contest it vigorously.

Other Contingencies: We derive a substantial portion of our revenues in our Electric Services segment from a series of agreements with LIPA pursuant to which we manage LIPA's transmission and distribution system and supply the majority of LIPA's customers' electricity needs. KeySpan and LIPA have entered

into agreements to extend, amend, and restate these contractual arrangements. See Note 10 ''2006 LIPA Settlement'' for a further discussion of these agreements.

LIPA completed its strategic review initiative that it had undertaken in connection with, among other reasons, its option under the Generation Purchase Rights Agreement. As part of its review, LIPA engaged a team of advisors and consultants, held public hearings and explored its strategic options, including continuing its existing operations, municipalizing, privatizing, selling some, but not all of its assets, becoming a regulator of rates and services, or merging with one or more utilities. Upon completion of its strategic review, LIPA determined that it would continue its existing operations, as part of its settlement with KeySpan and the renegotiated 2006 LIPA Agreements discussed in Note 10 ''2006 LIA Settlement.'' Following the announcement of the proposed acquisition of KeySpan by National Grid, LIPA, National Grid and KeySpan have engaged in discussions concerning the impact of the transaction on LIPA's operations. At this time, we are unable to determine what impact, if any, such discussions may have on the 2006 LIPA Agreements and the receipt and timing of governmental approvals relating thereto.

As reported in KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, KeySpan is currently in discussions with the Internal Revenue Service (''IRS'') at the Appeals level with regard to the Long Island Lighting Company's (''LILCO's'') tax returns for the tax years ending December 31, 1996 through March 31, 1999 and KeySpan's and the Brooklyn Union Gas Company's tax returns for the years ending September 30, 1997 through December 31, 1998. The primary issue relates to the valuation of the transferred assets in the KeySpan/LILCO combination. Additionally, the IRS has recently commenced the examination of KeySpan's tax returns for the year ended 2002 and 2003. At this time, we cannot predict the result of these audits. However, KeySpan has evaluated the potential outcomes based on the issues raised and progress of the discussions to date. KeySpan believes that it has adequately provided for the additional tax, if any, which may result.

Financial Guarantees

KeySpan has issued financial guarantees in the normal course of business, primarily on behalf of its subsidiaries, to various third party creditors. At March 31, 2006, 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		**Amount of Exposure**	**Expiration Dates**
		(In Millions of Dollars)	
Guarantees for Subsidiaries			
Medium-Term Notes—KEDLI	(i)	$ 525.0	2008 - 2010
Industrial Development Revenue Bonds	(ii)	128.3	2027
Ravenswood—Master Lease	(iii)	425.0	2009
Ravenswood—Sale/leaseback	(iv)	403.5	2019
Surety Bonds	(v)	71.7	2006 - 2008
Commodity Guarantees and Other	(vi)	52.9	2006 - 2009
Letters of Credit	(vii)	73.5	2006 - 2010
		$ 1,679.9	

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

(i) KeySpan has fully and unconditionally guaranteed $525 million to holders of Medium-Term Notes issued by KEDLI. These notes are due to be repaid on January 15, 2008 and 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.

(ii) KeySpan has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to $128 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 has been extended to June 20, 2009. The Master Lease is classified as $412.3 million long-term debt on the Consolidated Balance Sheet.

(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.

(v) KeySpan has agreed to indemnify the issuers of various surety and performance bonds associated with certain construction projects being performed by certain current or 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, 2006, the total cost to complete such remaining bonded projects is estimated to be approximately $33 million.

(vi) KeySpan has guaranteed commodity-related payments for subsidiaries within the Energy Services segment, as well as KeySpan Ravenswood, LLC. 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, 2006.

(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.

7 STOCK BASED COMPENSATION

From time to time, KeySpan awards stock based compensation to officers, directors, consultants and certain other management employees, primarily under the Long Term Performance Incentive Compensation Plan (the ''Incentive Plan''). The Incentive Plan provides for the award of incentive stock options, non-qualified stock options, performance shares and restricted shares. The purpose of the Incentive Plan is to optimize KeySpan's performance through incentives that directly link the participant's goals to those of KeySpan's shareholders and to attract and retain participants who make significant contributions to the success of KeySpan.

Under this Plan, 19,250,000 shares were authorized for issuance of which the total shares awarded to date include 16.9 million stock options, 222,143 shares of restricted stock, and 891,555 performance shares. At March 31, 2006, after adjusting for forfeitures, there are approximately 2.8 million shares still eligible to be granted under the Incentive Plan. In addition, under previous plans, there were an additional 1.7 million shares authorized for which approximately 1.2 million stock options were awarded.

In 2005, KeySpan continued to apply APB Opinion 25 ''Accounting for Stock Issued to Employees,'' in accounting for grants awarded prior to January 1, 2003. No compensation cost had been recognized for these stock option awards since the exercise prices and market values were equal on the grant dates. Had compensation cost for these plans been determined based on the fair value at the grant dates for awards under the plans consistent with SFAS 123 ''Accounting for Stock-Based Compensation,'' our net

income and earnings per share for the three months ended March 31, 2005 would have decreased to the pro-forma amounts indicated below:

	March 31, 2005 (In Millions of Dollars, Except Per Share Amounts)
Earnings available for common stock:	
As reported	$ 234.4
Add: recorded stock-based compensation expense, net of tax	2.9
Deduct: total stock-based compensation expense, net of tax	(3.4)
Pro-forma earnings	$ 233.9
Earnings per share:	
Basic—as reported	$ 1.45
Basic—pro-forma	$ 1.45
Diluted—as reported	$ 1.44
Diluted—pro-forma	$ 1.44

In 2003, KeySpan adopted the prospective method of transition of accounting for stock based compensation expense in accordance with SFAS 148 ''Accounting for Stock-Based Compensation—Transition and Disclosure''. Accordingly, compensation expense has been recognized by employing the fair value recognition provisions of SFAS 123 for grants awarded after January 1, 2003.

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 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 three months ended March 31, 2006, KeySpan recorded an expense of $0.3 million for stock option awards previously accounted for under APB 25 and which have not fully vested.

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.

	Three Months Ended	
	March 31, 2006	March 31, 2005
	(In Millions of Dollars, Except Per Share Amounts)	
Performance shares	$ 2.3	$ 1.7
Restricted stock	3.7	0.2
Stock options	1.5	1.5
EDSPP discount	1.5	1.2
Total stock-based compensation included in operations and maintenance expense	9.0	4.6
Income tax (benefit)	(3.2)	(1.7)
	5.8	2.9

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 three months ended March 31, 2006 and 2005, cash received from stock options exercised was $15.5 million and $24.3 million, respectively. The actual tax benefit realized for tax deductions from stock options exercised was $1.6 million and $2.6 million for the three months ended March 31, 2006

and 2005, respectively. The benefits received from these tax deductions were 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.

The following represents a discussion of the various awards granted under our stock based compensation plans:

Performance shares

Performance shares were awarded under the Incentive Plan in 2004 and 2005 based upon the attainment of overall corporate performance goals. These performance shares are measured over a three year period by comparing KeySpan's cumulative total shareholder return to the S&P Utilities Group. For actual performance achieved at a threshold level, 50% of the award will be granted; for actual performance achieved at a targeted level, 100% of the award will be granted; and for actual performance achieved at the maximum level, 150% of the award will be granted The 2004 and 2005 awards are being expensed ratably over their remaining performance periods. Previously, these awards met the performance based criteria under SFAS 123. However, under SFAS 123(R), the goals associated with these awards are now viewed as market conditions, which prohibits the reversal of previously recognized expense should the attainment of the market condition not be met.

The 2006 performance share award was revised to reflect the new performance condition criteria under SFAS 123(R). In 2006, 314,560 performance shares were granted to officers. Performance shares were granted with a three-year performance period with a threshold, target and maximum performance level. The number of performance shares earned at the end of the performance period can range from 0% to 150% of the shares granted and will be linked to two performance measures: the percentage improvement in return on invested capital, or ''ROIC'', and KeySpan's cumulative three-year total stockholder return, or ''TSR'', relative to the cumulative three-year TSR for the Standard and Poor's Utilities Group, using a matrix approach that encompasses both measures. The ROIC goal will act as the primary trigger. If the ROIC goal performance is below the threshold level, all shares shall be forfeited without payment. Upon a change of control, performance shares shall be distributed based upon the greater of the number of performance shares originally awarded at target level or the number of shares earned based on actual performance through the change of control date. Under the performance based criteria associated with SFAS 123(R), the inability to achieve goals requires reversal of the previously recognized expense.

Performance share awards were priced at fair value. The unearned compensation as of March 31, 2006 associated with all of the performance share awards was $18.4 million. Upon a change of control, all performance share awards granted and outstanding will vest immediately.

Restricted Stock Awards

KeySpan has made certain grants of restricted stock to officers and directors under the Incentive Plan. Awards of restricted stock were made in 2002, 2005 and 2006. These awards may not be sold or otherwise transferred until certain restrictions have lapsed. The unearned stock-based compensation related to these awards is being amortized to compensation expense over the period in which the awards vest. The share based expense for these awards was determined based on the fair value of the stock at the date of grant applied to the total number of shares that were anticipated to fully vest. The 2002 and 2005 awards will be fully expensed by the end of this year and the 2006 award was expensed in the first quarter of 2006. Upon a change of control, all restricted stock awards will vest immediately. The unearned compensation as of March 31, 2006 associated with these awards was $0.4 million.

Employee Discount Stock Purchase Plan

KeySpan's Employee Discount Stock Purchase Plan (''EDSPP'') allows KeySpan employees to purchase shares of KeySpan stock at a 10% discount through payroll deductions. KeySpan is currently expensing the discount. The number of shares of common stock authorized for issuance under the EDSPP is 1,750,000 shares and there are 538,551 shares remaining to be issued.

Stock Options

The stock option component of the Incentive Plan entitles the participants to purchase shares of common stock at an exercise price per share which is no less than the closing price of the common stock on the date of the grant. Stock options generally vest over a three-to-five year period and have an exercise period of ten years. Upon a change of control, all stock options granted and outstanding will vest immediately.

The value of all stock option grants are estimated on the date of the grant using the Black-Scholes option-pricing model. There were no stock grants issued in 2006. The following table presents the weighted average fair value, exercise price and assumptions used for the 2005 stock option grant:

	2005
Fair value of grants issued	$ 5.47
Dividend yield	4.74%
Expected volatility	23.48%
Risk free rate	3.22%
Expected lives	6.5 years
Exercise price	$ 37.54

A summary of the status of our fixed stock option plans and changes is presented below for the three months ended March 31, 2006:

Fixed Options	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (In Millions)
Outstanding at beginning of period	10,443,055	$ 33.74	
Granted during the year	—	$ —	
Exercised	(483,241)	$ 32.25	
Forfeited	(7,656)	$ 38.52	
Outstanding at end of period	9,952,158	$ 33.81	$ 49.0
Exercisable at end of period	7,280,106	$ 32.72	$ 43.7

The total intrinsic value of the options exercised during the periods ending March 31, 2006 and 2005 was approximately $3.1 million and $4.5 million, respectively.

Remaining Contractual Life	Options Outstanding at March 31, 2006	Weighted Average Exercise Price	Range of Exercise Price	Options Exercisable at March 31, 2006	Weighted Average Exercise Price	Range of Exercise Price
1 years	119,500	$ 30.50	30.50	119,500	$ 30.50	30.50
2 years	186,410	$ 32.52	$19.15 - 32.63	186,410	$ 32.52	$19.15 - 32.63
3 years	729,625	$ 27.99	$24.73 - 29.38	729,625	$ 27.99	$24.73 - 29.38
4 years	382,181	$ 26.97	$21.99 - 27.06	382,181	$ 26.97	$21.99 - 27.06
5 years	979,987	$ 22.69	$22.50 - 32.76	979,987	$ 22.69	$22.50 - 32.76
6 years	1,582,578	$ 39.50	$ 39.50	1,582,578	$ 39.50	$ 39.50
7 years	1,841,906	$ 32.66	$ 32.66	1,490,006	$ 32.66	$ 32.66
8 years	1,231,531	$ 32.40	$ 32.40	807,931	$ 32.40	$ 32.40
9 years	1,477,075	$ 37.54	$ 37.54	674,504	$ 37.54	$ 37.54
10 years	1,421,365	$ 39.25	$ 39.25	327,384	$ 39.25	$ 39.25
	9,952,158			7,280,106		

As of March 31, 2006, there are approximately 2.7 million options which have not yet vested. The unearned compensation cost related to these stock option awards is $7.8 million which is expected to be recognized over a weighted average period of 2.0 years.

8 POST-RETIREMENT BENEFITS

Pension Plans: The following information represents the consolidated net periodic pension cost for the three months ended March 31, 2006 and 2005 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 MADTE, respectively for pension costs and other postretirement benefit costs. Further, KeySpan's electric subsidiaries are subject to certain ''true-up'' provisions in accordance with the LIPA service agreements.

The calculation of net periodic pension cost is as follows:

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars)	
Service cost, benefits earned during the period	$ 16.1	$ 15.0
Interest cost on projected benefit obligation	38.6	37.4
Expected return on plan assets	(47.0)	(42.9)
Net amortization and deferral	21.9	18.9
Total pension cost	$ 29.6	$ 28.4

Other Post-retirement Benefits: The following information represents the consolidated net periodic other postretirement benefit cost for the three months ended March 31, 2006 and 2005 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:

	Three Months Ended March 31,	
	2006	2005
	(In Millions of Dollars)	
Service cost, benefits earned during the period	$ 6.9	$ 6.3
Interest cost on accumulated postretirement benefit obligation	20.2	19.9
Expected return on plan assets	(9.1)	(9.1)
Net amortization and deferral	16.6	16.5
Other postretirement cost	$ 34.6	$ 33.6

During the first quarter of 2006, KeySpan contributed $4.0 million to its pension plans and $9.0 million to its other postretirement benefit plans. KeySpan anticipates contributing an additional $107 million to its pension and other postretirement benefit plans during the remainder of 2006. These estimated contribution levels are subject to change based on future market returns, interest rates and certain other measurements. Actual contributions, therefore, may vary from these levels.

9 COMMERCIAL PAPER

At March 31, 2006, 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 0.07% based on our credit rating of A3 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, 2006, KeySpan's consolidated indebtedness was 48.9% 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, 2006, we had cash and temporary cash investments of $313.1 million. During the first quarter of 2006, we repaid $160.8 million of commercial paper and, at March 31, 2006, $496.8 million of commercial paper was outstanding at a weighted average annualized interest rate of 4.71%. At March 31, 2006, KeySpan had the ability to issue up to an additional $1 billion, under its commercial paper program.

10 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. At the time of this transaction, 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.'' Each of the 2006 LIPA Agreements will become effective as of January 1, 2006, upon all of the 2006 LIPA Agreements receiving the required governmental approvals; otherwise none of the 2006 LIPA Agreements will become effective. Following the announcement of the proposed acquisition of KeySpan by National Grid, LIPA, National Grid and KeySpan have engaged in discussions concerning the impact of the transaction on LIPA's operations. At this time, we are unable to determine what impact, if any, such discussions may have on the 2006 LIPA Agreements and the receipt and timing of governmental approvals relating thereto.

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 will increase from approximately $50 million to approximately $200 million. These credits and attributes may be used to satisfy KeySpan's previously incurred indemnity obligation to LIPA for any federal income tax liability that may result from the settlement of a pending Internal Revenue Service (''IRS'') audit for LILCO's tax year ended March 31, 1999. In recognition of these items, as well as for the

modification and extension of the 1998 MSA and the elimination of the GPRA, upon effectiveness of the Settlement Agreement, KeySpan will record a contractual asset in the amount of approximately $160 million, of which approximately $110 million will be attributed to the right to utilize such additional tax credits and attributes and approximately $50 million will be amortized over the eight year term of the 2006 MSA. In order to compensate LIPA for the foregoing, KeySpan will pay LIPA $69 million in cash and will settle certain accounts receivable in the amount of approximately $91 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 has the option during the period January 1, 2006 to December 31, 2006 to purchase only 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. The 2006 Option Agreement replaces the GPRA, the expiration of which has been stayed pending effectiveness of the 2006 LIPA Agreements. 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 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. In the event such agreements do not become effective by reason of failure to secure the requisite governmental approvals, the GPRA will be reinstated for a period of 90 days.

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 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. Subject to certain limitations, KeySpan will be able to retain all operational efficiencies realized during the term of the 2006 MSA.

LIPA will continue 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.

11 KEYSPAN GAS EAST CORPORATION SUMMARY FINANCIAL INFORMATION

KEDLI is a wholly owned subsidiary of KeySpan. KEDLI was formed on May 7, 1998 and on May 28, 1998 acquired substantially all of the assets related to the gas distribution business of the Long Island Lighting Company. KEDLI established a program for the issuance, from time to time, of up to $600 million aggregate principal amount of Medium-Term Notes, which are fully and unconditionally guaranteed by the parent, KeySpan Corporation. On February 1, 2000, KEDLI issued $400 million of 7.875% Medium-Term Notes due 2010. In January 2001, KEDLI issued an additional $125 million of Medium-Term Notes at 6.9% due January 2008. The following condensed financial statements are required to be disclosed by SEC regulations and set forth those of KEDLI, KeySpan Corporation as guarantor of the Medium-Term Notes and our other subsidiaries on a combined basis.

KeySpan Gas East Corporation

Statement of Income

	Three Months Ended March 31, 2006				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
Revenues	$ 0.2	$ 543.7	$ 2,117.4	$ (0.2)	$ 2,661.1
Operating Expenses					
Purchased gas	—	364.9	1,146.5	—	1,511.4
Fuel and purchased power	—	—	130.0	—	130.0
Operations and maintenance	7.9	36.3	361.8	—	406.0
Intercompany expense	—	1.2	(1.0)	(0.2)	—
Depreciation and amortization	—	25.1	85.2	—	110.3
Operating taxes	—	17.7	100.5	—	118.2
Total Operating Expenses	7.9	445.2	1,823.0	(0.2)	2,275.9
Income from equity investments	—	—	3.4	—	3.4
Gain on sale of property	—	—	0.5	—	0.5
Operating Income (Loss)	(7.7)	98.5	298.3	—	389.1
Interest charges	(39.8)	(14.1)	(53.0)	40.7	(66.2)
Other income and (deductions)	249.2	—	19.4	(257.2)	11.4
Total Other Income and (Deductions)	209.4	(14.1)	(33.6)	(216.5)	(54.8)
Income Taxes (Benefit)	(6.3)	29.9	102.7	—	126.3
Net Income	$ 208.0	$ 54.5	$ 162.0	$ (216.5)	$ 208.0

Statement of Income

	Three Months Ended March 31, 2005				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
Revenues	$ 0.2	$ 503.6	$ 1,976.9	$ (0.2)	$ 2,480.5
Operating Expenses					
Purchased gas	—	314.1	994.7	—	1,308.8
Fuel and purchased power	—	—	133.1	—	133.1
Operations and maintenance	6.3	32.5	348.4	—	387.2
Intercompany expense	—	1.3	(1.3)		—
Depreciation and amortization	—	26.5	79.6	—	106.1
Operating taxes	—	17.0	94.9	—	111.9
Total Operating Expenses	6.3	391.4	1,649.4	—	2,047.1
Income from equity investments	—	—	5.3	—	5.3
Operating Income (Loss)	(6.1)	112.2	332.8	(0.2)	438.7
Interest charges	(29.7)	(14.8)	(63.3)	47.8	(60.0)
Other income and (deductions)	261.7	0.1	13.4	(282.9)	(7.7)
Total Other Income and (Deductions)	232.0	(14.7)	(49.9)	(235.1)	(67.7)
Income Taxes (Benefit)	(9.8)	34.1	111.0	—	135.3
Net Income	$ 235.7	$ 63.4	$ 171.9	$ (235.3)	$ 235.7

KeySpan Gas East Corporation

Balance Sheet

	March 31, 2006				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
ASSETS					
Current Assets					
Cash & temporary cash investments	$ 276.2	$ 3.6	$ 33.3	$ —	$ 313.1
Accounts receivable, net	0.7	226.1	891.0	—	1,117.8
Other current assets	3.0	202.9	1,042.0	—	1,247.9
	279.9	432.6	1,966.3	—	2,678.8
Equity Investments	4,791.3	—	134.9	(4,674.1)	252.1
Property					
Gas	—	2,128.7	5,223.8	—	7,352.5
Other	—	1.7	2,932.5	—	2,934.2
Accumulated depreciation and depletion	—	(409.7)	(2,495.5)	—	(2,905.2)
	—	1,720.7	5,660.8	—	7,381.5
Intercompany Accounts Receivable	2,607.0	582.1	786.9	(3,976.0)	—
Deferred Charges	481.4	300.9	2,397.9	—	3,180.2
Total Assets	$8,159.6	$3,036.3	$ 10,946.8	$ (8,650.1)	$ 13,492.6
LIABILITIES AND CAPITALIZATION					
Current Liabilities					
Accounts payable	$ 46.9	$ 91.6	$ 629.1	$ —	$ 767.6
Commercial paper	496.8	—	—	—	496.8
Other current liabilities	349.2	43.7	174.2	—	567.1
	892.9	135.3	803.3	—	1,831.5
Intercompany Accounts Payable	45.0	803.2	1,599.0	(2,447.2)	—
Deferred Credits and Other Liabilities					
Deferred income tax	25.4	335.2	783.4	—	1,144.0
Other deferred credits and liabilities	694.6	160.2	1,101.5	—	1,956.3
	720.0	495.4	1,884.9	—	3,100.3
Capitalization					
Common shareholders' equity	4,639.3	951.5	3,708.8	(4,674.1)	4,625.5
Long-term debt	1,862.4	650.9	2,935.5	(1,528.8)	3,920.0
Total Capitalization	6,501.7	1,602.4	6,644.3	(6,202.9)	8,545.5
Minority Interest in Subsidiary Companies	—	—	15.3	—	15.3
Total Liabilities & Capitalization	$8,159.6	$3,036.3	$ 10,946.8	$ (8,650.1)	$ 13,492.6

KeySpan Gas East Corporation

Balance Sheet

	December 31, 2005				
	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
	(In Millions of Dollars)				
ASSETS					
Current Assets					
Cash & temporary cash investments	$ 79.6	$ 3.5	$ 41.4	$ —	$ 124.5
Accounts receivable, net	0.6	149.9	822.2	—	972.7
Other current assets	4.0	368.9	1,550.0	—	1,922.9
	84.2	522.3	2,413.6	—	3,020.1
Investments and Other	4,571.0	0.7	128.2	(4,457.5)	242.4
Property					
Gas	—	2,111.3	5,164.6	—	7,275.9
Other	—	—	3,092.8	—	3,092.8
Accumulated depreciation and depletion	—	(400.6)	(2,631.2)	—	(3,031.8)
	—	1,710.7	5,626.2	—	7,336.9
Intercompany Accounts Receivable	2,813.6	44.6	95.6	(2,953.8)	—
Deferred Charges	482.5	316.1	2,414.6	—	3,213.2
Total Assets	$7,951.3	$2,594.4	$ 10,678.2	$ (7,411.3)	$ 13,812.6
LIABILITIES AND CAPITALIZATION					
Current Liabilities					
Accounts payable	$ 36.4	$ 149.7	$ 900.9	$ —	$ 1,087.0
Commercial paper	657.6	—	—	—	657.6
Other current liabilities	196.2	128.5	85.9	—	410.6
	890.2	278.2	986.8	—	2,155.2
Intercompany Accounts Payable	51.8	338.3	1,049.8	(1,439.9)	—
Deferred Credits and Other Liabilities					
Deferred income tax	27.2	330.6	800.1	—	1,157.9
Other deferred credits and liabilities	634.0	225.3	1,240.0	—	2,099.3
	661.2	555.9	2,040.1	—	3,257.2
Capitalization					
Common shareholders' equity	4,485.4	897.0	3,539.3	(4,457.6)	4,464.1
Long-term debt	1,862.7	525.0	3,046.9	(1,513.8)	3,920.8
Total Capitalization	6,348.1	1,422.0	6,586.2	(5,971.4)	8,384.9
Minority Interest in Subsidiary Companies	—	—	15.3	—	15.3
Total Liabilities & Capitalization	$7,951.3	$2,594.4	$ 10,678.2	$ (7,411.3)	$ 13,812.6

KeySpan Gas East Corporation

Statement of Cash Flows

	Three Months Ended March 31, 2006			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
	(In Millions of Dollars)			
Operating Activities				
Net Cash Provided by Operating Activities	$ 32.7	$ 142.1	$ 369.1	$ 543.9
Investing Activities				
Capital expenditures	—	(20.8)	(101.4)	(122.2)
Cost of removal	—	(0.6)	(6.1)	(6.7)
Net Cash Provided by (Used in) Investing Activities	—	(21.4)	(107.5)	(128.9)
Financing Activities				
Treasury stock issued	15.5	—	—	15.5
Payment of debt, net	(160.8)	—	—	(160.8)
Common and preferred stock dividends paid	(81.1)	—	—	(81.1)
Net intercompany accounts	390.3	(120.6)	(269.7)	—
Net Cash Provided by (Used in) Financing Activities	163.9	(120.6)	(269.7)	(226.4)
Net Increase (Decrease) in Cash and Cash Equivalents	$ 196.6	$ 0.1	$ (8.1)	$ 188.6
Cash and Cash Equivalents at Beginning of Period	79.6	3.5	41.4	124.5
Cash and Cash Equivalents at End of Period	$ 276.2	$ 3.6	$ 33.3	$ 313.1

Statement of Cash Flows

	Three Months Ended March 31, 2005			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
	(In Millions of Dollars)			
Operating Activities				
Net Cash Provided by (Used in) Operating Activities	$ 33.4	$ 81.6	$ 268.4	$ 383.4
Investing Activities				
Capital expenditures	—	(17.0)	(94.8)	(111.8)
Cost of removal	—	(0.3)	(4.5)	(4.8)
Proceeds from sale of property	—	—	48.1	48.1
Net Cash Used in Investing Activities	—	(17.3)	(51.2)	(68.5)
Financing Activities				
Treasury stock issued	24.3	—	—	24.3
Payment of debt, net	(941.4)	—	(15.0)	(956.4)
Common and preferred stock dividends paid	(75.9)	—	—	(75.9)
Other	9.1	—	—	9.1
Intercompany dividend payment	265.0		(265.0)	—
Net intercompany accounts	187.5	(68.6)	(118.9)	—
Net Cash Provided by (Used in) Financing Activities	(531.4)	(68.6)	(398.9)	(998.9)
Net Increase (Decrease) in Cash and Cash Equivalents	$ (498.0)	$ (4.3)	$ (181.7)	$ (684.0)
Net Cash Flow from Discontinued Operations	—	—	(15.0)	(15.0)
Cash and Cash Equivalents at Beginning of Period	580.7	(0.9)	342.2	922.0
Cash and Cash Equivalents at End of Period	$ 82.7	$ (5.2)	$ 145.5	$ 223.0

SECTION III: KEYSPAN'S FINANCIAL STATEMENTS: IFRS RESTATEMENT

1 Basis of preparation

The tables below reconcile the consolidated net income of KeySpan for each of the three years ended 31 December 2005 and the three months ended 31 March 2006 and its consolidated shareholders' equity as of the end of each of those periods prepared under US GAAP to such amounts attributable to its ongoing operations on a basis which is consistent in all material respects with the accounting policies of the Company in accordance with IFRS, as required by Listing Rule 13.5.27(2)(a).

During the three years ended 31 December 2005, KeySpan sold its interests in The Houston Exploration Company, KeySpan Canada and certain other entities (the ''**Sold Businesses**''). As a consequence of legal and contractual restrictions, the Directors of the Company are unable to gain sufficient access to the books, records and management of the Sold Businesses to enable the preparation of the adjustments required to the net income and shareholders' equity attributable to these sold businesses in order to present them on a basis which is consistent in all material respects with the accounting policies of the Company. Therefore, the reconciliations for the three years ended 31 December 2005 and the three months ended 31 March 2006 are presented in two sections:

(a) the adjustments represent those required to remove the net income and amounts of shareholders' equity attributable to the Sold Businesses from the consolidated net income and consolidated shareholders' equity of KeySpan as presented under US GAAP in order to present the net income and shareholders' equity under US GAAP attributable to the ongoing operations of KeySpan (the ''**Sold Businesses Adjustments**''); and

(b) the adjustments required to the net income and shareholders' equity under US GAAP attributable to the ongoing operations of KeySpan to present them on a basis which is consistent in all material respects with the accounting policies of the Company (the ''**Accounting Policy Adjustments**'').

This presentation is considered by the Directors of the Company to be most relevant to National Grid Shareholders in determining whether to approve the proposed transaction as the restated financial information presented relates solely to the ongoing business being acquired.

2 Reconciliation of KeySpan's financial information from US GAAP to the accounting policies of the Company

Consolidated net income

	Note	Year ended 31 December 2003	2004	2005	Three months ended 31 March 2006
		US Dollars in millions			
Consolidated net income under US GAAP, as reported†		**386.7**	**463.7**	**390.2**	**208.0**
Sold Businesses Adjustments:					
Adjustment to exclude the results of the Sold Businesses from the consolidated net income of KeySpan		(96.9)	(178.3)	0.4	—
Net income under US GAAP attributable to the ongoing operations of KeySpan		**289.8**	**285.4**	**390.6**	**208.0**
Accounting Policy Adjustments:					
Regulatory accounting	a	(61.0)	4.3	70.7	(146.4)
Derivatives and financial instruments	b	(67.1)	(17.9)	(14.0)	19.0
Pensions and other post-employment benefits	c	95.7	106.2	115.1	37.5
Environmental provisions	d	(2.6)	(40.7)	114.4	(8.7)
Deferred taxes	e	(18.0)	(8.7)	(6.3)	(9.1)
Variable interest entity	f	55.4	—	—	—
Goodwill	g	7.2	(7.5)	(0.9)	—
Other	h	(13.0)	(6.0)	(2.7)	(0.5)
Tax effects of adjustments	i	(10.4)	(9.7)	(112.5)	40.5
Net income attributable to the ongoing operations of KeySpan under the accounting policies of the Company		**276.0**	**305.4**	**554.5**	**140.3**

† As reported in filings with the SEC on Forms 10-K in respect of the years ended 31 December 2003, 2004 and 2005 and Form 10-Q in respect of the three months ended 31 March 2006.

Consolidated shareholders' equity

	Note	As of December 2003	As of December 2004	As of December 2005	As of 31 March 2006
		US Dollars in millions			
Consolidated shareholders' equity under US GAAP, as reported†		**3,754.2**	**3,914.5**	**4,464.1**	**4,625.5**
Sold Businesses Adjustments:					
Adjustment to exclude the results of the Sold Businesses from the consolidated shareholders' equity of KeySpan		(909.2)	(13.2)	—	—
Shareholders' equity under US GAAP attributable to the ongoing operations of KeySpan		**2,845.0**	**3,901.3**	**4,464.1**	**4,625.5**
Accounting Policy Adjustments:					
Regulatory accounting	a	(352.2)	(347.4)	(265.5)	(423.1)
Derivatives and financial instruments	b	(37.2)	22.8	32.3	51.7
Pensions and other post-employment benefits	c	(1,042.5)	(1,082.6)	(1,078.3)	(1,040.9)
Environmental provisions	d	(265.4)	(306.1)	(191.6)	(200.4)
Deferred taxes	e	2.4	(6.4)	(12.6)	(12.7)
Goodwill	g	(122.6)	(130.1)	(131.0)	(131.0)
Other	h	(34.1)	(40.1)	(33.7)	(34.2)
Tax effects of adjustments	i	657.1	647.4	534.7	575.2
Shareholders' equity attributable to the ongoing operations of KeySpan under the accounting policies of the Company		**1,650.3**	**2,658.6**	**3,318.4**	**3,410.1**

† As reported in filings with the SEC on Forms 10-K in respect of 31 December 2003, 2004 and 2005 and Form 10-Q in respect of 31 March 2006.

Sold Businesses Adjustments

During the three years ended 31 December 2005, KeySpan sold its interests in the Sold Businesses in a series of transactions. As set out in the basis of preparation note, due to certain legal and contractual restrictions, the Directors of the Company do not have sufficient access to the books, records and management of the Sold Businesses in order to restate their net income and shareholders' equity to a basis consistent in all material respects with the accounting policies of the Company. Therefore, these adjustments are presented to exclude the results (including the profit and loss arising on the disposal of the Sold Businesses) and shareholders' equity of the Sold Businesses under US GAAP from the restatement of the consolidated net profit and consolidated shareholders' equity of KeySpan as required by Listing Rule 13.5.27(2)(a).

Accounting Policy Adjustments

The Accounting Policy Adjustments presented in the above tables relate to adjustments required to restate the net income and shareholders' equity under US GAAP attributable to the ongoing businesses of KeySpan to a basis consistent in all material respects with the accounting policies of the Company.

a) Regulatory accounting

Statement of Financial Accounting Standards (''**SFAS**'') No. 71, *Accounting for the Effects of Certain Types of Regulation*, establishes US GAAP for utilities whose regulators have the power to approve and/or regulate rates that may be charged to customers. Provided that through the regulatory process the utility is substantially assured of recovering its allowable costs by the collection of revenue from its customers, such costs not yet recovered are deferred as regulatory assets. Such recoverable assets which would be recognised as regulatory assets under US GAAP are not recognised as assets under IFRS on the basis that they do not meet the criteria for recognition as an asset, intangible or other, under IFRS and are therefore expensed. Similarly, KeySpan records

regulatory liabilities when it will be required to pass cost savings or other benefits to rate payers through rate decreases. These liabilities are not recognised under IFRS.

b) Derivatives and Financial Instruments

IFRS accounting requirements for derivatives are set out in International Accounting Standard No. 39, *Financial Instruments: Recognition and Measurement* (''**IAS 39**''). Under US GAAP, SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (''**SFAS 133**'') and related pronouncements set out the applicable accounting requirements.

Both US GAAP and IFRS seek to provide a framework for identifying the existence of financial instruments including derivative contracts. All derivatives, including embedded derivatives, are required to be reported on the balance sheet at fair market value. However there are some differences in the detail of application of the standards.

A gain or loss arising on the cancellation of a derivative contract held as a qualifying hedge is recognised immediately under US GAAP. Under IFRS, such a gain or loss is deferred and recognised over the period to maturity of the underlying hedged item.

A contract that is ''entered into and continues to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements'' may qualify as an ''own use'' contract and thus be excluded from the scope of IAS 39. This exclusion has similarities to the ''Normal Purchases and Normal Sales (''**NPNS**'') exemption'' set out in SFAS 133. However, there are some significant differences that have impacts on the net income and shareholders' equity of KeySpan.

The general definition of a derivative is much broader under IAS 39 than under US GAAP. Under SFAS 133, a contract meets the definition of a derivative, if it (1) has an underlying and a notional or payment provision (or both), (2) requires no significant initial investment, and (3) its terms require or permit net settlement. Under IAS 39, neither notional nor the ability to settle net is a consideration in determining whether a contract is a derivative.

IAS 39 requires assessment for the existence of embedded derivatives in contracts deemed to be held for own use. Under SFAS 133, an embedded derivative assessment is required for a contract that meets the derivative definition, regardless of whether it qualifies and was elected for the NPNS exemption.

SFAS 133 requires a review for embedded derivatives only for contracts written, acquired, or amended on or after 1 January 1998 (or 1 January 1999 if the entity so chooses). IAS 39 requires all active contracts, regardless of inception date, to be assessed for embedded derivatives.

Differences also exist in the required classification of certain instruments. KeySpan has outstanding preferred stock as of 31 December 2003 and 2004. Under US GAAP, the preferred stock is required to be classified as equity, while under IFRS, the stock is required to be classified as a liability. Amounts classified as dividends on the preferred stock under US GAAP are classified as interest expense under IFRS.

c) Pensions and other post-employment benefits

Under US GAAP, past service costs that have vested are amortised over the remaining service period. Under IFRS, vested past service costs are recognised immediately as an expense.

IFRS allows an election to recognise in equity all cumulative actuarial gains and losses upon adoption of IFRS and subsequently as they occur. The Company made the election to recognise such gains and losses and accordingly, KeySpan has followed this policy choice for purposes of this reconciliation. Under US GAAP, it is not permissible to recognise actuarial gains and losses in equity when they occur, rather they are amortised in the income statement.

Under US GAAP, when a pension plan has an accumulated benefit obligation that exceeds the fair value of the plan asset, the unfunded amount is recognised as a minimum liability. Under IFRS, there is no requirement to recognise a minimum liability.

d) Environmental provisions

Under both US GAAP and IFRS, provisions are recognised when an obligation has been established. The methodology used by KeySpan to determine values under US GAAP is different from that used by the Company to under IFRS. KeySpan recognises the individual elements of the provision as their recognition becomes ''probable''. Although ''probable'' is not quantitatively defined for this purpose under US GAAP, a threshold higher than ''more likely than not'' is generally applied. The Company recognises provisions using an expected value methodology to determine its best estimate of the future cost. Additionally, IFRS requires discounting of these provisions, which is not required under US GAAP.

e) Deferred taxes

The primary differences between US GAAP and IFRS in accounting for deferred tax that affect KeySpan are the treatment of special deductions and share-based payments.

Under US GAAP, a special deduction that is available to certain of KeySpan's operations is recognised no earlier than the year in which it is tax deductible on the tax return and is not explicitly used to determine the rate used to measure deferred tax assets and liabilities. Under IFRS, this deduction is included in determining the rate to be used to measure deferred tax assets and liabilities.

Under US GAAP, deferred tax on share-based payments is computed based on expense recognised in the income statement and is adjusted at realisation of the tax benefit. Under IFRS, deferred tax is computed based on the expected tax deduction for share-based payments at the end of each reporting period.

f) Variable interest entity

KeySpan is the primary beneficiary of a variable interest entity, as defined in Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*, under US GAAP. As such, the variable interest entity is required to be consolidated by KeySpan beginning 31 December 2003. Under IFRS, the entity is required to be consolidated by KeySpan for all periods presented.

g) Impairment of goodwill

Under US GAAP, KeySpan tests its goodwill for impairment at the reporting unit level. Under IFRS, KeySpan is required to test goodwill for impairment at the cash generating unit (''**CGU**'') level. The effect of this difference resulted in additional impairments under IFRS of goodwill for certain CGUs and impairment of other assets in one CGU after goodwill had been eliminated entirely. In subsequent periods, reversal of certain of the other asset impairments occurred; such impairment reversal would not have been permitted under US GAAP.

h) Other measurement adjustments

Other differences between IFRS and US GAAP are not individually material and primarily relate to timing of recognition and measurement of asset retirement obligations and the accounting for share based payments.

i) Tax effects of adjustments

The tax effect of the IFRS adjustments discussed above resulted in a reduction in the net deferred tax liability.

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The Directors
Morgan Stanley & Co. Limited
20 Cabot Square
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E14 4QW

28 June 2006

Dear Sirs

National Grid plc (the "Company")

We report on the unaudited restatements (the "**restatements**"), under the accounting policies applied by the Company in preparing its financial statements, of the net income attributable to the ongoing operations of KeySpan Corporation ("**KeySpan**") for each of the three years ended 31 December 2005 and for the three months ended 31 March 2006 and of its shareholders' equity attributable to ongoing operations as at the end of each of those periods prepared under the accounting policies applied by KeySpan in preparing its financial statements. The restatements are set out in Part IV of the circular dated 28 June 2006 issued by the Company.

As set out in the basis of preparation paragraph on page 111, the Directors of the Company were unable to obtain sufficient access to the books, records and management of businesses sold in 2003, 2004 and 2005 (the "**Sold Businesses**"), to enable the preparation of adjustments to the results and shareholders' equity attributable to the Sold Businesses required to present them on a basis consistent in all material respects with the accounting policies of the Company. Therefore, adjustments are included within the Financial Information tables presented on pages 112 and 113 to exclude the results and shareholders' equity attributable to the Sold Businesses (the "**Sold Businesses Adjustments**") from the net income and shareholders' equity under US GAAP attributable to the ongoing businesses of KeySpan.

The adjustments made to restate the financial information to the basis consistent in all material respects with the accounting policies of the Company (the "**Accounting Policy Adjustments**") relate solely to the ongoing operations of KeySpan.

Responsibility

It is the responsibility solely of the Directors of the Company to prepare the restatements in accordance with item 13.5.27(2)(a) of the Listing Rules of the Financial Services Authority (the ''**Listing Rules**''). It is our responsibility to form an opinion, as required by the Listing Rules, on the restatements and to report our opinion to you.

The restatements incorporate significant adjustments to the historical consolidated financial statements of KeySpan. The historical consolidated financial statements of KeySpan for each of the three years ended 31 December 2005 were the responsibility of the directors of KeySpan. These financial statements received unqualified audit opinions. We do not accept any responsibility for any of the historical consolidated financial statements of KeySpan or for the audit reports thereon.

The historical interim consolidated financial statements of KeySpan for the three months ended 31 March 2006 prepared under US GAAP were the responsibility of the directors of KeySpan and have been filed with the Securities and Exchange Commission. We have neither audited nor reviewed these interim financial statements.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board. Our work, which involved no independent examination of any historical underlying financial information, consisted primarily of making enquiries of management of KeySpan to establish the accounting policies which were applied in the preparation of the historical underlying financial information.

We have considered the evidence supporting the restatements and discussed the restatements with the Directors of the Company.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards.

Opinion

In our opinion:

i) the Sold Businesses Adjustments have been properly compiled on the basis stated.

ii) the Accounting Policy Adjustments made are those appropriate for the purpose of presenting the net income attributable to the ongoing operations of KeySpan for the three years ended 31 December 2005 and the three months ended 31 March 2006 and the shareholders' equity attributable to its ongoing operations as at the end of each of those periods (as adjusted), on the basis consistent in all material respects with the accounting policies of the Company, and the restatements have been properly compiled on the basis stated.

Yours faithfully

PricewaterhouseCoopers LLP
Chartered Accountants

PART V

WORKING CAPITAL

On the basis that the Acquisition takes place, National Grid is of the opinion that it does not have sufficient working capital for its present requirements, that is, for at least the next twelve months from the date of this document.

This is because National Grid has decided not to put in place, at the present time, additional financing to cover its working capital requirements as increased by the cost of the Acquisition, due to the extended period to Completion and National Grid's desire not to incur commitment fees on financing arrangements unnecessarily.

At an appropriate time prior to Completion, National Grid intends to raise additional financing by issuing or putting in place additional bonds, committed medium term bank facilities, and shorter term committed bank facilities. National Grid has already had discussions with a number of banks and other financial institutions regarding their willingness to provide such financing. Therefore, taking into account these financing plans and the outcome of these discussions, as well as bonds in issue or to be issued, available committed facilities and other uncommitted money market facilities, National Grid is of the opinion that the Group will have sufficient funds to complete the Acquisition and to meet the Enlarged Group's present working capital requirements.

PART VI

ADDITIONAL INFORMATION

1 Responsibility

The Company and the Directors, whose names are set out in paragraph 3 below, accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Company and the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

2 The Company

(a) The Company was incorporated and registered in England and Wales on 11 July 2000 under the Companies Act as a private company limited by shares with company number 4031152. The Company was re-registered as a public limited company on 29 November 2000 and adopted the name National Grid plc on 25 July 2005. The principal legislation under which the Company operates, and pursuant to which the National Grid Shares have been created, is the Companies Act and regulations thereunder.

(b) The Company's registered office and principal place of business is 1-3 Strand, London WC2N 5EH. The telephone number of the registered office is 020 7004 3000.

3 Directors

(a) The Directors of the Company are as follows:

Sir John Parker (Chairman)
Roger Urwin (Group Chief Executive)
Steve Holliday (Deputy Group Chief Executive)
Steve Lucas (Group Finance Director)
Nick Winser (Group Director)
Mike Jesanis (Group Director)
Edward Astle (Group Director)
Ken Harvey (Non-Executive Director)
John Allan (Non-Executive Director)
John Grant (Non-Executive Director)
Paul Joskow (Non-Executive Director)
Stephen Pettit (Non-Executive Director)
Maria Richter (Non-Executive Director)
George Rose (Non-Executive Director)

(b) Each of the Directors can be contacted at the Company's registered address at 1-3 Strand, London WC2N 5EH.

4 Directors' and other interests

4.1 Directors' interests in National Grid Shares

As at 27 June 2006, being the latest practicable date prior to the publication of this document, the beneficial interests of the Directors and their connected persons (within the meaning of Section 346 of the Companies Act) in the Issued Ordinary Share Capital of the Company, which:

(i) have been notified to the Company pursuant to Section 324 or 328 of the Companies Act; or

(ii) are required pursuant to Section 325 of the Companies Act to be entered in the register to be kept in accordance with that Section; or

(iii) are interests of a connected person (within the meaning of Section 346 of the Companies Act) of a Director, which would, if the connected person were a Director, be required to be disclosed under

paragraph (i) or (ii) above, and the existence of which is known to or could, with reasonable diligence, be ascertained by that Director, are as follows:

Names	National Grid Shares beneficially owned	Percentage of Issued Ordinary Share Capital	National Grid B Shares beneficially owned
Sir John Parker	63,832	0.0023	—
Roger Urwin	247,695	0.0091	281,977
Steve Holliday	28,128	0.0010	—
Steve Lucas	109,379	0.0040	318
Nick Winser	56,687	0.0021	20,787
Mike Jesanis	3,281	0.0001	—
Edward Astle	28,428	0.0010	—
Ken Harvey	3,399	0.0001	3,874
John Allan	2,000	0.0001	—
John Grant	8,775	0.0003	—
Paul Joskow	4,385	0.0002	—
Stephen Pettit	2,632	0.0001	—
Maria Richter	1,755	0.0001	—
George Rose	4,409	0.0002	5,025

As at 27 June 2006, being the latest practicable date prior to the publication of this document, the following options to subscribe for National Grid Shares had been granted and remained outstanding under the ESOP, the Share Matching Plan and Sharesave schemes:

Directors	Number of options outstanding	Exercise price per National Grid Share (pence)	Date from which exercisable	Expiry date
Roger Urwin	**ESOP**			
	1997 grant—169,340	280.5	Sept. 2000	Sept. 2007
	1998 grant—91,656	375.75	June 2001	June 2008
	1999 grant—22,098	455.25	June 2002	June 2009
	2000 grant—33,867	531.5	June 2003	June 2010
	2002 grant—124,610	481.5	June 2005	June 2012
	Share Matching Plan			
	2002 award—18,644	£1 in total	June 2005	June 2012
	2003 award—25,000	£1 in total	June 2006	June 2013
	2004 award—30,762	Nil cost	May 2007	May 2014
	2005 award—25,570	Nil cost	June 2008	June 2015
	Sharesave			
	2003 grant—2,910	317	April 2007	Sept. 2007
Steve Holliday	**ESOP**			
	2002 grant—67,497	481.5	June 2005	June 2012
	Share Matching Plan			
	2002 award—10,350	£1 in total	June 2005	June 2012
	2003 award—14,083	£1 in total	June 2006	June 2013
	2004 award—18,713	Nil cost	May 2007	May 2014
	2005 award—9,983	Nil cost	June 2008	June 2015
	Sharesave			
	2002 grant—4,692	350	March 2008	Aug. 2008
Steve Lucas	**ESOP**			
	2002 grant—54,404	434.25	Dec. 2005	Dec. 2012
	Share Matching Plan			
	2002 award—16,909	Nil cost	May 2007	May 2014
	2005 award—14,778	Nil cost	June 2008	June 2015

Directors	Number of options outstanding	Exercise price per National Grid Share (pence)	Date from which exercisable	Expiry date
Nick Winser	**ESOP**			
	2000 grant—19,755	531.5	June 2003	June 2010
	Share Matching Plan			
	2003 award—3,937	£1 in total	June 2006	June 2013
	2004 award—14,059	Nil cost	May 2007	May 2014
	2005 award—11,581	Nil cost	June 2008	June 2015
Mike Jesanis	**ESOP**			
	2000 grant—77,861	566.5	March 2003	March 2010
	2002 grant—66,099	481.5	June 2005	June 2012
Edward Astle	**ESOP**			
	2002 grant—67,497	481.5	June 2005	June 2012
	2003 grant—131,086	400.5	June 2006	June 2013
	Share Matching Plan			
	2002 award—6,553	£1 in total	June 2005	June 2012
	2003 award—13,812	£1 in total	June 2006	June 2013
	2004 award—15,716	Nil cost	May 2007	May 2014
	2005 award—14,637	Nil cost	June 2008	June 2015

As at 27 June 2006, being the latest practicable date prior to the publication of this document, the Directors had the following conditional awards of National Grid Shares under the Performance Share Plan (the ''**PSP**'') and the Deferred Share Plan (the ''**DSP**''):

Directors	Number of conditional shares	Date of award	Release date
Roger Urwin	**PSP**		
	195,866	June 2003	June 2007
	198,587	June 2004	June 2008
	181,442	June 2005	June 2009
	DSP		
	62,881	June 2006	June 2009
Steve Holliday	**PSP**		
	115,669	June 2003	June 2007
	117,681	June 2004	June 2008
	100,801	June 2005	June 2009
	126,788	June 2006	June 2010
	DSP		
	36,389	June 2006	June 2009
Steve Lucas	**PSP**		
	115,669	June 2003	June 2007
	116,210	June 2004	June 2008
	99,615	June 2005	June 2009
	101,430	June 2006	June 2010
	DSP		
	34,882	June 2006	June 2009
Nick Winser	**PSP**		
	92,535	June 2003	June 2007
	98,558	June 2004	June 2008
	91,314	June 2005	June 2009
	88,751	June 2006	June 2010
	DSP		
	31,316	June 2006	June 2009

Directors	Number of conditional shares	Date of award	Release date
Mike Jesanis	**PSP**		
	41,871	June 2003	June 2007
	99,935*	June 2004	June 2008
	108,170*	June 2005	June 2009
	102,175*	June 2006	June 2010
	DSP		
	31,015	June 2006	June 2009
Edward Astle	**PSP**		
	107,958	June 2003	June 2007
	110,326	June 2004	June 2008
	94,872	June 2005	June 2009
	88,751	June 2006	June 2010
	DSP		
	28,769	June 2006	June 2009

* Awarded in the form of National Grid ADSs.

4.2 Directors' interests in transactions

No Director has, or has had, any interests in any transactions which are or were unusual in their nature or conditions or significant to the business of the Group and which were effected by the Company during the current or immediately preceding financial year or during an earlier financial year and which remain in any respect outstanding or unperformed.

4.3 Directors' service agreements and terms of appointment

Details of the Directors' service contracts or letters of appointment are set out at page 83 of the Annual Report and Accounts 2005/06 and are incorporated by reference herein.

The amount of remuneration paid (including any contingent or deferred compensation), and benefits in kind granted to each Director by the Company and its subsidiaries during the financial year ended 31 March 2006 is set out at page 84 of the Annual Report and Accounts 2005/06, and incorporated by reference herein.

Details of the total amounts set aside or accrued by the Company or its subsidiaries to provide pension, retirement or similar benefits are set out at page 85 of the Annual Report and Accounts 2005/06, and incorporated by reference herein.

5 Major shareholders

As at 27 June 2006, being the latest practicable date prior to the publication of this document, the Company was aware of the following persons who were directly or indirectly interested in three per cent. or more of the Company's Issued Ordinary Share Capital (excluding treasury shares):

Shareholder	Number of National Grid Shares	Percentage interest of Issued Ordinary Share Capital (excluding treasury shares)
The Capital Group Companies, Inc.	158,845,806	5.86
Legal & General Investment Management Ltd	114,673,601	4.21
Barclays plc	104,940,379	3.86
Credit Suisse First Boston Group	92,446,121	3.41

Save as set out above, the Company is not aware of any other person who is directly or indirectly interested in three per cent. or more of the Company's Issued Ordinary Share Capital.

6 Related party transactions

Details of related party transactions that the Company has entered into during the period covered by the financial years ended 31 March 2004, 2005 and 2006 and up to the date of this document are summarised below:

	Years ended 31 March		
	2006	2005	2004
	£m	£m	£m
Sales:			
Services supplied	4	4	6
Purchases:			
Services received	32	24	25

At 31 March 2006, the Group had amounts receivable and payable amounting to £nil (2005: £1 million) and £1 million (2005: £1 million) respectively with related parties. Sales to related parties for the financial years ended 31 March 2006, 2005 and 2004 primarily comprised amounts receivable from the National Grid UK Pension Scheme (formerly the Lattice Group Pension Scheme) for services provided. Purchases from related parties for the financial years ended 31 March 2006, 2005 and 2004 primarily comprised amounts payable to joint ventures in the US in respect of services and decommissioning expenditure.

7 Material contracts

7.1 Material contracts relating to the Group

Save for the Merger Agreement, details of which are set out in Part III of this document, there are no contracts (other than contracts entered into in the ordinary course of business) which have been entered into by any members of the Group (i) within the two years immediately preceding the date of this document which are, or may be, material to the Group or (ii) which contain any provision under which any member of the Group has any obligation or entitlement which is material to the Group as at the date of this document.

7.2 Material contracts relating to KeySpan

Save as disclosed below, there are no contracts (other than contracts entered into in the ordinary course of business) which have been entered into by KeySpan (i) within the two years immediately preceding the date of this document which are, or may be, material to KeySpan or (ii) which contain any provision under which KeySpan has any obligation or entitlement which is material to KeySpan as at the date of this document:

7.2.1 the Merger Agreement, details of which are set out in Part III of this document; and

7.2.2 On 18 January 2006, KeySpan entered into an International SWAP Dealers Association Master Agreement for a fixed for float unforced capacity financial swap (the ''**ISDA Master Agreement**'') with Morgan Stanley Capital Group Inc. (''**Morgan Stanley Inc.**''). The ISDA Master Agreement has a three year term which commenced on 1 May 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 (the ''**Fixed Price**''), subject to adjustment upon the occurrence of certain events. Cash settlement will occur on a monthly basis based on the In-City Unforced Capacity price determined by the relevant NYISO Spot Demand Curve Auction Market (the ''**Floating Price**''). For each monthly settlement period, the price difference will equal the Fixed Price minus the Floating Price. If such price difference is less than zero, Morgan Stanley Inc. will pay KeySpan an amount equal to the product of (i) the Notional Quantity and (ii) the absolute value of such price difference. Conversely, if such price difference is greater than zero, KeySpan will pay Morgan Stanley Inc. an amount equal to the product of (i) the Notional Quantity and (ii) the absolute value of such price difference. KeySpan believes that the average annual monthly capacity market price will settle above the Fixed Price.

8 Litigation

8.1 The Group

No member of the Group is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware)

during the 12 months preceding the date of this document, which may have, or have had in the recent past, significant effects on the Company and/or the Group's financial position or profitability.

8.2 KeySpan

KeySpan is not nor has it been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which KeySpan is aware) during the 12 months preceding the date of this document, which may have, or have had in the recent past, significant effects on KeySpan's financial position or profitability.

9 Significant change

9.1 The Group

There has been no significant change in the financial or trading position of the Group since 31 March 2006, the date to which the last audited financial statements were prepared.

9.2 KeySpan

There has been no significant change in the financial or trading position of KeySpan since 31 March 2006, the date to which the last published financial statements were prepared.

10 Consents

(a) Deutsche Bank AG and Morgan Stanley have given and have not withdrawn their written consent to the issue of this document with the inclusion herein of the references to their names in the form and context in which they appear;

(b) Rothschild has given and has not withdrawn its written consent to the issue of this document with the inclusion herein of the references to its name in the form and context in which it appears; and

(c) PricewaterhouseCoopers LLP has given and has not withdrawn its written consent to the issue of this document with the inclusion herein of its report provided in accordance with Listing Rule 13.5.27(2)(b).

11 Documents available for inspection

Copies of the following documents will be available for inspection during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the registered office of the Company at 1-3 Strand, London WC2N 5EH and at the offices of Linklaters, One Silk Street, London EC2Y 8HQ up to and including the date of the Extraordinary General Meeting:

(a) the Memorandum and Articles of Association of the Company;

(b) the consent letters referred to in paragraph 10 above; and

(c) the report of PricewaterhouseCoopers LLP set out in Part IV of this document.

PART VII

CHECKLIST OF DOCUMENTATION INCORPORATED BY REFERENCE

Information incorporated by reference	Document reference	Page number in Circular
Directors' service contracts or letters of appointment	Annual Report and Accounts 2005/06 (page 83)	122
Details of Directors' remuneration and other benefits in kind for the financial year ended 31 March 2006	Annual Report and Accounts 2005/06 (page 84)	122
Details of Company's pension scheme	Annual Report and Accounts 2005/06 (page 85)	122

DEFINITIONS

The following definitions apply throughout this document, unless stated otherwise:

Acquisition	the proposed acquisition of KeySpan pursuant to the Merger Agreement
Annual General Meeting/AGM	the annual general meeting of the Company to be held at The ICC, Birmingham on 31 July 2006
Board or Directors	the board of directors of the Company, whose names are set out on page 119 of this document
Business Performance	earnings from continuing operations before exceptional items and intangible asset amortisation
Company or National Grid	National Grid plc, registered in England and Wales with company number 4031152
Companies Act	the Companies Act 1985, as amended from time to time
Completion	the closing of the Acquisition following satisfaction or waiver of the conditions attaching to the Acquisition and the delivery of a certificate of merger for filing with the Secretary of State in New York
Depositary	The Bank of New York
Deutsche Bank AG	Deutsche Bank AG London
Enlarged Group	the Group following Completion
ESOP	the Executive Share Option Plan
Extraordinary General Meeting/EGM	the extraordinary general meeting of the Company to be held at 2.15 p.m. on 31 July 2006 or, if later, immediately following the conclusion or adjournment of the AGM
FERC	the Federal Energy Regulatory Commission
FSA	the Financial Services Authority
GPRA	the Generation Purchase Rights Agreement dated 26 June 1997 and made between LIPA and KeySpan Generation LLC
Group	the Company and its subsidiary undertakings
GW	Gigawatt, 10^9 watts
IFRS	International Financial Reporting Standards
ISDA Master Agreement	the International SWAP Dealers Association Master Agreement dated 18 January 2006 entered into between KeySpan and Morgan Stanley Capital Group Inc.
Issued Ordinary Share Capital	the issued ordinary shares of the Company
KeySpan	KeySpan Corporation and its subsidiary undertakings, if the context so requires
KeySpan Shares	shares of KeySpan
KeySpan Shareholders	holders of KeySpan Shares
kW	Kilowatt, 1000 watts
LIPA	the Long Island Power Authority
Listing Rules	the listing rules made by the UKLA for the purposes of Part 6 of the Financial Services and Markets Act 2000, as amended
load pocket	a geographic area supplied by a networked delivery transmission system subject to limitations which can undermine market efficiency

Merger Agreement	the Agreement and Plan of Merger dated 25 February 2006 entered into between National Grid, National Grid US8 Inc. and KeySpan, described in Part III of this document
Morgan Stanley	Morgan Stanley & Co. Limited
MW	Megawatt, 1 million watts
National Grid ADSs	ADSs of National Grid, each of which represents five ordinary shares in National Grid. Such ADSs are endorsed by American Depositary Receipts of National Grid, each representing any number of underlying ADSs
National Grid B Shares	non-cumulative preference shares of 10 pence each in the capital of National Grid
National Grid Shares	ordinary shares of $11\frac{17}{43}$ pence each in the capital of National Grid
National Grid Shareholders	holders of National Grid Shares
National Grid USA	National Grid's wholly-owned US subsidiary, National Grid USA, Inc.
National Grid US8 Inc.	a US wholly-owned subsidiary owned by National Grid
NHPUC	the New Hampshire Public Utilities Commission
NJBPU	the New Jersey Board of Public Utilities
NYISO	the New York Independent System Operator
NYPA	the New York Power Authority
NYPSC	the New York Public Service Commission
Ofgem	the Office of Gas and Electricity Markets
Proxy Card	the proxy card accompanying this document for use by National Grid Shareholders in relation to the Extraordinary General Meeting
Ravenswood Expansion	the 2,200 MW Ravenswood electric generation facility, located in the Queens County in New York City
Ravenswood Facility	the 250 MW combined cycle generating unit which began full commercial operation in May 2004
Ravenswood Generation Station	the Ravenswood Facility and the Ravenswood Expansion, together having a total electric capacity of 2,450 MW
Resolution	the ordinary resolution to approve the Acquisition as set out in the notice of Extraordinary General Meeting at the end of this document
Rothschild	N M Rothschild & Sons Limited and Rothschild Inc.
SEC	the US Securities and Exchange Commission
US GAAP	accounting principles generally accepted in the United States
$	US dollar
2006 Option Agreement	the option agreement dated 1 January 2006 and made between LIPA and KeySpan Generation LLC
US or United States	the United States of America, its territories, possessions, any State of the United States of America and the District of Columbia

National Grid plc

(the ''**Company**'')

(Incorporated in England and Wales under the Companies Act with registered number 4031152)

NOTICE OF EXTRAORDINARY GENERAL MEETING

NOTICE IS HEREBY GIVEN that an EXTRAORDINARY GENERAL MEETING of the Company will be held at The ICC, Birmingham on 31 July 2006 at 2.15 p.m. or, if later, immediately following the conclusion or adjournment of the Annual General Meeting of the Company, to consider and, if thought fit, pass the following resolution, which will be proposed as an ordinary resolution:

Ordinary Resolution

THAT the Acquisition, on the terms and subject to the conditions set out in the Merger Agreement (both as defined in the circular to shareholders dated 28 June 2006 (the ''**Circular**''), a copy of which is produced to the meeting and initialled by the Chairman for the purposes of identification), be and is hereby approved and the Directors (or a duly authorised committee of the Directors) be and are hereby authorised to waive, amend, vary or extend any of the terms of the Merger Agreement and to do all things as they may consider to be necessary or desirable to complete, implement and give effect to, or otherwise in connection with, the Acquisition and any matters incidental to the Acquisition.

Registered office:
1-3 Strand
London
WC2N 5EH

By order of the Board,
Helen Mahy
Group Company Secretary and General Counsel
28 June 2006

Notes:

1. A Shareholder of National Grid who is entitled to attend and vote at the EGM but is unable or does not wish to attend is entitled to appoint a proxy or proxies to attend and vote on his/her behalf. A proxy does not need to be a Shareholder. Shareholders will have been sent a Proxy Card. If you do not have a Proxy Card and believe that you should, please contact Capita Registrars on 0870 242 2379 (if calling from within the United Kingdom) or +44 20 7098 1198 (if calling from outside the United Kingdom).

2. Completing your Proxy Card:

   - Unless you choose someone else, the Chairman will act as your proxy. If acting as your proxy, the Chairman must vote as you direct and cannot change the votes you mark on your Proxy Card.
   - To choose someone other than the Chairman as your proxy, cross out the words ''the Chairman of the Meeting'' on the Proxy Card and write their name in the box provided. Please note: if you choose someone other than the Chairman as your proxy, you are responsible for ensuring that they attend the meeting and know how you wish to vote. If your proxy does not attend, your votes will not be cast.
   - Place an X in the box showing how you wish to vote for each resolution. If you do not mark a resolution your proxy can decide how to vote.
   - Sign and date the Proxy Card in the boxes provided. Where shares are held in joint names only one shareholder needs to sign.
   - Once completed, return the Proxy Card which is prepaid in the UK. To be valid, Proxy Cards must be received 48 hours before the start of the meeting.
   - If you wish to use an envelope, Proxy Cards should be sent to: Capita Registrars, The Registry, Proxy Department, 34 Beckenham Road, Beckenham, Kent BR3 4TU. Postage will be payable.
   - If you return a Proxy Card, this does not stop you from attending and voting at the meeting yourself.

3. To be valid any Proxy Cards or other Proxy Instructions must be received by post or (during normal business hours only) by hand at Capita Registrars, The Registry, Proxy Department, 34 Beckenham Road, Kent BR3 4TU no later than 2.15 p.m. on 29 July 2006. The return of a completed Form of Proxy or CREST Proxy Instruction will not prevent you from attending the EGM and voting in person if you wish to do so.

4. ADS Holders on the register with The Bank of New York should complete a Voting Instruction Card and return it to the Depositary at National Grid plc, c/o Bank of New York, PO Box 11243, New York, NY 10203-0243. This card represents an instruction relating to the voting rights of the Ordinary Shares underlying the ADSs.

5. ADS Voting Instruction Cards should be returned before 5.00 p.m. (New York time) on 27 July 2006.

6. Anyone holding their ADSs through a bank, broker or other financial institution should consult with the institution to determine the deadline by which their voting instructions must be returned.

7. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider, should refer to their CREST sponsor or voting service provider, who will be able to take the appropriate action on their behalf.

8. Any message, regardless of whether it relates to the appointment of a proxy or to an amendment to an instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by Capita Registrars (CREST participant ID RA10) by 6.00 p.m. on 28 July 2006. After this time any change to instructions to proxies appointed through CREST should be communicated to the agent by other means.

9. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

10. The Company, pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those Shareholders registered in the register of members of the Company as at 6.00 p.m. on 29 July 2006 or, in the event that this meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be entitled to attend and vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries in the register of members after 6.00 p.m. on 29 July 2006 or, in the event that this meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend and vote at the meeting.

Merrill Corporation Ltd, London
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