

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-14161

KEYSPAN CORPORATION

(Exact Name of Registrant as Specified in its Charter)

NEW YORK

(State or Other Jurisdiction of Incorporation or Organization)

One MetroTech Center, Brooklyn, New York
175 East Old Country Road, Hicksville, New York
(Address of Principal Executive Offices)

11-3431358

(I.R.S. Employer Identification No.)

11201

11801

(Zip Code)

(718) 403-1000 (Brooklyn)

(516) 755-6650 (Hicksville)

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock
\$.01 par value

Outstanding at October 19, 2006
175,283,247

KEYSPAN CORPORATION AND SUBSIDIARIES

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CONSOLIDATED BALANCE SHEET
(Unaudited)

<i>(In Millions of Dollars)</i>	September 30, 2006	December 31, 2005
ASSETS		
Current Assets		
Cash and temporary cash investments	\$ 40.0	\$ 124.5
Restricted cash	5.6	13.2
Accounts receivable	779.9	1,035.6
Unbilled revenue	221.0	685.6
Allowance for uncollectible accounts	(52.7)	(62.8)
Gas in storage, at average cost	788.9	766.9
Material and supplies, at average cost	144.8	140.5
Derivative contracts	46.9	142.8
Other	172.5	173.8
	<u>2,146.9</u>	<u>3,020.1</u>
Investments and Other	257.9	242.4
Property		
Gas	7,545.8	7,275.9
Electric	2,549.3	2,492.3
Other	430.4	416.3
Accumulated depreciation	(3,096.0)	(2,922.6)
Gas exploration and production, at cost	186.0	184.2
Accumulated depletion	(112.3)	(109.2)
	<u>7,503.2</u>	<u>7,336.9</u>
Deferred Charges		
Regulatory assets:		
Miscellaneous assets	710.7	688.3
Derivative contracts	260.2	30.9
Goodwill and other intangible assets	1,666.3	1,666.3
Derivative contracts	138.5	75.2
Other	754.7	752.5
	<u>3,530.4</u>	<u>3,213.2</u>
Total Assets	<u>\$ 13,438.4</u>	<u>\$ 13,812.6</u>

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF INCOME
(Unaudited)

<i>(In Millions of Dollars, Except Per Share Amounts)</i>	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2006	2005	2006	2005
Revenues				
Gas Distribution	\$ 595.5	\$ 629.6	\$ 3,648.8	\$ 3,476.1
Electric Services	565.6	619.9	1,434.6	1,488.9
Energy Services	49.0	45.4	147.8	134.1
Energy Investments	8.4	8.2	26.1	27.0
Total Revenues	1,218.5	1,303.1	5,257.3	5,126.1
Operating Expenses				
Purchased gas for resale	361.5	395.7	2,412.7	2,206.1
Fuel and purchased power	172.6	254.6	418.3	546.9
Operations and maintenance	372.7	364.3	1,199.3	1,143.3
Depreciation, depletion and amortization	84.2	92.1	295.7	295.8
Operating taxes	95.9	97.1	309.9	303.0
Total Operating Expenses	1,086.9	1,203.8	4,635.9	4,495.1
Income from equity investments	3.2	2.5	9.5	12.5
Sale of assets	1.0	1.0	1.4	1.2
Operating Income	135.8	102.8	632.3	644.7
Other Income and (Deductions)				
Interest charges	(67.1)	(67.4)	(192.7)	(200.1)
Gain on sale of investments	-	-	-	4.1
Cost of debt redemption	-	-	-	(20.9)
Other	8.0	(3.8)	25.6	9.4
Total Other Income and (Deductions)	(59.1)	(71.2)	(167.1)	(207.5)
Income Taxes				
Current	(17.9)	(25.8)	104.3	119.0
Deferred	44.3	34.8	53.3	41.0
Total Income Taxes	26.4	9.0	157.6	160.0
Earnings from continuing operations	50.3	22.6	307.6	277.2
Discontinued Operations				
Income (loss) from discontinued operations, net of tax	-	-	-	(4.1)
Gain on disposal, net of tax	-	-	-	2.3
Loss from discontinued operations	-	-	-	(1.8)
Net Income	50.3	22.6	307.6	275.4
Preferred stock dividend requirements	-	-	-	2.2
Earnings for Common Stock	\$ 50.3	\$ 22.6	\$ 307.6	\$ 273.2
Basic Earnings Per Share:				
Continuing Operations,				
less preferred stock dividends	\$ 0.29	\$ 0.13	\$ 1.76	\$ 1.63
Discontinued Operations	-	-	-	(0.01)
Basic Earnings Per Share	\$ 0.29	\$ 0.13	\$ 1.76	\$ 1.62
Diluted Earnings Per Share				
Continuing Operations,				
less preferred stock dividends	\$ 0.29	\$ 0.13	\$ 1.75	\$ 1.62
Discontinued Operations	-	-	-	(0.01)
Diluted Earnings Per Share	\$ 0.29	\$ 0.13	\$ 1.75	\$ 1.61
Average Common Shares Outstanding (000)	175,114	174,332	174,935	168,465
Average Common Shares Outstanding - Diluted (000)	176,295	175,238	175,996	169,403

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

<i>(In Millions of Dollars)</i>	Nine Months Ended Sept. 30,	
	2006	2005
Operating Activities		
Net income	\$ 307.6	\$ 275.4
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation, depletion and amortization	295.7	295.8
Deferred income tax	53.3	41.0
Income from equity investments	(9.5)	(12.5)
Dividends from equity investments	8.7	5.3
Amortization of interest rate swap / financing fees	6.2	(2.5)
(Gain) on sale of property and investments	(1.5)	(5.3)
Loss from discontinued operations	-	1.8
Amortization of property tax prepayments	106.9	91.8
Changes in assets and liabilities		
Accounts receivable	712.5	294.3
Materials and supplies, fuel oil and gas in storage	(26.3)	(245.2)
Accounts payable and other liabilities	(409.8)	(165.2)
Insurance recovery and regulatory settlements, net	16.6	21.1
Property tax prepayment	(79.4)	(69.5)
Environmental payments	(37.8)	(24.4)
Other	(35.6)	(29.8)
Net Cash Provided by Operating Activities	907.6	472.1
Investing Activities		
Construction expenditures	(377.6)	(372.1)
Cost of removal	(23.1)	(10.8)
Derivative margin calls	(42.7)	(63.3)
Net proceeds from sale of property and investments	1.5	46.9
Net Cash Used in Investing Activities	(441.9)	(399.3)
Financing Activities		
Treasury stock issued	21.2	41.0
MEDs equity conversion	-	460.0
Payment of long-term debt	-	(590.1)
Payment of commercial paper	(327.6)	(592.2)
Common and preferred stock dividends paid	(243.8)	(229.1)
Other	-	14.0
Net Cash Used in Financing Activities	(550.2)	(896.4)
Net Decrease in Cash and Cash Equivalents	(84.5)	(823.6)
Cash Flow from Discontinued Operations - Operating	-	(15.1)
Cash Flow from Discontinued Operations - Investing	-	0.5
Cash Flow from Discontinued Operations - Financing	-	0.2
Cash and Cash Equivalents at Beginning of Period	124.5	922.0
Cash and Cash Equivalents at End of Period	\$ 40.0	\$ 84.0

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 THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

INTRODUCTION TO THE NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

KeySpan Corporation (referred to in the Notes to the Financial Statements as “KeySpan,” “we,” “us” and “our”) is a 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 adoption of the Merger Agreement by the stockholders of KeySpan and the Parent and the receipt of requisite regulatory approvals from certain United States federal and state public utility, antitrust and other regulatory authorities, many of which have been filed or obtained. Specifically, we filed our application for approval of the Merger pursuant to the Federal Power Act in May 2006 and in October the requisite approval was obtained from the Federal Energy Regulatory Commission (“FERC”). In early July 2006, we cleared review by the Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvement Act and received notification that the Committee on Foreign Investment in the U.S. has determined that there are no issues of national security sufficient to warrant an investigation of the transaction. On July 20, 2006 we filed an application for approval of the transaction with the New York Public Service Commission (“NYPSC”). KeySpan has also sought approval of the merger from the New Hampshire Public Utility Commission. In October 2006, the State of New Jersey Board of Public Utilities approved a change of control of KeySpan Communication Corp., which provides telecommunications services in New Jersey. In addition, the Merger was approved by our shareholders at our Annual Meeting on August 17, 2006. Shareholders of National Grid plc approved the transaction at a meeting held on July 31, 2006.

In addition to seeking approval of the Merger, the application filed with the NYSPSC also contained a proposed ten-year rate plan for KeySpan Energy Delivery of New York (“KEDNY”) and KeySpan Energy Delivery of Long Island (“KEDLI”), as well as proposals concerning corporate structure, affiliate rules and transactions and the rate treatment for contemplated synergy savings. Specifically, the rate plan proposal provides for, among other things, a freeze of base delivery rates for KEDNY and KEDLI for 18 months. Thereafter, KEDNY’s and KEDLI’s gas adjustment clause would be increased to recover, on a prospective basis, gas commodity-related costs of \$68.6 million for KEDNY and \$28.7 million for KEDLI that would no longer be included in base rates. In addition, KEDNY and KEDLI base delivery rates would be increased by an average of 2.5% (\$62.4 million) and 2.3% (\$39.4 million), respectively in years 3, 5, 7 and 9 of the rate plan. The proposed rate plan also contemplates an allowed return on equity of 11.0% for each entity. Cumulative earnings above 11.75% would be shared between gas sales customers and KeySpan over the rate plan period. On October 3, 2006 Nation Grid plc filed testimony and exhibits with the NYSPSC that refers to both exhibits and attachments that were previously submitted as part of the July 20, 2006 petition.

Assuming receipt of all required approvals, it is currently anticipated that the Merger will be consummated in mid-2007. However, we are unable to predict the outcome of the regulatory proceedings and no assurance can be given that the Merger will occur or the timing of its completion

In the meantime, individual applications for a proposed annual increase in revenues for KEDNY and KEDLI were filed on October 3, 2006 with the NYSPSC. The proposed revenue increases are for 9.1% and 10.9% for KEDNY and KEDLI, respectively. KEDNY’s last base rate increase took effect October 1, 1993 and since then base rates have been reduced twice – once in 1996 and then again in 1998. KEDLI’s last base rate increase took effect December 1, 1995. Since that time KEDLI’s base rates were reduced twice in 1998. The principal factors creating the need for rate relief are increases in operating and maintenance expenses, increases in rate base, increased property taxes and depreciation expense, and the need to commence recovery of previously deferred costs such as pension and post retirement benefits, environmental expenditures and property taxes.

The total projected increase in revenues is comprised of two components; (i) an increase in base rates of \$180.7 million for KEDNY and \$145 million for KEDLI; and (ii) projected increases of \$32.8 million and \$14 million for KEDNY and KEDLI, respectively, for gas related expenses that will be recovered through the Gas Adjustment Clause (“GAC”) and/or Transportation Adjustment Clause (“TAC”). The proposed rate of return on equity is 11.0% for both KEDNY and KEDLI.

The NYSPSC may suspend the implementation of the proposed tariff changes for up to eleven months, which would mean, absent other intervening events, an effective date of September 3, 2007 for new rates. Although KEDNY and KEDLI proposed the new rates described above in these tariff filings, KeySpan does not expect that the rate increases proposed therein will be implemented because KEDNY’s and KEDLI’s need for rate relief on a stand alone basis will be superseded and rendered moot by an earlier NYSPSC approval of the merger between National Grid plc and KeySpan and the approval of the related ten-year rate plan previously noted.

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 repeal 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 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 September 30, 2006, and the results of operations for the three and nine months ended September 30, 2006 and September 30, 2005, as well as cash flows for the nine months ended September 30, 2006 and September 30, 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:

<i>(In Millions of Dollars, Except Per Share Amounts)</i>	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2006	2005	2006	2005
Earnings for common stock	\$ 50.3	\$ 22.6	\$ 307.6	\$ 273.2
Weighted average shares outstanding (000)	175,114	174,332	174,935	168,465
Add dilutive securities:				
Options	1,045	906	970	938
Performance shares	136	-	91	-
Total weighted average shares outstanding - assuming dilution	176,295	175,238	175,996	169,403
Basic earnings per share	\$ 0.29	\$ 0.13	\$ 1.76	\$ 1.62
Diluted earnings per share	\$ 0.29	\$ 0.13	\$ 1.75	\$ 1.61

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 “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. See Footnote 12 "Gas Exploration and Production Property – Depletion" for a discussion of the September 30, 2006 ceiling test calculation.

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, KeySpan has a 26.3% interest in the Millennium Pipeline Company LLC, the developer of the Millennium pipeline project, which is expected to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning, New York to Ramapo, New York, where it will connect to an existing pipeline. Additionally, subsidiaries in this segment hold a 20% equity interest in the Iroquois Gas Transmission System LP, a pipeline that transports Canadian gas supply to markets in the northeastern United States. These investments are accounted for under the equity method. Accordingly, equity income from these investments is reflected as a component of operating income in the Consolidated Statement of Income.

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 September 30, 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:

<i>(In Millions of Dollars)</i>	Gas Distribution	Electric Services	Energy Services	Energy Investments	Eliminations	Consolidated
Three Months Ended Sept. 30, 2006						
Unaffiliated revenue	595.5	565.6	49.0	8.4	-	1,218.5
Intersegment revenue	-	-	2.8	1.3	(4.1)	-
Operating Income	(10.8)	144.4	3.0	4.7	(5.5)	135.8
Three Months Ended Sept. 30, 2005						
Unaffiliated revenue	629.6	619.9	45.4	8.2	-	1,303.1
Intersegment revenue	-	-	1.7	3.7	(5.4)	-
Operating Income	(45.5)	149.6	(1.1)	4.7	(4.9)	102.8

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 \$553.5 million and \$612.1 million for the three months ended September 30, 2006 and 2005, respectively, represent approximately 45% and 47%, respectively of our consolidated revenues in these periods.

<i>(In Millions of Dollars)</i>	Gas Distribution	Electric Services	Energy Services	Energy Investments	Eliminations	Consolidated
Nine Months Ended Sept. 30, 2006						
Unaffiliated revenue	3,648.8	1,434.6	147.8	26.1	-	5,257.3
Intersegment revenue	-	-	7.6	4.0	(11.6)	-
Operating Income	365.1	271.7	4.6	11.3	(20.4)	632.3
Nine Months Ended Sept. 30, 2005						
Unaffiliated revenue	3,476.1	1,488.9	134.1	27.0	-	5,126.1
Intersegment revenue	-	4.6	7.9	3.7	(16.2)	-
Operating Income	376.8	266.3	(6.7)	16.6	(8.3)	644.7

Eliminating items include 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 \$1,415.5 million and \$1,423.4 million for the nine months ended September 30, 2006 and 2005, respectively, represent approximately 27%, of our consolidated revenues in both periods.

3. COMPREHENSIVE INCOME

The table below indicates the components of comprehensive income:

<i>(In Millions of Dollars)</i>	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2006	2005	2006	2005
Net Income	\$ 50.3	\$ 22.6	\$ 307.6	\$ 275.4
Other comprehensive income (loss), net of tax				
Reclassification of (gains) losses included in net income	(4.7)	10.7	(43.6)	18.4
Foreign currency translation adjustments	-	-	-	(5.0)
Unrealized gains on marketable securities	0.2	2.9	0.5	1.4
Unrealized (losses) gains on derivative financial instruments	7.3	(59.8)	48.1	(78.0)
Other comprehensive gain (loss), net of tax	2.8	(46.2)	5.0	(63.2)
Comprehensive Income (Loss)	\$ 53.1	\$ (23.6)	\$ 312.6	\$ 212.2
Related tax (benefit) expense				
Reclassification of (gains) losses included in net income	(2.6)	5.8	(23.5)	9.9
Foreign currency translation adjustments	-	-	-	(2.7)
Unrealized gains on marketable securities	0.1	1.6	0.3	0.8
Unrealized (losses) gains on derivative financial instruments	4.5	(33.6)	27.4	(44.3)
Total Tax (Benefit) Expense	\$ 2.0	\$ (26.2)	\$ 4.2	\$ (36.3)

4. HEDGING AND DERIVATIVE FINANCIAL INSTRUMENTS

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 Generating Station.

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.” Therefore, the fair value of these derivatives are recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. 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 and thus are not subject to deferral accounting treatment. 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. During 2006, KeySpan used 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. At September 30, 2006, there were no outstanding derivative

instruments associated with this strategy. However, KeySpan may elect to enter into similar derivative financial instruments when prevailing market conditions are favorable.

We have three fixed price forward sale contracts with large-volume interruptible gas sales customers. KeySpan uses OTC natural gas swaps to hedge the cash-flow variability of gas purchases associated with these customers. These gas swaps are accounted for as hedges. KeySpan uses market quoted forward prices to value these swap positions. The maximum length of time over which we have hedged such cash flow variability is through October 2007. The fair value of these derivative instruments at September 30, 2006 was a liability of \$2.5 million, all of which is reported in accumulated other comprehensive income and is expected to be reclassified into earnings within the next twelve months.

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 September 30, 2006, Seneca-Upshur has hedge positions in place for approximately 90% of its estimated 2006 through 2009 gas production, net of gathering costs. We use market quoted forward prices to value these swap positions. The maximum length of time over which Seneca-Upshur has hedged such cash flow variability is through December 2009. The fair value of these derivative instruments at September 30, 2006 was a liability of \$5.2 million. The estimated amount of losses associated with such derivative instruments that are reported in accumulated other comprehensive income and that are expected to be reclassified into earnings over the next twelve months is \$2.9 million. Ineffectiveness associated with these outstanding derivative financial instruments was immaterial for the nine months ended September 30, 2006.

The Ravenswood Generating Station hedges the cash flow variability associated with a portion of electric energy sales. Our strategy is to hedge up to 50% of the on-peak capacity of the Ravenswood Generating Station. The maximum length of time over which we have hedged cash flow variability is through March 2007. 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 the electric power derivative instruments at September 30, 2006 was \$17.1 million, all of which is reported in accumulated other comprehensive income and 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 September 30, 2006, was a liability of \$3.8 million all of which is reported in accumulated other comprehensive income and 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 September 30, 2006, was a liability of \$14.6 million, of which \$13.6 million is reported in accumulated 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 for the nine months ended September 30, 2006.

The above noted derivative financial instruments are cash flow hedges that are accounted for as

hedges 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 record the effective portion of unrealized gains or losses in accumulated other comprehensive income. Gains and losses are reclassified from accumulated other comprehensive income to the Consolidated Statement of Income in the period the hedged transaction affects earnings. Gains and losses on settled transactions are reflected as a component of either revenue or fuel and purchased power depending on the hedged transaction. Hedge ineffectiveness results from changes during the period in the price differentials between the index price of the derivative contract and the price of the purchase or sale for the cash flow that is being hedged, and is recorded directly to earnings.

Firm Gas Sales Financial Derivative Instruments - Regulated Utilities: We use derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases associated with our Gas Distribution operations. Our strategy is to minimize fluctuations in gas sales prices to our regulated firm gas sales customers in our New York and New England service territories. The accounting for these derivative instruments is subject to SFAS 71. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets and regulatory liabilities on the Consolidated Balance Sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. At September 30, 2006 the fair value of these derivative instruments was a liability of \$276.8 million.

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 qualify for the normal purchases and sales exception. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities do not qualify for normal purchases under SFAS 133. Since these contracts are for the purchase of natural gas sold to regulated firm gas sales customers, the accounting for these contracts is subject to SFAS 71. At September 30, 2006, these derivatives had a net fair value of \$130.1 million.

Financially-Settled Commodity Derivative Instruments that Do Not Qualify for Hedge Accounting: KeySpan subsidiaries also have financial derivatives that do not qualify for hedge accounting treatment under SFAS 133. In 2006, 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 noted above regarding sales to certain large-volume customers. As of September 30, 2006, these derivatives have expired. However, KeySpan may elect to enter into similar derivative financial instruments when prevailing market conditions are favorable.

The Ravenswood Generating Station also employs a limited number of financial derivatives that

have not been designated for hedge accounting treatment under SFAS 133 to economically hedge the cash flow variability for a portion of forecasted purchases of natural gas that will be consumed during the generation of electricity. The fair value of these derivative instruments at September 30, 2006 was a liability of \$2.3 million. In addition, the Ravenswood Generating Station employs a limited number of financial derivatives that have not been designated for hedge accounting treatment to economically hedge the cash flow variability for a portion of forecasted electric energy sales. The fair value of these derivative instruments at September 30, 2006 was \$3.6 million; such amount was recorded in the Consolidated Statement of Income to reflect the change in the market value associated with these derivative instruments for the nine months ended September 30, 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 “ Swap Agreement”) with Morgan Stanley Capital Group Inc. (“Morgan Stanley”). The Swap Agreement has a three year term that began on May 1, 2006. The notional quantity was 1,800,000kW (the “Notional Quantity”) of In-City Unforced Capacity and the fixed price is \$7.57/kW-month (“Fixed Price”), subject to adjustment upon the occurrence of certain events. Cash settlement occurs on a monthly basis based on the In-City Unforced Capacity price determined by the relevant New York Independent System Operator (“NYISO”) Spot Demand Curve Auction Market (“Floating Price”). For each monthly settlement period, the price difference equals the Fixed Price minus the Floating Price. If such price difference is less than zero, Morgan Stanley will pay KeySpan an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference. Conversely, if such price difference is greater than zero, KeySpan will pay Morgan Stanley an amount equal to the product of (a) the Notional Quantity and (b) the absolute value of such price difference. This derivative instrument does not qualify for hedge accounting treatment under SFAS 133 and is subject to fair value accounting treatment. The recognized fair value associated with this instrument is immaterial to the consolidated financial statements at September 30, 2006. As noted, this is a financial derivative instrument and is unrelated to any physical production of electricity.

KeySpan has a management contract with Merrill Lynch Trading, under which KeySpan and Merrill Lynch Trading will share the responsibilities for managing KeySpan’s upstream gas distribution assets associated with its Massachusetts gas distribution subsidiaries, as well as providing city-gate delivered supply. This contract, which replaces the prior arrangement with Merrill Lynch Trading, allows for both KeySpan and Merrill Lynch Trading to employ derivative instruments to maximize the profitability of KeySpan’s portfolio of gas distribution assets. Profits associated with these activities are shared between KeySpan, Merrill Lynch Trading and KeySpan’s Massachusetts ratepayers. At September 30, 2006, KeySpan’s proportionate share of the fair value associated with these derivative instruments amounted to \$10.8 million. KeySpan has recorded a regulatory liability of \$7.8 million on the Consolidated Balance Sheet representing the portion to be shared with Massachusetts ratepayers. The remaining amount was recorded as a benefit to revenues. KeySpan provides these services internally for its New York and New Hampshire gas distribution subsidiaries.

Interest Rate Derivative Instruments: KeySpan anticipates issuing, subject to execution of definitive

agreements, approximately \$400 million Senior Unsecured Notes at KEDNY and approximately \$100 million Senior Unsecured Notes at KEDLI in the fourth quarter of 2006. The Notes are anticipated to be issued with ten year maturities. KeySpan utilized a \$125 million treasury lock, at 4.77%, to hedge the 5-year US Treasury component of the underlying notes and a \$125 million treasury lock, at 4.82%, to hedge the 10-year US Treasury component of the underlying notes. At September 30, 2006 the fair value of these derivative instruments was a liability of \$2.9 million. The accounting for these derivative instruments is subject to SFAS 71. Therefore, the fair value of these derivatives was recorded as a current liability, with an offsetting position recorded as a regulatory asset on the Consolidated Balance Sheet.

These derivative instruments settled on October 25, 2006 at which time KeySpan paid \$0.2 million to the counterparty to the contracts. The loss on the settlement of these contracts has been deferred for future collection from firm gas sales customers consistent with regulatory requirements.

The table below summarizes the fair value of all of the above outstanding derivative instruments at September 30, 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.

<i>(In Millions of Dollars)</i>	Sept. 30, 2006	December 31, 2005
Gas Contracts:		
Other current assets	\$ 26.2	\$ 132.1
Other deferred charges	138.2	75.2
Regulatory asset	257.3	30.9
Other current liability	(272.7)	(39.8)
Other deferred liabilities	(47.7)	(44.3)
Regulatory liability	(122.2)	(175.4)
Oil Contracts:		
Other current assets	-	0.5
Other current liability	(3.8)	(6.8)
Electric Contracts:		
Other current assets	20.7	10.2
Other deferred charges	0.3	-
Other current liability	-	(0.7)
Interest Rate Contracts:		
Regulatory asset	2.8	-
Other current liability	(2.8)	-
	\$ (3.7)	\$ (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, which expired during the first quarter of 2006, 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 entire primary winter heating season –November 2005 through March 2006 – 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.

In the third quarter of 2006, we entered into heating-degree day put options to mitigate the effect of fluctuations from normal weather on KEDNE's financial position and cash flows for the upcoming 2006/2007 winter heating season – November 2006 through March 2007. These put options will pay KeySpan up to \$37,500 per heating degree day when the actual temperature is below 4,159 heating degree days, or approximately 5% 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 \$15 million. The net premium cost for these options is \$1.7 million and will be amortized over the heating season.

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 September 30, 2006, KeySpan has received \$5.6 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 September 30, 2006, KeySpan has \$51.6 million of outstanding margin calls to its counterparties for open derivative instruments associated with its strategy to minimize fluctuations in gas sales prices to its regulated firm gas sales customers.

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 September 29, 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard 158 (“SFAS 158”) “Employers’ Accounting for Defined Benefit Pensions and Other Postretirement Benefit Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R).” SFAS 158 requires employers to fully recognize all postretirement plans funded status on the balance sheet as a net liability or asset and will require an offsetting adjustment to accumulated other comprehensive income in shareholders’ equity. KeySpan estimates, using actual results through January 1, 2006 adjusted for the amortization of unrecognized gains and losses and prior service cost during 2006, that the pre-tax increase in its total postretirement liabilities resulting from the adoption of the recognition provisions of SFAS 158 will be approximately \$1 billion. Certain of KeySpan’s subsidiaries are subject to deferral accounting requirements pursuant to rate agreements with the NYPSC and the Massachusetts Department of Telecommunications and Energy (“MADTE”). Further, KeySpan has certain contractual rights to reimbursement for postretirement liabilities in its agreements with the Long Island Power Authority (“LIPA”). As such, a portion of the offsetting position to the increase in the total postretirement liabilities will be reflected as a regulatory asset and long-term receivable. The amount to be recorded as a regulatory asset and long-term receivable and the related impact on shareholders’ equity is subject to final determination. At this point in time, KeySpan believes that it will remain in compliance with all applicable financial covenants upon implementation of SFAS 158. SFAS 158 does not change how postretirement benefits are accounted for and reported in the income statement; companies will continue to apply existing accounting guidance. KeySpan is currently reviewing the income tax implications, if any, of SFAS 158.

The recognition and disclosure provisions of SFAS 158 are effective for fiscal years ending after December 15, 2006, on a prospective basis. SFAS 158 does not permit retroactive application of its provisions; however, SFAS 158 requires footnote disclosure of the incremental effect on the balance sheet on a line item basis in the year of adoption.

On September 15, 2006, the FASB issued SFAS 157 “Fair Value Measurements.” This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value. This Statement expands the disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value, the recurring fair value measurements using significant unobservable inputs and the effect of the measurement on earnings (or changes in net assets) for the period. The guidance in this Statement also applies for derivatives and other financial instruments measured at fair value under Statement 133 “Accounting for Derivative Instruments and Hedging Activities” at initial recognition and in all subsequent periods. This Statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. KeySpan is currently reviewing the requirements of this

Statement, and at this point in time cannot determine what impact, if any, this Statement will have on its results of operations or financial position. This Statement will have no impact on cash flow.

On July 13, 2006, the FASB issued Interpretation No. 48 “Accounting for Uncertainty In Income Taxes.” The FASB, in its interpretation of SFAS 109, “Accounting for Income Taxes,” seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement requirements related to accounting for income taxes. The Interpretation requires application for fiscal years beginning after December 15, 2006. KeySpan is currently reviewing the requirements of this Statement, and at this point in time cannot determine what impact, if any, this Statement will have on its results of operations or financial position. This Statement will have no impact on cash flow.

In December 2004 the FASB issued SFAS 123 (revised 2004 “SFAS 123R”) “Share-Based Payment.” SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123R 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 SFAS 123R 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 now 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 now 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 SFAS 123R compared to Statement 123. SFAS 123R also clarifies and expands SFAS 123’s guidance in several areas. The effective date of SFAS 123R was 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 SFAS 123R 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 it leases a portion of the Ravenswood Facility. We acquired the Ravenswood Facility, a 2,200-megawatt electric generating facility located in Queens, New York, in part, through the variable interest entity, from Consolidated Edison on June 18, 1999, for approximately \$597 million. In order to reduce the initial cash requirements, we entered into a lease agreement (the “Master Lease”) with a variable interest, unaffiliated financing entity that acquired a portion of the facility, or three steam generating units, directly from Consolidated Edison and leased it to our subsidiary, KeySpan

Ravenswood LLC. The variable interest unaffiliated financing entity acquired the property for \$425 million, financed with debt of \$412.3 million (97% of capitalization) and equity of \$12.7 million (3% of capitalization). KeySpan has no ownership interests in the units or the variable interest entity. KeySpan has guaranteed all payment and performance obligations of KeySpan Ravenswood, LLC, under the Master Lease. Monthly lease payments substantially equal the monthly interest expense on such debt securities.

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, as residual value, 84% of the acquisition 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 \$311.4 million.

If 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 normal 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; or dispose of sections of gas main when removed from the pipeline

system; (ii) cleaning and removal requirements associated with storage tanks containing waste oil and other waste contaminants; and (iii) legal requirements to remove asbestos upon major renovation or demolition of structures and facilities. At September 30, 2006, these obligations total \$49.4 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 KeySpan, have been identified to 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 the effect emerging case law will have on contribution suits which may be brought against other parties who impacted these sites for their share of remedial cost. KeySpan continues to evaluate how to proceed with respect to participation in the BCP or alternative DEC remediation programs. Regardless of which cleanup program is ultimately employed, KeySpan fully intends to investigate and remediate these sites, as necessary, and has adjusted its planned expenditures accordingly.

KeySpan has 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 \$75.2 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 \$59.1 million.

KeySpan presently estimates the remaining cost of its KEDNY and KEDLI MGP-related environmental remediation activities will be \$333.7 million, which amount has been accrued by us as a reasonable estimate of probable cost for known sites. However, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered.

With respect to remediation costs, KEDNY and KEDLI rate plans generally provide for the recovery

from customers of investigation and remediation costs of certain sites. At September 30, 2006, we have reflected a regulatory asset of \$378.4 million for 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 the New York MGP sites. That petition is still pending. KeySpan has recently filed proposed rate plans for KEDNY and KEDLI with the NYPSC as part of its application for approval of the KeySpan / National Grid plc merger, as well as individual applications for a proposed annual increase in revenues for KEDNY and KEDLI. Among other things, these filings seek recovery of deferred expenses associated with remediation of MGP sites, as well as recovery of ongoing remediation expenses. See the “Introduction to the Notes to the Consolidated Financial Statements” for additional details on the filings.

KeySpan is also responsible for environmental obligations associated with the Ravenswood Facility, purchased from Consolidated Edison in 1999, including remediation activities associated with its historical operations and those of the MGP facilities that formerly operated at the site. KeySpan is not responsible for liabilities arising from disposal of waste at off-site locations prior to the acquisition closing and any monetary fines arising from Consolidated Edison’s pre-closing conduct. We presently estimate the remaining environmental clean up activities for this site will be \$1.5 million, which amount has been accrued by us. Expenditures incurred to date total \$3.5 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.

KeySpan presently estimates the remaining cost of the Massachusetts KEDNE MGP-related environmental cleanup activities will be \$10.5 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 the November 8, 2000, the acquisition date of these subsidiaries, with respect to these MGP-related activities total \$32.8 million.

KeySpan may have or share responsibility under applicable environmental laws for the remediation

of 10 MGP sites and related facilities associated with the historical operations of EnergyNorth in New Hampshire. At four of these sites, KeySpan has entered into cost sharing agreements with other parties who share responsibility for remediation of these sites. EnergyNorth also entered into an agreement with the 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. The Nashua River Asbestos Site now has been fully remediated.

KeySpan presently estimates the remaining cost of EnergyNorth MGP-related environmental cleanup activities will be \$26.7 million, which amount has been accrued as a reasonable estimate of probable cost for known sites, however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site and actual environmental conditions encountered. Expenditures incurred since November 8, 2000, the acquisition date of this subsidiary, with respect to the MGP-related activities total \$21.7 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 September 30, 2006, we have reflected a regulatory asset of \$49.3 million for the KEDNE MGP sites.

KeySpan New England, LLC Sites: KeySpan is aware of three non-utility sites associated with KeySpan New England, LLC, a successor company to Eastern Enterprises, for which it may have or share environmental remediation or ongoing maintenance responsibility. These three sites, located in Philadelphia, Pennsylvania, New Haven, Connecticut and Everett, Massachusetts, were associated with historical operations involving the production of coke and related industrial processes. Honeywell International, Inc. and Beazer East, Inc. (both former owners and/or operators of certain facilities at Everett (the “Everett Facility”) together with KeySpan, have entered into an ACO with the Massachusetts Department of Environmental Protection for the investigation and development of a remedial response plan for a portion of that site. In 1989, KeySpan, Honeywell and Beazer East entered into a cost-sharing agreement under which each company agreed to pay one-third of the costs of compliance with the consent order, while preserving any claims it may have against the other companies for, among other things, reallocation of proportionate liability. In 2002, Beazer East commenced an action in the U.S. District Court for the Southern District of New York, which sought a judicial determination on the allocation of liability for the Everett Facility. A confidential settlement agreement has been executed on favorable terms to KeySpan and the Beazer lawsuit has been discontinued.

KeySpan presently estimates the remaining cost of the environmental cleanup activities for these three non-utility sites will be approximately \$13.4 million, which amount has been accrued as a reasonable estimate of probable costs for known sites however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. Expenditures

incurred since November 8, 2000, with respect to these sites total \$19.5 million.

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

Insurance Settlements: KeySpan has entered into confidential settlement agreements with certain of its insurance carriers for recovery of costs associated with the investigation and remediation of its MGP sites and the KeySpan New England LLC non-utility sites. Pursuant to these settlements, KeySpan recorded a benefit of \$5.5 million in its Consolidated Statement of Income for the nine months ended September 30, 2006, reflecting the benefit accruing to KeySpan's shareholders. Recovery of environmental costs from insurance carriers associated with utility MGP sites are refunded to KeySpan's ratepayers, subject to certain sharing provisions. During the past year, KeySpan has received approximately \$20 million from insurance carriers in settlements for recovery of environmental costs associated with remediation of MGP sites.

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 KeySpan is subject to various legal proceedings arising out of the ordinary course of its 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 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 KeySpan and its directors. The complaint, which was filed in the New York State Supreme Court for the County of Kings (the "Court"), related to the execution of the Merger Agreement with National Grid plc and alleged that the merger consideration which KeySpan's stockholders would receive in connection with the proposed merger transaction was inadequate and unfair because the transaction value of \$42.00 for each share of KeySpan's common stock outstanding did not provide its stockholders with a meaningful premium over the market price of the common stock. On April 19, 2006, we moved to dismiss the complaint for failure to state a cause of action upon which relief could be granted. On May 26, 2006, the plaintiff served an amended complaint adding National Grid plc as a defendant. The amended complaint alleged that National Grid plc aided and abetted the alleged breach of fiduciary duties and added claims of inadequate disclosure with respect to

KeySpan's preliminary proxy materials. In June 2006, the parties agreed in principle to settle the case, the terms of which provide for, among other things, the inclusion of additional disclosures in our 2006 Annual Meeting Proxy Statement concerning the background and principle events leading to execution of the Merger Agreement, as well as the payment of plaintiff's counsel fees of up to \$350,000 following closing of the transaction. In October 2006, definitive settlement documents were executed by the parties and submitted to the Court. The settlement remains subject to a number of conditions, including Court approval following notice to shareholders.

On July 12, 2006, a purported class action was filed alleging damages resulting from contamination associated with the historic operations of a former manufactured gas plant in Bay Shore, New York. On September 6, 2006 KeySpan filed a motion to dismiss this matter which is pending. In addition, on October 31, 2006, a lawsuit was filed alleging damages resulting from the contamination associated with the historic operations of a former manufactured gas plant in Staten Island, New York. KeySpan has been conducting site investigation and remediation activities at this location pursuant to an Order on Consent with the DEC. KeySpan intends to contest each of these proceedings vigorously. At this time, we are unable to predict what effect, if any, the outcome of these proceedings will have on our financial condition, results of operation and cash flows.

Other Contingencies: We derive a substantial portion of our revenues in the 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 with KeySpan. 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 and entered into the renegotiated 2006 LIPA Agreements that are discussed in Note 10 "2006 LIPA Settlement." Following the announcement of the proposed acquisition of KeySpan by National Grid plc, LIPA, National Grid plc 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, pursuant to indemnity obligations contained in the Long Island Lighting Company ("LILCO") / KeySpan merger agreement, KeySpan has been in discussions with the Internal Revenue Service ("IRS") with regard to LILCO's tax returns for the tax years ended December 31, 1996 through March 31, 1999, and KeySpan's and the Brooklyn Union Gas Company's tax returns for the years ended September 30, 1997 through December 31, 1998. Two issues were resolved in the second

quarter of 2006. It is anticipated that the remaining issues, including the primary issue relating to the valuation of certain assets transferred in the KeySpan/LILCO business combination, will be settled following approval by the Joint Committee on Taxation. The IRS submitted the case to the Joint Committee on Taxation on October 30, 2006. Additionally, the IRS recently commenced the examination of KeySpan's tax returns for the years ended 2002 and 2003. At this time, we cannot predict the result of these audits. See Note 11 "Income Taxes" for additional information.

Financial Guarantees

KeySpan has issued financial guarantees in the normal course of business, on behalf of its subsidiaries, to various third party creditors. At September 30, 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:

<i>Nature of Guarantee (In Millions of Dollars)</i>		Amount of Exposure	Expiration Dates
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)	71.4	2006 - 2008
Commodity Guarantees and Other	(vi)	77.0	2006 - 2009
Letters of Credit	(vii)	80.3	2006 - 2010
		\$ 1,710.5	

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 September 30, 2006, the total cost to complete such remaining bonded projects is estimated to be approximately \$26.5 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 September 30, 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 September 30, 2006, after adjusting for forfeitures, there are approximately 3.1 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 and nine months ended September 30, 2005 would have decreased to the pro-forma amounts indicated below:

<i>(In Millions of Dollars, Except Per Share Amounts)</i>	Three Months Ended September 30, 2005		Nine Months Ended September 30, 2005	
Earnings available for common stock:				
As reported	\$	22.6	\$	273.2
Add: recorded stock-based compensation expense, net of tax		1.3		7.4
Deduct: total stock-based compensation expense, net of tax		(1.8)		(8.8)
Pro-forma earnings	\$	22.1	\$	271.8
Earnings per share:				
Basic - as reported	\$	0.13	\$	1.62
Basic - pro-forma	\$	0.13	\$	1.61
Diluted - as reported	\$	0.13	\$	1.61
Diluted - pro-forma	\$	0.13	\$	1.60

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 nine months ended September 30, 2006, KeySpan recorded an expense of \$1.0 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.

<i>(In Millions of Dollars, Except Per Share Amounts)</i>	Nine Months Ended	
	September 30, 2006	September 30, 2005
Performance shares	\$ 6.1	\$ 2.5
Restricted stock	3.9	0.6
Stock options	4.6	4.2
EDSPP discount	3.8	3.9
Total stock-based compensation included in operations and maintenance expense	18.4	11.2
Income tax benefit	(6.4)	(3.9)
Total stock based compensation expense, net of tax	\$ 12.0	\$ 7.3

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 nine months ended September 30, 2006 and 2005, cash received from stock options exercised was \$24.9 million and \$42.7 million, respectively. The actual tax benefit realized for tax deductions from stock options exercised was \$2.6 million and \$5.3 million for the nine months ended September 30, 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.

The 2006 performance share award reflects the new performance condition criteria under SFAS 123R. 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 awarded at target level or the number of shares earned based on actual performance through the change of control date. Performance share awards were priced at fair value on the date of grant. The unearned compensation as of September 30, 2006 associated with all of the performance share awards was \$13.8 million.

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 September 30, 2006, associated with these awards was \$0.1 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 414,602 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 options granted 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	\$ 6.15
Dividend yield	4.64%
Expected volatility	22.63%
Risk free rate	4.10%
Expected lives	6.4 years
Exercise price	\$ 39.25

A summary of the status of our fixed stock option plans and changes is presented below for the nine months ended September 30, 2006:

Fixed Options	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value <i>(In Millions)</i>
Outstanding at beginning of period	10,443,055	\$ 33.74	
Granted during the year	-	\$ -	
Exercised	(774,984)	\$ 32.18	
Forfeited	(136,436)	\$ 36.77	
Outstanding at end of period	9,531,635	\$ 33.82	\$ 65.4
Exercisable at end of period	6,984,633	\$ 32.74	\$ 55.5

The total intrinsic value of the options exercised during the nine months ended September 30, 2006 and 2005 was approximately \$6.6 million and \$11.4 million, respectively.

Remaining Contractual Life	Options Outstanding at September 30, 2006	Weighted Average Exercise Price	Range of Exercise Price	Options Exercisable at September 30, 2006	Weighted Average Exercise Price	Range of Exercise Price
1 years	-	\$ -	\$ -	-	\$ -	\$ -
2 years	185,000	\$ 32.63	\$32.63	185,000	\$ 32.63	\$32.63
3 years	704,625	\$ 28.00	\$ 24.73 - 29.38	704,625	\$ 28.00	\$ 24.73 - 29.38
4 years	382,181	\$ 26.97	\$ 21.99 - 27.06	382,181	\$ 26.97	\$ 21.99 - 27.06
5 years	972,837	\$ 22.69	\$ 22.50 - 32.76	972,837	\$ 22.69	\$ 22.50 - 32.76
6 years	1,557,199	\$ 39.50	\$39.50	1,557,199	\$ 39.50	\$39.50
7 years	1,769,595	\$ 32.66	\$32.66	1,436,495	\$ 32.66	\$32.66
8 years	1,174,801	\$ 32.40	\$32.40	770,961	\$ 32.40	\$32.40
9 years	1,424,134	\$ 37.54	\$37.54	656,945	\$ 37.54	\$37.54
10 years	1,361,263	\$ 39.25	\$39.25	318,390	\$ 39.25	\$39.25
	9,531,635			6,984,633		

As of September 30, 2006, there are approximately 2.5 million options which have not yet vested. The unearned compensation cost related to these stock option awards is \$4.7 million which is expected to be recognized over a weighted average period of 2 years.

8. POSTRETIREMENT BENEFITS

Pension Plans: The following information represents the consolidated net periodic pension cost for the three and nine months ended September 30, 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:

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service cost, benefits earned during the period	\$ 14.9	\$ 14.2	\$ 47.0	\$ 42.5
Interest cost on projected benefit obligation	39.1	37.1	116.3	111.4
Expected return on plan assets	(45.5)	(43.2)	(139.5)	(129.8)
Net amortization and deferral	22.7	18.4	66.5	55.4
Total pension cost	\$ 31.2	\$ 26.5	\$ 90.3	\$ 79.5

Other Postretirement Benefits: The following information represents the consolidated net periodic other postretirement benefit cost for the three and nine months ended September 30, 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:

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service cost, benefits earned during the period	\$ 4.7	\$ 6.1	\$ 18.6	\$ 18.3
Interest cost on accumulated				
postretirement benefit obligation	15.9	19.0	56.2	56.8
Expected return on plan assets	(9.2)	(9.0)	(27.5)	(27.1)
Net amortization and deferral	9.7	14.9	43.0	44.9
Other postretirement cost	\$ 21.1	\$ 31.0	\$ 90.3	\$ 92.9

During the first nine months of 2006, KeySpan contributed \$90.0 million to its pension plans and \$18.0 million to its other postretirement benefit plans. KeySpan anticipates contributing an additional \$12.0 million to its other postretirement benefit plans during the remainder of 2006. 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 September 30, 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 September 30, 2006, KeySpan's consolidated indebtedness was 48.3% 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 September 30, 2006, we had cash and temporary cash investments of \$40.0 million. During the first nine months of 2006, we repaid \$327.6 million of commercial paper and, at September 30, 2006, \$330.0 million of commercial paper was outstanding at a weighted average annualized interest rate of 5.38%. At September 30, 2006, KeySpan had the ability to issue up to an additional \$1.2 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 plc, LIPA, National Grid plc 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, the results of 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. INCOME TAXES

KeySpan's consolidated effective income tax rate, including city and state income taxes, was 33.9% for the nine months ended September 30, 2006 compared to 36.6% for the corresponding period in 2005. During the second quarter of 2006, KeySpan resolved its dispute with the New York City Department of Taxation and Finance with respect to income taxes relating to the operations of its merchant electric generating facility. In addition, pursuant to indemnity obligations contained in the LILCO / KeySpan merger agreement, KeySpan has been in discussions with the IRS with regard to LILCO's tax returns for the tax years ended December 31, 1996 through March 31, 1999 and KeySpan's and The Brooklyn Union Gas Company's tax returns for the years ended September 30, 1997 through December 31, 1998. Two issues were resolved in the second quarter of 2006. As a result of settling the two issues with the IRS, as well as the New York City tax issue, KeySpan realized a tax benefit of \$16.4 million for the nine months ended September 30, 2006. It is anticipated that the remaining issues including the primary issue relating to the valuation of certain assets transferred in the KeySpan/LILCO business combination of May 1998 will be settled following approval by the Joint Committee on Taxation. The IRS submitted the case to the Joint Committee on Taxation on October 30, 2006. Further, a \$3.4 million benefit was recorded in the third quarter of 2006 reflecting an accrual for prior investment tax credits that KeySpan is entitled to. KeySpan has recently filed amended tax returns to reflect its entitlement to investment tax

credits for the period 2000 through 2004. The decrease in the effective tax rate for the nine months ended September 30, 2006 compared to the same period in 2005, was primarily due to the aforementioned items.

The IRS has also recently commenced the examination of KeySpan's tax returns for the years ended December 31, 2002 and 2003. At this time, we cannot predict the result of these audits.

12. GAS EXPLORATION AND PRODUCTION PROPERTY - DEPLETION

KeySpan has 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 September 30, 2006, these subsidiaries had net exploration and production property in the amount of \$73.7 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 capitalized into a "full cost pool" as incurred. Unproved properties and related costs are excluded from the depletion and amortization base until a determination is made as to the existence of proved reserves. Properties are depleted and charged to operations using the unit of production method using proved reserve quantities.

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

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

As of September 30, 2006, KeySpan estimated that its capitalized costs exceeded the ceiling test limitation by \$25.8 million. KeySpan used an average wellhead price of \$3.63 per MCF for this measurement. In accordance with current SEC guidelines, we have included estimated future cash flows from our hedging program in the ceiling test calculation. At September 30, 2006, Seneca-Upshur's cash flow hedges had an average fixed price of approximately \$7.00 per MCF. Therefore, since the fixed price of \$7.00 MCF was in excess of the average wellhead price of \$3.63 per MCF, the cash flow hedges resulted in a favorable impact to the ceiling test calculation of \$15.2 million.

Subsequent to September 30, 2006, the average wellhead price increased substantially and was \$7.77 per MCF on October 26, 2006. As permitted by current SEC guidelines, KeySpan elected to use this

measurement date to re-compute the ceiling test limitation. Based on this price, KeySpan determined that its capitalized costs did not exceed the ceiling test limitation, and as a result, a non-cash impairment charge was not recorded in the third quarter of 2006. As noted previously, at September 30, 2006, Seneca-Upshur's cash flow hedges had an average fixed price of approximately \$7.00 per MCF. Therefore, since the fixed price of \$7.00 MCF was below the more current average wellhead price of \$7.77 per MCF, the cash flow hedges resulted in an unfavorable impact to the re-computed ceiling test calculation of \$3.5 million.

13. 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.

Statement of Income					
Three Months Ended September 30, 2006					
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
Revenues	\$ 0.2	\$ 163.3	\$ 1,055.2	\$ (0.2)	\$ 1,218.5
Operating Expenses					
Purchased gas	-	112.9	248.6	-	361.5
Fuel and purchased power	-	-	172.6	-	172.6
Operations and maintenance	13.0	33.3	326.4	-	372.7
Intercompany expense	-	1.3	(1.1)	(0.2)	-
Depreciation and amortization	-	15.0	69.2	-	84.2
Operating taxes	-	15.5	80.4	-	95.9
Total Operating Expenses	13.0	178.0	896.1	(0.2)	1,086.9
Income from equity investments	-	-	4.2	-	4.2
Operating Income (Loss)	(12.8)	(14.7)	163.3	-	135.8
Interest charges	(42.5)	(13.4)	(20.5)	9.3	(67.1)
Other income and (deductions)	93.9	1.1	(16.8)	(70.2)	8.0
Total Other Income and (Deductions)	51.4	(12.3)	(37.3)	(60.9)	(59.1)
Income Taxes (Benefit)	(11.7)	(11.5)	49.6	-	26.4
Net Income (Loss)	\$ 50.3	\$ (15.5)	\$ 76.4	\$ (60.9)	\$ 50.3

Statement of Income					
	Three Months Ended September 30, 2005				
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
Revenues	\$ 0.2	\$ 185.1	\$ 1,118.0	\$ (0.2)	\$ 1,303.1
Operating Expenses					
Purchased gas	-	136.5	259.2	-	395.7
Fuel and purchased power	-	-	254.6	-	254.6
Operations and maintenance	3.5	32.6	328.2	-	364.3
Intercompany expense	-	1.2	(1.0)	(0.2)	-
Depreciation and amortization	-	14.1	78.0	-	92.1
Operating taxes	-	15.5	81.6	-	97.1
Total Operating Expenses	3.5	199.9	1,000.6	(0.2)	1,203.8
Income from equity investments	-	-	2.5	-	2.5
Gain on sale of property	-	-	1.0	-	1.0
Operating Income (Loss)	(3.3)	(14.8)	120.9	-	102.8
Interest charges	(37.3)	(13.7)	(22.4)	6.0	(67.4)
Other income and (deductions)	50.4	0.3	(28.3)	(26.2)	(3.8)
Total Other Income and (Deductions)	13.1	(13.4)	(50.7)	(20.2)	(71.2)
Income Taxes (Benefit)	(12.8)	(9.9)	31.7	-	9.0
Net Income (Loss)	\$ 22.6	\$ (18.3)	\$ 38.5	\$ (20.2)	\$ 22.6

Statement of Income					
	Nine Months Ended September 30, 2006				
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
Revenues	\$ 0.5	\$ 952.9	\$ 4,304.4	\$ (0.5)	\$ 5,257.3
Operating Expenses					
Purchased gas	-	631.6	1,781.1	-	2,412.7
Fuel and purchased power	-	-	418.3	-	418.3
Operations and maintenance	30.2	104.1	1,065.0	-	1,199.3
Intercompany expense	-	4.0	(3.5)	(0.5)	-
Depreciation and amortization	-	58.8	236.9	-	295.7
Operating taxes	-	48.5	261.4	-	309.9
Total Operating Expenses	30.2	847.0	3,759.2	(0.5)	4,635.9
Income from equity investments	-	-	9.5	-	9.5
Gain on sale of assets	-	-	1.4	-	1.4
Operating Income (Loss)	(29.7)	105.9	556.1	-	632.3
Interest charges	(122.2)	(40.7)	(51.5)	21.7	(192.7)
Other income and (deductions)	418.8	2.1	(50.7)	(344.6)	25.6
Total Other Income and (Deductions)	296.6	(38.6)	(102.2)	(322.9)	(167.1)
Income Taxes (Benefit)	(40.7)	23.9	174.4	-	157.6
Net Income	\$ 307.6	\$ 43.4	\$ 279.5	\$ (322.9)	\$ 307.6

Statement of Income					
Nine Months Ended September 30, 2005					
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
Revenues	\$ 0.5	\$ 916.1	\$ 4,210.0	\$ (0.5)	\$ 5,126.1
Operating Expenses					
Purchased gas	-	588.1	1,618.0	-	2,206.1
Fuel and purchased power	-	-	546.9	-	546.9
Operations and maintenance	10.9	96.4	1,036.0	-	1,143.3
Intercompany expense	-	3.7	(3.2)	(0.5)	-
Depreciation and amortization	-	59.1	236.7	-	295.8
Operating taxes	-	47.8	255.2	-	303.0
Total Operating Expenses	10.9	795.1	3,689.6	(0.5)	4,495.1
Income from equity investments	-	-	12.5	-	12.5
Gain on sale of property	-	-	1.2	-	1.2
Operating Income (Loss)	(10.4)	121.0	534.1	-	644.7
Interest charges	(104.8)	(46.1)	(64.9)	15.7	(200.1)
Other income and (deductions)	364.8	3.2	(62.4)	(313.0)	(7.4)
Total Other Income and (Deductions)	260.0	(42.9)	(127.3)	(297.3)	(207.5)
Income Taxes (Benefit)	(25.8)	28.2	157.6	-	160.0
Earnings from Continuing Operations	275.4	49.9	249.2	(297.3)	277.2
Discontinued Operations	-	-	(1.8)	-	(1.8)
Net Income	\$ 275.4	\$ 49.9	\$ 247.4	\$ (297.3)	\$ 275.4

Balance Sheet					
	September 30, 2006				
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets					
Cash & temporary cash investments	\$ 8.6	\$ 3.3	\$ 28.1	\$ -	\$ 40.0
Accounts receivable, net	0.6	101.8	624.8	-	727.2
Other current assets	2.1	268.5	1,109.1	-	1,379.7
	<u>11.3</u>	<u>373.6</u>	<u>1,762.0</u>	<u>-</u>	<u>2,146.9</u>
Equity Investments	<u>4,893.5</u>	<u>-</u>	<u>138.7</u>	<u>(4,774.3)</u>	<u>257.9</u>
Property					
Gas	-	2,146.0	5,399.8	-	7,545.8
Other	-	25.3	3,140.4	-	3,165.7
Accumulated depreciation and depletion	-	(425.5)	(2,782.8)	-	(3,208.3)
	<u>-</u>	<u>1,745.8</u>	<u>5,757.4</u>	<u>-</u>	<u>7,503.2</u>
Intercompany Accounts Receivable	<u>976.1</u>	<u>289.7</u>	<u>1,980.7</u>	<u>(3,246.5)</u>	<u>-</u>
Deferred Charges	<u>1,971.0</u>	<u>409.3</u>	<u>1,150.1</u>	<u>-</u>	<u>3,530.4</u>
Total Assets	<u>\$ 7,851.9</u>	<u>\$ 2,818.4</u>	<u>\$ 10,788.9</u>	<u>\$ (8,020.8)</u>	<u>\$ 13,438.4</u>
LIABILITIES AND CAPITALIZATION					
Current Liabilities					
Accounts payable	\$ 32.2	\$ 102.8	\$ 546.9	\$ -	\$ 681.9
Commercial paper	330.0	-	-	-	330.0
Other current liabilities	207.8	84.4	342.7	-	634.9
	<u>570.0</u>	<u>187.2</u>	<u>889.6</u>	<u>-</u>	<u>1,646.8</u>
Intercompany Accounts Payable	<u>128.8</u>	<u>473.4</u>	<u>1,130.4</u>	<u>(1,732.6)</u>	<u>-</u>
Deferred Credits and Other Liabilities					
Deferred income tax	24.3	364.1	834.0	-	1,222.4
Other deferred credits and liabilities	680.1	203.3	1,183.6	-	2,067.0
	<u>704.4</u>	<u>567.4</u>	<u>2,017.6</u>	<u>-</u>	<u>3,289.4</u>
Capitalization					
Common shareholders' equity	4,586.7	939.5	3,815.5	(4,774.3)	4,567.4
Long-term debt	1,862.0	650.9	2,920.3	(1,513.9)	3,919.3
Total Capitalization	<u>6,448.7</u>	<u>1,590.4</u>	<u>6,735.8</u>	<u>(6,288.2)</u>	<u>8,486.7</u>
Minority Interest in Subsidiary Companies	<u>-</u>	<u>-</u>	<u>15.5</u>	<u>-</u>	<u>15.5</u>
Total Liabilities & Capitalization	<u>\$ 7,851.9</u>	<u>\$ 2,818.4</u>	<u>\$ 10,788.9</u>	<u>\$ (8,020.8)</u>	<u>\$ 13,438.4</u>

Balance Sheet

	December 31, 2005				
<i>(In Millions of Dollars)</i>	Guarantor	KEDLI	Other Subsidiaries	Eliminations	Consolidated
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

Statement of Cash Flows

<i>(In Millions of Dollars)</i>	Nine Months Ended September 30, 2006			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
Operating Activities				
Net Cash (Used in) Provided by Operating Activities	\$ (11.3)	\$ 124.1	\$ 794.8	\$ 907.6
Investing Activities				
Capital expenditures	-	(63.1)	(314.5)	(377.6)
Cost of removal	-	(5.5)	(17.6)	(23.1)
Derivative margin calls	-	(17.6)	(25.1)	(42.7)
Proceeds from sale of property	-	-	1.5	1.5
Net Cash Provided by (Used in) Investing Activities	-	(86.2)	(355.7)	(441.9)
Financing Activities				
Treasury stock issued	21.1	-	-	21.1
Payment of debt, net	(327.5)	-	-	(327.5)
Common and preferred stock dividends paid	(243.8)	-	-	(243.8)
Intercompany dividend payments	8.4	-	(8.4)	-
Net intercompany accounts	482.2	(38.1)	(444.1)	-
Net Cash (Used in) Financing Activities	(59.6)	(38.1)	(452.5)	(550.2)
Net (Decrease) in Cash and Cash Equivalents	\$ (70.9)	\$ (0.2)	\$ (13.4)	\$ (84.5)
Cash and Cash Equivalents at Beginning of Period	79.5	3.5	41.5	124.5
Cash and Cash Equivalents at End of Period	\$ 8.6	\$ 3.3	\$ 28.1	\$ 40.0

Statement of Cash Flows

<i>(In Millions of Dollars)</i>	Nine Months Ended September 30, 2005			
	Guarantor	KEDLI	Other Subsidiaries	Consolidated
Operating Activities				
Net Cash Provided by (Used in) Operating Activities	\$ (326.2)	\$ 156.7	\$ 641.6	\$ 472.1
Investing Activities				
Capital expenditures	-	(70.9)	(301.2)	(372.1)
Cost of removal	-	(1.6)	(9.2)	(10.8)
Proceeds from sale of investment	-	(2.1)	49.0	46.9
Derivative margin calls	-	-	(63.3)	(63.3)
Net Cash (Used in) Investing Activities	-	(74.6)	(324.7)	(399.3)
Financing Activities				
Treasury stock issued	41.0	-	-	41.0
Payment of debt, net	(1,092.2)	-	(15.1)	(1,107.3)
Redemption of preferred stock	(75.0)	-	-	(75.0)
Common and preferred stock dividends paid	(229.1)	-	-	(229.1)
MEDs equity conversion	460.0	-	-	460.0
Intercompany dividend payments	317.0	-	(317.0)	-
Net intercompany accounts	304.0	(80.0)	(224.0)	-
Other	(2.4)	-	16.4	14.0
Net Cash (Used in) Financing Activities	(276.7)	(80.0)	(539.7)	(896.4)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (602.9)	\$ 2.1	\$ (222.8)	\$ (823.6)
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	\$ (22.2)	\$ 1.2	\$ 105.0	\$ 84.0

Item 2. Management's Discussion and Analysis of Financial Condition and Results of

Operations

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.

Consummation of the Merger is subject to various closing conditions. Assuming receipt of all required approvals, it is currently anticipated that the Merger will be consummated in mid-2007. However, no assurance can be given that the Merger will occur, or the timing of its completion. See the Introduction to the Notes to the Consolidated Financial Statements for additional information regarding the Merger.

Consolidated Review of Results

The following is a summary of transactions affecting comparative earnings for the three and nine months ended September 30, 2006, compared to the three and nine months ended September 30, 2005. Capitalized terms used in the following discussion, but not otherwise defined, have the same meaning as when used in the Notes to the Consolidated Financial Statements included under Item 1.

References to “KeySpan,” “we,” “us,” and “our” mean KeySpan Corporation, together with its consolidated subsidiaries.

Operating income by segment, as well as consolidated earnings for common stock is set forth in the

following table for the periods indicated.

<i>(In Millions of Dollars, Except per Share)</i>					
	Three Months Ended September 30,		Nine Months Ended September 30,		
	2006	2005	2006	2005	
Gas Distribution	\$ (10.8)	\$ (45.5)	\$ 365.1	\$ 376.8	
Electric Services	144.4	149.6	271.7	266.3	
Energy Services	3.0	(1.1)	4.6	(6.7)	
Energy Investments	4.7	4.7	11.3	16.6	
Eliminations and other	(5.5)	(4.9)	(20.4)	(8.3)	
Operating Income	135.8	102.8	632.3	644.7	
Other Income and (Deductions)					
Interest charges	(67.1)	(67.4)	(192.7)	(200.1)	
Gain on sale of investments	-	-	-	4.1	
Cost of debt redemption	-	-	-	(20.9)	
Other income and (deductions)	8.0	(3.8)	25.6	9.4	
Total Other Income and (Deductions)	(59.1)	(71.2)	(167.1)	(207.5)	
Earnings before income taxes	76.7	31.6	465.2	437.2	
Income taxes	26.4	9.0	157.6	160.0	
Earnings from continuing operations	50.3	22.6	307.6	277.2	
Discontinued operations	-	-	-	(1.8)	
Net Income	50.3	22.6	307.6	275.4	
Preferred stock dividend requirements	-	-	-	2.2	
Earnings for Common Stock	\$ 50.3	\$ 22.6	\$ 307.6	\$ 273.2	
Basic Earnings per Share					
Continuing operations, less preferred stock dividends	\$ 0.29	\$ 0.13	\$ 1.76	\$ 1.63	
Discontinued operations	-	-	-	(0.01)	
	\$ 0.29	\$ 0.13	\$ 1.76	\$ 1.62	

Results of Operations For The Quarter Ended September 30, 2006 vs 2005

KeySpan's earnings for common stock for the three months ended September 30, 2006, were \$50.3 million, or \$0.29 per share, compared to \$22.6 million or \$0.13 per share realized during the corresponding quarter last year, an increase of \$27.7 million, or \$0.16 per share. The favorable comparative operating results primarily reflect an increase in operating income of \$33.0 million or 32%.

The primary driver behind the increase in operating income was lower operating expenses in the Gas Distribution segment of \$30.9 million. The Electric Services segment results were slightly lower than last year, reflecting a decrease in net electric revenues associated with the Ravenswood Generating Station, KeySpan's merchant electric generating facility. During the quarter, this segment also recognized a gain on a fixed for floating unforced capacity financial swap which is reflected in operating results of this segment. (See the discussion under the caption "Review of Operating Segments" for further details on each segment.)

For the third quarter of 2006, other income and (deductions) reflects a net expense of \$59.1 million

compared to a net expense of \$71.2 million for the third quarter of 2005. Included in the caption “Other Income and (Deductions)” are interest charges and certain other miscellaneous items. The favorable variation of \$12.1 million is due, in part, to an increase in interest income on certain investments. Further, during the third quarter of 2005, KeySpan recorded an \$8.5 million non-cash charge associated with the fair value of outstanding derivative financial instruments that did not qualify for hedge accounting treatment.

Income tax expense increased \$17.4 million for the third quarter of 2006 compared to the same quarter in 2005, due to the increase in pre-tax income. Offsetting this increase, to some extent, was a \$3.4 million benefit recorded in the third quarter of 2006, reflecting an accrual for prior investment tax credits that KeySpan is entitled to. KeySpan has recently filed amended tax returns to reflect its entitlement to investment tax credits for the period 2000 through 2004.

Results of Operations For The Nine Months Ended September 30, 2006 vs 2005

KeySpan’s earnings for common stock for the nine months ended September 30, 2006, were \$307.6 million, compared to \$273.2 million realized during the same period last year, an increase of \$34.4 million. The favorable comparative earnings primarily reflect: (i) the benefits associated with the settlement of certain outstanding issues with the New York City Department of Taxation and Finance and the Internal Revenue Service (“IRS”); and (ii) debt redemption costs incurred in 2005, but not repeated in 2006; offset by (iii) a decrease in operating income.

KeySpan’s earnings per share for the nine months ended September 30, 2006, were \$1.76 per share, compared to \$1.62 per share realized during the same period last year, an increase of \$0.14 per share. Earnings per share for the nine months ended September 30, 2006 reflect a higher level of outstanding common stock compared to last year. In May 2005, KeySpan issued 12.1 million shares of common stock upon the conversion of previously held MEDs Equity Units. The dilutive effect on earnings per share in 2006 from this issuance, in addition to KeySpan’s employee stock purchase plans, was approximately \$0.07 per share. (See KeySpan’s Annual Report of Form 10-K for the year ended December 31, 2005, Note 6 to the Consolidated Financial Statements “Long-Term Debt and Commercial Paper” for additional details on the MEDs Equity Units.)

Operating income decreased \$12.4 million, or 2% for the nine months ended September 30, 2006, compared to the corresponding period last year. Comparative operating income reflects lower earnings from the Gas Distribution segment and Energy Investments segments of \$11.7 million and \$5.3 million, respectively, offset by higher earnings from KeySpan’s electric operations and its Energy Services segment of \$5.4 million and \$11.3 million respectively. Operating income from the Gas Distribution segment was adversely impacted by the warm weather experienced during the first quarter of 2006 (KeySpan’s primary heating season) which resulted in a decrease to comparative net gas revenues. The decrease in operating income from the Energy Investments segment reflects lower earnings from KeySpan’s investment in the Iroquois Gas Transmission System pipeline, as well as lower earnings from the transportation of liquefied natural gas. The Electric Services segment results were favorably affected by a gain recognized on a fixed for floating unforced

capacity financial swap. The favorable comparative results from the Energy Services segment were due to higher gross margins on engineering and service contracts and lower general and administrative expenses. The operating income variation as reflected in “elimination and other” is due primarily to incremental costs residing at KeySpan’s holding company level primarily related to the anticipated KeySpan / National Grid plc merger including legal and consulting fees, as well as to corporate advertising expenses. (See the discussion under the caption “Review of Operating Segments” for further details on each segment.)

Other income and (deductions) reflects interest charges, costs associated with debt redemptions, income from subsidiary stock transactions and other miscellaneous items. For the nine months ended September 30, 2006, other income and (deductions) reflects a net expense of \$167.1 million compared to a net expense of \$207.5 million for the same period of 2005. The favorable variation of \$40.4 million is due, in part, to debt redemption costs incurred in 2005. In 2005, KeySpan redeemed \$500 million 6.15% Series Notes due 2006. KeySpan incurred \$20.9 million in call premiums and wrote-off \$1.3 million of previously deferred financing costs. In addition, we accelerated the amortization of approximately \$11.2 million of previously unamortized benefits associated with an interest rate swap on the redeemed bonds. The write-off of the deferred financing costs and the amortization of the benefits associated with an interest rate swap were recorded to interest expense.

Interest expense for the nine months ended September 30, 2006 decreased \$7.4 million compared to the same period in 2005, reflecting, in part, the reversal of a previously recorded \$6 million reserve established in connection with an income tax dispute with the New York City Department of Taxation and Finance. During the second quarter of 2006, KeySpan resolved its dispute with the New York City Department of Taxation and Finance with respect to income taxes relating to the operations of its merchant electric generating facility. As a result of the favorable settlement of this issue, KeySpan reversed a previously recorded interest reserve established in connection with this dispute. Further, comparative interest expense reflects lower carrying charges on regulatory deferrals in 2006, offset by the benefits recorded in 2005 associated with the amortization of the interest rate swap.

The favorable variation in other income and (deductions) for the nine months ended September 30, 2006, compared to the same period in 2005, also reflects higher interest income on certain investments. Further, in 2005, KeySpan recorded an \$8.5 million non-cash charge associated with the fair value of outstanding derivative financial instruments that did not qualify for hedge accounting treatment.

Other income and (deductions) for the nine months ended September 30, 2005, reflects the sale of KeySpan’s 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, which took place in the first quarter of 2005, resulted in a pre-tax gain of \$4.1 million reflecting the difference

from earlier estimates.

Income tax expense decreased \$2.4 million for the nine months ended September 30, 2006, compared to same period of 2005, despite the higher pre-tax income, primarily reflecting the settlement of certain outstanding issues with the New York City Department of Taxation and Finance and the IRS.

Pursuant to indemnity obligations contained in the Long Island Lighting Company (“LILCO”) / KeySpan merger agreement, KeySpan has been in discussions with the IRS with regard to LILCO’s tax returns for the tax years ended December 31, 1996 through March 31, 1999, and KeySpan’s and the Brooklyn Union Gas Company’s tax returns for the years ended September 30, 1997 through December 31, 1998. Two issues were resolved in the second quarter of 2006. It is anticipated that the remaining issues, including the primary issue relating to the valuation of certain assets transferred in the KeySpan/LILCO business combination, will be settled following approval by the Joint Committee on Taxation. In addition, as noted above, KeySpan resolved its dispute with New York City Department of Taxation and Finance with respect to income taxes relating to its merchant electric generating facility. As a result of settling the two issues with the IRS, as well as the New York City issue, KeySpan realized a tax benefit of \$16.4 million during the nine months ended September 30, 2006. Further, as noted previously, during the third quarter of 2006 KeySpan recorded a \$3.4 million benefit for prior investment tax credits to which KeySpan is entitled.

The IRS has also recently commenced the examination of KeySpan’s tax returns for the years ended December 31, 2002 and 2003. At this time, we cannot predict the result of these audits.

Additionally, it should be noted that KeySpan recorded a \$1.8 million loss from discontinued operations for the nine months ended September 30, 2005. In the fourth quarter of 2004, KeySpan’s investment in its mechanical contracting subsidiaries was written-down to fair value. During the first six months of 2005, operating losses amounting to \$4.1 million after tax were incurred through the dates of sale of these companies, 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 nine months ended September 30, 2005.

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

In light of the pending merger between KeySpan and National Grid plc and the widespread integration efforts being undertaken by both companies, KeySpan believes that it is no longer relevant to comment on previously issued guidance on projected 2006 earnings.

Review of Operating Segments

KeySpan reports its segment results on an Operating Income basis. Management believes that this Generally Accepted Accounting Principle (“GAAP”) based measure provides a reasonable indication of KeySpan’s underlying performance associated with its operations. The following is a discussion of financial results achieved by KeySpan’s operating segments presented on an operating income basis.

Gas Distribution

KeySpan Energy Delivery New York (“KEDNY”) provides gas distribution service to customers in the New York City Boroughs of Brooklyn, Staten Island and a portion of Queens, and KeySpan Energy Delivery Long Island (“KEDLI”) provides gas distribution service to customers in the Long Island counties of Nassau and Suffolk and the Rockaway Peninsula of Queens County. Four gas distribution companies - Boston Gas Company, Colonial Gas Company, Essex Gas Company, and EnergyNorth Natural Gas Inc., each doing business under the name KeySpan Energy Delivery New England (“KEDNE”), provide gas distribution service to customers in Massachusetts and New Hampshire.

The table below highlights certain significant financial data and operating statistics for the Gas Distribution segment for the periods indicated.

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	\$ 595.5	\$ 629.6	\$ 3,648.8	\$ 3,476.1
Cost of gas	362.8	399.8	2,416.5	2,214.9
Revenue taxes	6.9	7.8	43.1	43.0
Net Revenues	225.8	222.0	1,189.2	1,218.2
Operating Expenses				
Operations and maintenance	145.5	162.9	512.4	519.8
Depreciation and amortization	52.3	63.5	197.3	207.4
Operating taxes	38.8	41.1	114.4	114.2
Total Operating Expenses	236.6	267.5	824.1	841.4
Operating Income	\$ (10.8)	\$ (45.5)	\$ 365.1	\$ 376.8
Firm gas sales and transportation (MDTH)	27,682	28,020	203,437	228,260
Transportation - Electric Generation (MDTH)	28,689	9,756	55,797	21,188
Other Sales (MDTH)	48,274	47,937	146,217	142,398
Warmer (Colder) than Normal - New York	N/A	N/A	14%	(3%)
Warmer (Colder) than Normal - New England	N/A	N/A	5%	(12%)

A MDTH is 10,000 therms (British Thermal Units) and reflects the heating content of approximately one million cubic feet of gas. A therm reflects the heating content of approximately 100 cubic feet of gas. One billion cubic feet (BCF) of gas equals approximately 1,000 MDTH.

Executive Summary

For the third quarter of 2006, the Gas Distribution segment realized a seasonal operating loss of \$10.8 million, compared to a seasonal operating loss of \$45.5 million realized in the third quarter of 2005. The favorable comparative operating results were primarily due to a decrease of \$30.9 million in operating expenses as a result of a lower provision for uncollectible accounts receivable of \$16.4 million and a decrease in depreciation charges of \$11.6 million.

For the nine months ended September 30, 2006, operating income decreased \$11.7 million compared to the same period last year, primarily due to a decrease in net gas revenues of \$29.0 million, primarily resulting from the warm first quarter weather. Operating expenses, however, decreased \$17.3 million due to a lower provision for uncollectible accounts receivable of \$13.9 million and a decrease in depreciation charges of \$7.9 million, partially offset by higher employee benefit costs, primarily postretirement expenses.

Net Revenues

Net gas revenues from our gas distribution operations decreased \$29.0 million, or 2%, for the nine months ended September 30, 2006, compared to the same period last year. Both the New York and New England based gas distribution operations were adversely impacted by the significantly warmer than normal weather experienced throughout the northeastern United States during the 2006 heating season – January through April. As measured in heating degree days, weather during that period in our New York and New England service territories was approximately 13% and 8% warmer than normal, respectively, and was approximately 15% warmer than last year across KeySpan's service territories.

Net revenues from firm gas customers (residential, commercial and industrial customers) decreased \$43.8 million in the first nine months of 2006 compared to the same period last year. The favorable impact to net gas revenues from load growth additions was more than offset by declining usage per customer due to the extremely warm weather during the winter heating season, the use of more efficient gas heating equipment and higher gas costs. KeySpan estimates that the warm winter weather resulted in an adverse impact to net gas revenues of approximately \$26 million, net of the benefits from the weather normalization adjustment and weather derivatives discussed below.

KEDNY and KEDLI each operate under utility tariffs that contain a weather normalization adjustment that significantly offsets variations in firm net revenues due to fluctuations in weather. These weather normalization adjustments resulted in a benefit to KeySpan of \$25 million during the nine months ended September 30, 2006, but this did not fully mitigate the impact of the loss in revenues due to the extremely warm weather experienced, as previously noted. The New England-based gas distribution subsidiaries do not have weather normalization adjustments. To mitigate the effect of fluctuations in normal weather patterns on KEDNE's results of operations and cash flows, weather derivatives were in place for the 2005/2006 winter heating season. Weather, during the first quarter of 2006 was significantly warmer than normal as noted earlier. However, during 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 for the first nine months of 2006. (See Note 4 to the Consolidated Financial Statements “Hedging and Derivative Financial Instruments” for further information).

Firm gas distribution rates for KEDNY, KEDLI and KEDNE in 2006, other than for the recovery of gas costs, have remained substantially unchanged from rates charged in 2005.

In our large-volume heating and other interruptible (non-firm) markets, which include large apartment houses, government buildings and schools, gas service is provided under rates that are designed to compete with prices of alternative fuel, including No. 2 and No. 6 grade heating oil. These “dual-fuel” customers can consume either natural gas or fuel oil for heating purposes. Net revenues in these markets increased \$14.8 million during the nine months ended September 30, 2006, compared to the same period last year primarily reflecting higher pricing.

Firm Sales, Transportation and Other Quantities

Firm gas sales and transportation quantities for the nine months ended September 30, 2006, decreased 11% compared to the same period in 2005 due primarily to the warmer weather this year compared to last year. Customer additions and oil-to-gas conversions offset the full impact of the warmer weather. Net revenues are not affected by customers opting to purchase their gas supply from other sources, since delivery rates charged to transportation customers generally are the same as delivery rates charged to full sales service customers. Transportation quantities related to electric generation reflect the transportation of gas to our electric generating facilities located on Long Island. Net revenues from these services are not material.

Other sales quantities include on-system interruptible quantities, off-system sales quantities (sales made to customers outside of our service territories) and related transportation. We have a management contract with Merrill Lynch Trading, under which KeySpan and Merrill Lynch Trading will share the responsibilities for managing KeySpan’s upstream gas distribution assets associated with its Massachusetts gas distribution subsidiaries, as well as providing city-gate delivered supply. KeySpan, Merrill Lynch Trading and KeySpan’s Massachusetts gas sales customers will share in the profits generated from the optimization of these assets. The Massachusetts Department of Telecommunications and Energy (“MADTE”) approved this contract in March 2006 effective April 1, 2006. KeySpan provides these services internally for its New York and New Hampshire gas distribution subsidiaries.

Purchased Gas for Resale

The increase in gas costs for the nine months ended September 30, 2006, compared to the same period of 2005 of \$201.6 million, or 9%, reflects an increase of 20% in the price per dekatherm of gas purchased for firm gas sales customers, offset by a 13% decrease in the quantity of gas purchased due to the warm winter heating season weather. The current gas rate structure of each of

our gas distribution utilities includes a gas adjustment clause, pursuant to which variations between actual gas costs incurred for resale to firm sales customers and gas costs billed to firm sales customers are deferred and refunded to or collected from customers in a subsequent period.

Operating Expenses

Operating expenses for the third quarter of 2006 compared to the same quarter last year decreased \$30.9 million, or 12%. Operations and maintenance expense decreased \$17.4 million, or 11%, in 2006 compared to 2005 primarily reflecting a decrease of \$16.4 million in the provision for uncollectible accounts receivable. In December 2005, The Boston Gas Company (“Boston Gas”) received a MADTE order, effective January 1, 2006, permitting Boston Gas 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. The beneficial impact of this MADTE order was the primary driver behind the reduction in the provision for uncollectible accounts receivable, combined with a decrease in firm sales quantities in 2006 compared to 2005. See the discussion under the caption “Regulation and Rate Matters - Gas Matters” for additional details of the MADTE order.

The decrease in depreciation and amortization charges of \$11.2 million, or 18%, for the third quarter of 2006 compared to the third quarter of 2005, was primarily due to an adjustment recorded this quarter to the depreciation allowance to correct for an error in useful lives associated with certain gas distribution assets.

For the nine months ended September 30, 2006, operating expenses decreased \$17.3 million, or 2% compared to the same period last year. Operations and maintenance expense decreased \$7.4 million, or 1%, in 2006 compared to 2005 due to a decrease of \$13.9 million in the provision for uncollectible accounts receivable, resulting from the MADTE order noted above and lower firm sales quantities in 2006 compared to 2005. This beneficial impact to operations and maintenance expense was partially offset by increases in postretirement expenses and regulatory fees.

The decrease in depreciation and amortization charges of \$10.1 million, or 5%, for the nine months ended September 30, 2006 compared to the same period of 2005, reflects a decrease in depreciation charges of \$7.9 million and lower regulatory amortization charges of \$2.2 million. As noted previously, the decrease in depreciation charges reflects an adjustment to the depreciation allowance to correct for an error in useful lives associated with certain gas distribution assets.

Gas Supply and Pricing

KeySpan believes it has adequate gas supply available to meet its gas load demand in its service territories for the 2006/2007 winter heating season as KeySpan expects its gas storage to be 100% full at the start of the winter heating season. The current gas rate structure of each of our gas distribution utilities includes a gas adjustment clause, pursuant to which gas costs are recovered in billed sales to regulated firm gas sales customers. Although KeySpan is allowed to “pass through” the cost of gas to its customers, the volatility of natural gas prices can have an adverse impact on

customers' gas bills and recovery of customer accounts receivable. High gas prices have led to an increase in price elasticity resulting in an increase in customer conservation measures and attrition. The MADTE order, received in the fourth quarter of 2005, permitting Boston Gas regulatory recovery of the gas cost component of net bad debt write-offs has helped to mitigate any increase in bad debt expense.

With KeySpan's continuing strategy of having its storage facilities 100% full at the start of the heating season and through the use of financial derivatives, KeySpan anticipates that it will effectively hedge the price of approximately two-thirds of the gas supply needed to serve its gas heating customers during the 2006/2007 winter heating season. This strategy mitigates the volatility of natural gas prices on customers' winter heating gas bills. Further, KeySpan has programs in place to help customers manage their gas bills, such as balanced billing plans, deferred payment arrangements and the low income home energy assistance program, which we supported the expansion of through the Energy Policy Act of 2005. Management believes that these measures help mitigate the impact of high gas prices on customers' bills.

Other Matters

We remain committed to our ongoing gas system expansion strategies. We believe that significant growth opportunities exist on Long Island and in our New England service territories, as well as continued growth in the New York service territory, despite the volatility in gas prices. We estimate that on Long Island approximately 37% of the residential and multi-family markets, and approximately 60% of the commercial market, currently use natural gas for space heating. Further, we estimate that in our New England service territories approximately 50% of the residential and multi-family markets, as well as approximately 60% of the commercial market, currently use natural gas for space heating purposes. We will continue to seek growth, in all our market segments, through the expansion of our gas distribution system for new construction and to penetrate existing communities where no distribution system exists, as well as through the conversion of residential homes from oil-to-gas for space heating purposes and the pursuit of opportunities to grow multi-family, industrial and commercial markets.

In order to serve the anticipated market requirements in our New York service territories, KeySpan and Duke Energy Corporation formed Islander East Pipeline Company, LLC ("Islander East") in 2000. Once in service, the pipeline is expected to have the capacity to transport up to 260,000 DTH of natural gas to the Long Island and New York City energy markets, enough natural gas to heat 600,000 homes. In addition, KeySpan has a 26.3% interest in the Millennium Pipeline development project which is anticipated to transport up to 525,000 DTH of natural gas a day to the Algonquin pipeline. KEDLI has executed a Precedent Agreement for 175,000 DTH of natural gas per day of transportation capacity from the Millennium Pipeline system, increasing to 200,000 DTH in the second year of the pipeline being in service. These pipeline projects will allow KeySpan to diversify the geographic sources of its gas supply. See the discussion under the caption "Energy Investments" for additional information regarding these pipeline projects.

Electric Services

The Electric Services segment primarily consists of subsidiaries that own and operate oil and gas-fired electric generating plants in the Borough of Queens (including the “Ravenswood Generating Station” which comprises the Ravenswood Facility and Ravenswood Expansion) and the counties of Nassau and Suffolk on Long Island. In addition, through long-term contracts of varying lengths, we (i) provide to the Long Island Power Authority (“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 (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”). The 1998 MSA, 1998 PSA and 1998 EMA all became effective on May 28, 1998 and are collectively referred to herein 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.” (For a further discussion on these LIPA agreements see Note 10 to the Consolidated Financial Statements “2006 LIPA Settlement.”) The Electric Services segment also provides retail marketing of electricity to commercial customers.

Selected financial data for the Electric Services segment is set forth in the table below for the

periods indicated.

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues from Operations	\$ 539.0	\$ 619.9	\$ 1,390.3	\$ 1,493.5
Purchased fuel	172.5	254.2	418.0	546.0
Net Revenues from Operations	366.5	365.7	972.3	947.5
Derivative Financial Instrument	26.6	-	44.3	-
Net Electric Revenues	393.1	365.7	1,016.6	947.5
Operating Expenses				
Operations and maintenance	176.8	150.6	527.3	480.8
Depreciation	24.9	21.5	77.1	67.6
Operating taxes	47.5	45.0	141.0	133.8
Total Operating Expenses	249.2	217.1	745.4	682.2
Sale Of Property	0.5	1.0	0.5	1.0
Operating Income	\$ 144.4	\$ 149.6	\$ 271.7	\$ 266.3
Electric sales (MWH)*	1,718,241	2,351,722	3,605,693	4,798,239
Capacity(MW)*	2,450	2,450	2,450	2,450
Cooling degree days	839	1,125	1,115	1,438

*Reflects the operations of the Ravenswood Generating Station only.

Executive Summary

Operating income decreased \$5.2 million, or 3%, for the three months ended September 30, 2006, compared to the same quarter last year, due primarily to a decrease in net revenues from the Ravenswood Generating Station of \$50.4 million as a result of lower energy margins and capacity revenues, as well as to higher operating expenses of \$4.1 million, partially offset by higher revenues associated with KeySpan's service agreements with LIPA of approximately \$24 million, which are primarily timing in nature. KeySpan also recognized a gain of \$26.6 million on a fixed for floating unforced capacity financial swap.

For the nine months ended September 30, 2006, operating income increased \$5.4 million, or 2%, compared to the same period last year, due, in part, to a \$44.3 million gain recognized on the fixed for floating unforced capacity financial swap, higher off-system sales associated with service agreements with LIPA of \$4.5 million, an increase of \$4.4 million in revenues associated with our electric marketing activities and slightly lower operating expenses. These benefits to comparative operating income were partially offset by a decrease in net revenues from the Ravenswood Generating Station of \$51.6 million as a result of lower energy margins and capacity revenues.

Net Revenues

Total electric net revenues realized during the third quarter of 2006 were \$27.4 million higher than such revenues realized during the corresponding period last year.

KeySpan has entered into an International SWAP Dealers Association Master Agreement for a fixed

for floating unforced capacity financial swap with Morgan Stanley Capital Group Inc. (“Swap Agreement”). This agreement has a three year term that began on May 1, 2006. For the three months ended September 30, 2006 KeySpan recognized a gain of \$26.6 million from this derivative financial instrument. (See Note 4 to the Consolidated Financial Statements, “Hedging and Derivative Financial Instruments,” for further information on this swap agreement.)

Net revenues for the third quarter of 2006 from the service agreements with LIPA, including the power purchase agreements associated with two electric peaking facilities, increased \$52.0 million compared to the third quarter of 2005. This increase reflects, in part, the recovery of operations and maintenance costs billed to LIPA, which increased by approximately \$28 million. Therefore, approximately \$24 million of the increase in net revenues resulted in a benefit to operating income. The major portion of this increase is timing in nature with \$4.6 million resulting from an increase in off-system sales. (For a description of the LIPA Agreements and power purchase agreements, see KeySpan’s 2005 Annual Report on Form 10-K for the year ended December 31, 2005 Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations under the caption “Electric Services – Revenue Mechanisms.”)

Net revenues associated with KeySpan’s electric marketing activities decreased \$0.8 million during the third quarter of 2006 compared to the same quarter of 2005.

Net revenues from the Ravenswood Generating Station decreased \$50.4 million, or 31% for the three months ended September 30, 2006, compared to the same quarter last year reflecting lower capacity revenues of \$27.0 million and a decrease in energy margins of \$23.4 million. The decrease in capacity revenues was due to additional capacity installed in New York City in 2006.

The decrease in energy margins for the third quarter of 2006 reflects, in part, a 28% decrease in realized “spark-spreads” (the selling price of electricity less the cost of fuel, exclusive of hedging gains or losses). Further, the level of megawatt hours (“MWh”) sold into the New York Independent System Operator (“NYISO”) energy market decreased 27% due to increased competition and cooler comparative weather. As measured in cooling-degree days, weather was 25% cooler during the third quarter of 2006 compared to the third quarter of 2005. Combined, these two items reduced energy margins by \$44.6 million. Partially offsetting these adverse impacts to energy margins were the benefits recognized from derivative financial instruments. We employ derivative financial hedging instruments to hedge the cash flow variability for a portion of forecasted purchases of natural gas and fuel oil consumed at the Ravenswood Generating Station. We have also engaged in the use of derivative financial hedging instruments to hedge the cash flow variability associated with a portion of forecasted electric energy sales from the Ravenswood Generating Station. These derivative instruments resulted in hedging gains, which are reflected in net electric margins, of \$9.4 million for the third quarter of 2006 compared to hedging losses of \$11.8 million for the third quarter of 2005. (See Note 4 to the Consolidated Financial Statements “Hedging and Derivative Financial Instruments” for further information on KeySpan’s hedging strategy.)

Total electric net revenues realized during the nine months ended September 30, 2006, were \$69.1 million higher than such revenues realized during the corresponding period last year. For the nine

months ended September 30, 2006, KeySpan recognized a gain of \$44.3 million from the fixed for floating unforced capacity derivative financial instrument described previously.

Net revenues for the nine months ended September 30, 2006, from the service agreements with LIPA, including the power purchase agreements associated with two electric peaking facilities, increased \$72.0 million compared to the same period of 2005, reflecting the recovery of approximately \$67 million in operations and maintenance costs billed to LIPA and therefore had no impact on operating income. The remaining increase reflects higher off-system energy sales.

Net revenues associated with KeySpan's electric marketing activities increased \$4.4 million during the nine months ended September 30, 2006 compared to the same period of 2005.

The Ravenswood Generating Station, however, realized a decrease of \$51.6 million in net revenues during the nine months ended September 30, 2006, compared to the same period last year, reflecting lower capacity revenues of \$61.7 million, partially offset by an increase in energy margins of \$10.1 million. Installed capacity additions during 2006 in New York City were the primary driver behind the decrease in capacity revenues.

The increase in energy margins for the nine months ended September 30, 2006 reflects the settlement of derivative financial instruments. As noted previously, we employ derivative financial hedging instruments to hedge the cash flow variability for a portion of forecasted purchases of natural gas and fuel oil consumed at the Ravenswood Generating Station and to hedge the cash flow variability associated with a portion of forecasted electric energy sales. These derivative instruments resulted in hedging gains, which are reflected in net electric margins, of \$72.1 million during the nine months ended September 30, 2006 compared to hedging losses of \$4.5 million during the same period of 2005. The benefits to energy margins from KeySpan's hedging strategy were offset by a 36% decrease in realized "spark-spreads." Further, the level of MWh sold into the NYISO energy market decreased 25% due to additional competition and cooler weather. As measured in cooling-degree days, weather was 22% cooler during the nine months ended September 30, 2006 compared to the same period of 2005. Combined, these two items resulted in an adverse impact to comparative net revenues of \$66.5 million.

The rules and regulations for capacity, energy sales and the sale of certain ancillary services to the NYISO energy markets continue to evolve and there are several matters pending with the Federal Energy Regulatory Commission ("FERC"). See the discussion under the caption "Market and Credit Risk Management Activities" for further details on these matters.

In addition, on September 29, 2006, the NYISO Management Committee recommended approval of an in-City capacity mitigation proposal (the "Mitigation Proposal"). The Mitigation Proposal imposes a reduced capacity offer cap on bids by the Ravenswood Generating Station and certain other generation owners of capacity into the NYISO Spot Demand Curve Auction Market. The current offer cap is \$105/kW-year and is proposed to be reduced to \$82/kW-year plus 3%.

The reduced offer cap would be implemented using a conduct and impact test on the offers of

capacity from the Ravenswood Generating Station and other owners of Consolidated Edison divested generation units. Under the Mitigation Proposal, if an offer to sell capacity is 3% or more above \$82/kW-year, then the offer is subject to possible mitigation. To determine if mitigation will be applied, a second test, an impact test, is utilized. If the unmitigated offer causes market clearing prices to be 3% or more above \$82/kW-year, then the offer is mitigated (reduced) to \$82/kW-year. Essentially, the Ravenswood Generating Station and the other owners of generation divested by Consolidated Edison may not set the market clearing price in excess of this new offer cap. The Mitigation Proposal is in addition to the existing in-City capacity mitigation measures.

The Mitigation Proposal must be approved by the NYISO Board of Directors and the FERC. On October 11, 2006, KeySpan and other parties filed appeals to the NYISO Board of Directors requesting that the Mitigation Proposal be rejected and more thoroughly analyzed and revised pursuant to detailed stakeholder meetings. At this time, we are unable to predict the outcome of this proceeding and what effect it will have on our financial condition, results of operations, and cash flows. However, adoption and implementation of the Mitigation Proposal in its current form could materially adversely affect the revenue realized by KeySpan from the sale of capacity from the Ravenswood Generating Station, as well as the potential revenue that could be realized in connection with the fixed for floating financial Swap Agreement.

Operating Expenses

Operating expenses increased \$32.1 million during the third quarter of 2006 compared to the second quarter of 2005 primarily reflecting a \$28 million increase in recoverable costs from LIPA, as noted previously. The remaining increase primarily reflects higher postretirement expenses and an increase in plant overhaul costs and non-outage work performed on KeySpan's Long Island based generating units.

Operating expenses increased \$63.2 million during the nine months ended September 30, 2006, compared to the same period of 2005 reflecting a \$67 million increase in recoverable costs from LIPA, as noted previously, partially offset by a decrease in overhaul costs associated with the Ravenswood Generating Station.

Other Matters

In 2003, the New York State Board on Electric Generation Siting and the Environment issued an opinion and order which granted a certificate of environmental capability and public need for a 250 MW combined cycle electric generating facility in Melville, Long Island, which is final and non-appealable. Also in 2003, LIPA issued a Request for Proposal ("RFP") seeking bids from developers to either build and operate a Long Island generating facility, and/or a new cable that will link Long Island to power from a non-Long Island source of between 250 to 600 MW of electricity by no later than the summer of 2007. KeySpan filed a proposal in response to LIPA's RFP. In 2004, LIPA selected proposals submitted by two other bidders in response to the RFP. KeySpan remains committed to the Melville project and the benefits to Long Island's energy future that this project would supply. The project has received New York State Article X approval by having met

all operational and environmental permitting requirements. Further, the project is strategically located in close proximity to both the high voltage power transmission grid and the high pressure gas distribution network. In addition, given the intense public pressure to reduce emissions from existing generating facilities, development of the Melville project is possible as a means to "virtually re-power" older, less efficient generating units. Specifically, KeySpan believes that it would be able to reduce emissions on Long Island in a cost effective manner by developing the Melville project and retiring an older, less efficient generating facility. Additionally, in August 2006, the NYISO included the Melville project in its Reliability Report as one of the market solutions to help address the long-term reliability of New York State's electric grid. At September 30, 2006, total capitalized costs associated with the siting, permitting and procurement of equipment for the Melville facility were \$63.1 million.

On February 6, 2006, the NYISO's New York City local reliability rules that required that 80% of the electric capacity needs of New York City be provided by "in-City" generators was increased to 83%. However, in March 2006, the NYISO Operating Committee reversed its decision and returned the local reliability rules to 80%. See the discussion under the caption "Market and Credit Risk Management Activities – Regulatory Issues and the Competitive Environment" for further information regarding this matter.

Energy Services

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.

The table below highlights selected financial information associated with the Energy Services segment.

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	\$ 51.8	\$ 47.1	\$ 155.4	\$ 142.0
Operating expenses	48.8	48.2	150.8	148.7
Operating Income (Loss)	\$ 3.0	\$ (1.1)	\$ 4.6	\$ (6.7)

The Energy Services segment posted operating profits of \$3.0 million and \$4.6 million for the three and nine months ended September 30, 2006, respectively, compared to operating losses of \$1.1 million and \$6.7 million incurred for the three and nine months ended September 30, 2005, respectively. The improved performance reflects higher gross profit and operating margins on engineering contracts and appliance service work, as well as the completion and favorable pricing associated with these contracts, an increase in bandwidth sales and a reduction in general and administrative expenses as a result of cost containment measures implemented in 2005.

Energy Investments

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.

As of September 30, 2006, based on an average wellhead price of \$3.63 per MCF, adjusted for derivative instruments, KeySpan estimated that its capitalized costs exceeded the ceiling test limitation by \$25.8 million. However, as permitted by current SEC guidelines, KeySpan elected to use a measurement date closer to the filing of its September 30, 2006 Form 10-Q to re-compute the ceiling test limitation. Using an average wellhead price on October 26, 2006 of \$7.77 per MCF, adjusted for derivative instruments, KeySpan determined that its capitalized costs did not exceed the ceiling test limitation. Therefore, an impairment charge was not considered necessary at September 30, 2006. 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. See Note 12 to the Consolidated Financial Statements "Gas Exploration and Production Property- Depletion" for additional details.

This segment is also engaged in pipeline development activities. KeySpan and Duke Energy Corporation each own a 50% interest in 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. Further, KeySpan has a 26.3% interest in the Millennium Pipeline Company LLC, the developer of the Millennium pipeline project which is expected to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning, New York to Ramapo, New York, where it will connect to an existing pipeline. Additionally, subsidiaries in this segment hold a 20% equity interest in the Iroquois Gas Transmission System LP, a pipeline that transports Canadian gas supply to markets in the northeastern United States. These investments are accounted for under the equity method of accounting. Accordingly, equity income from these investments is reflected as a component of operating income in the Consolidated Statement of Income.

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

As noted previously, in the first quarter of 2005, KeySpan sold its 50% interest in Premier, a gas pipeline from southwest Scotland to Northern Ireland. On March 18, 2005, the sale was completed and generated cash proceeds of \$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, which took place in the first quarter of 2005, resulted in a pre-tax gain of

\$4.1 million reflecting the difference from earlier estimates. This gain was recorded in other income and (deductions) on the Consolidated Statement of Income.

Selected financial data for these energy-related investments is set forth in the following table for the periods indicated.

<i>(In Millions of Dollars)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	\$ 9.7	\$ 11.9	\$ 30.1	\$ 30.7
Less: Operation and maintenance expense	5.5	7.0	19.5	19.0
Other operating expenses	2.7	2.7	9.0	7.7
Add: Equity earnings	3.2	2.5	9.5	12.5
Sale of assets	-	-	0.2	0.1
Operating Income	\$ 4.7	\$ 4.7	\$ 11.3	\$ 16.6

As indicated in the above table, operating income for the Energy Investments segment for the third quarter of 2006 remained consistent with the third quarter of 2005, as an increase in earnings from our investment in the Iroquois Gas Transmission System of \$0.6 million was offset by lower realized gas prices associated with our Seneca-Upshur investment.

For the nine months ended September 30, 2006, operating income decreased \$5.3 million compared to the same period in 2005 due, in part, to lower earnings from KeySpan's investment in the Iroquois Gas Transmission System. In 2005, the Iroquois Gas Transmission System realized a benefit from a court settlement relating to a gas supply contract that was defaulted on by a counterparty in an earlier period. Further, a KeySpan subsidiary engaged in the transportation of liquefied natural gas realized lower earnings due to the warm winter weather. Finally, equity earnings were adversely impacted by the sale of Premier in March 2005.

Other Matters

In order to serve the anticipated market requirements in our New York service territories, KeySpan and Duke Energy Corporation formed Islander East Pipeline Company, LLC ("Islander East") in 2000. Islander East is owned 50% by KeySpan and 50% by Duke Energy, and 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. Applications for all necessary regulatory authorizations were filed in 2000 and 2001. Islander East has received a final certificate from the FERC and all necessary permits from the State of New York. The State of Connecticut denied Islander East's request for a consistency determination under the Coastal Zone Management Act ("CZMA") and application for a permit under Section 401 of the Clean Water Act. Islander East appealed the State of Connecticut's determination on the CZMA issue to the United States Department of Commerce. In 2004, the Secretary of Commerce overrode Connecticut's denial and granted the CZMA authorization. The determination of the Secretary of Commerce was appealed to the United States District Court for the District of Columbia and a decision from that court is pending. Islander East's petition for a declaratory order overriding the denial of the Clean Water Act permit is pending with Connecticut's State Superior Court. Pursuant to a provision of the Energy

Policy Act of 2005 (the “Energy Act”), Islander East appealed the denial of the Clean Water Act permit directly to the United States Court of Appeals for the Second Circuit and moved to stay the Connecticut case pending the Second Circuit’s decision. The State of Connecticut filed a motion to challenge the constitutionality of the provisions of the Energy Act providing this appeal. The appeal was argued in January 2006 and oral arguments on the constitutional and jurisdictional issues were held in April 2006. The Second Circuit Court of Appeals ruled on October 5, 2006 that the Energy Act is constitutional and that the Connecticut Department of Environmental Protection (“CTDEP”) acted arbitrarily and capriciously in denying the Clean Water Act permit. The Court remanded the matter to CTDEP to conduct, within 75 days of October 5, 2006, “the sort of complete and reasoned review required by law.” KeySpan anticipates that this pipeline will be in service in late 2008. As of September 30, 2006, KeySpan’s total capitalized costs associated with the siting and permitting of the Islander East pipeline were approximately \$29.5 million.

As noted, KeySpan also owns a 26.3% ownership interest in the Millennium Pipeline Company LLC, the developer of the Millennium Pipeline project. The other partners in the Millennium Pipeline are Columbia Gas Transmission Corp. (“Columbia Transmission”), a unit of NiSource Incorporated and DTE Energy Company. The Millennium Pipeline project is anticipated to have the capacity to transport up to 525,000 DTH of natural gas a day from Corning to Ramapo, New York, interconnecting with the pipeline systems of various other utilities in New York. The project received a FERC certificate to construct, acquire and operate the facilities in 2002, subject to certain conditions. On August 1, 2005, the project filed an application to amend the FERC certificate requesting, among other things, authority to phase in over time the construction of the proposed pipeline system, approval of a reduction in capacity and maximum allowable operating pressure, minor route modifications, the addition of certain facilities and the acquisition of certain facilities from Columbia Transmission. Additionally, in November and December 2005, Consolidated Edison, KEDLI and Columbia Transmission each entered into amended precedent agreements to purchase capacity on the pipeline. KEDLI has agreed to purchase 175,000 DTH per day from the Millennium Pipeline system, increasing to 200,000 DTH in the second year of the pipeline being in service. This will provide KEDLI with new, competitively priced supplies of natural gas from Canada and other North American supply basins. The conditions in the precedent agreements are subject to, among other things, the receipt of necessary regulatory approvals and financing. On May 3, 2006, Millennium filed a further amendment to its August 1, 2005 filing requesting, among other things, that the FERC vacate those portions of its certificate not included in its August 1, 2005 filing; that request is pending before the FERC. On June 9, 2006, the FERC issued a favorable draft supplemental environmental impact statement. On July 11, 2006, Millennium informed the FERC that the anticipated in-service date for Millennium Phase 1 will be extended from November 1, 2007 to November 1, 2008, or earlier, if feasible. On October 13, 2006, the FERC issued its Final Supplemental Environmental Impact Statement with respect to Millennium and its companion applicants. Millennium’s amended application and those of its companion applicants are pending decision by the FERC. As of September 30, 2006, KeySpan’s investment in the Millennium Pipeline project was \$17.7 million.

In 2005, KeySpan LNG entered into a precedent agreement with BG LNG Services, a subsidiary of British Gas, to provide liquefied natural gas terminalling service. KeySpan LNG proposed to upgrade the liquefied natural gas facility to accept marine deliveries and to triple vaporization (or

regasification) capacity to provide these services. In June 2005, the FERC denied KeySpan LNG's application to expand the facility citing concerns that the proposed upgraded facility would not meet current federal new construction standards. KeySpan sought a rehearing with FERC, and on January 20, 2006, the FERC denied such request, although the order provided that KeySpan LNG could file an amendment to its original application addressing a revised expansion project which would differ substantially from that originally proposed by KeySpan. Any amended application would need to include a detailed analysis of the new project scope, including upgrades to the existing facilities and alternative plans for any service disruptions that may be necessary during construction of a new expanded project. KeySpan has filed a petition for judicial review of the FERC order with the United States Circuit Court for the District of Columbia. The Court is expected to issue a decision affirming or vacating the FERC orders by the second quarter of 2007.

In addition to the proceeding at FERC, KeySpan LNG also is involved in seeking other required regulatory approvals and the resolution of certain litigation regarding such approvals. In February 2005, KeySpan LNG filed an action in Federal District Court in Rhode Island seeking a declaratory judgment that it is not required to obtain a "Category B Assent" from the State of Rhode Island and an injunction preventing the Rhode Island Coastal Resources Management Council ("CRMC") from enforcing the Category B assent requirements. In March 2005, the Rhode Island Attorney General answered the complaint and moved to substitute the State of Rhode Island as the defendant and filed a counterclaim seeking a declaratory judgment that the expansion requires a Category B Assent. In April, the parties filed cross motions for summary judgment with respect to all issues presented to the Court. On April 14, 2005, the Attorney General also filed on behalf of the State a complaint against KeySpan LNG in Rhode Island State Superior Court raising substantially the same issues as the federal court action. KeySpan LNG removed that action to federal court and moved for summary judgment. The Attorney General subsequently withdrew both the motion to substitute defendants and the counterclaim. Although the Court had indicated its intention to issue a decision in the pending cases by August 2005, the Court subsequently stayed the litigation pending resolution of the FERC appeal process discussed above. As of September 30, 2006, our investment in this project was \$16.8 million, a portion of which may be subject to reimbursement from BG LNG pursuant to the terms of the precedent agreement.

Allocated Costs

We are subject to the jurisdiction of the FERC under PUHCA 2005. As part of the regulatory provisions of PUHCA 2005, the FERC regulates various transactions among affiliates within a holding company system. In accordance with regulations under PUHCA 2005 and regulations and policies of the New York State Public Service Commission, the Massachusetts Department of Telecommunications and Energy and the New Hampshire Public Utility Commission, we established service companies that provide: (i) traditional corporate and administrative services; (ii) gas and electric transmission and distribution system planning, marketing, and gas supply planning and procurement; and (iii) engineering and surveying services to subsidiaries. The operating income variation as reflected in "elimination and other" is due primarily to costs residing at KeySpan's holding company level such as incremental costs associated with the anticipated merger with National Grid plc, as well as corporate advertising expenses. Also, KeySpan entered into

confidential settlement agreements with certain of its insurance carriers for recovery of environmental costs associated with investigation and remediation of gas plant sites and non-utility sites. KeySpan recorded a \$5.5 million benefit in its Consolidated Statement of Income for the nine months ended September 30, 2006 associated with these settlement agreements.

Liquidity

Cash flow from operations increased \$435.5 million, or 90%, for the nine months ended September 30, 2006 compared to the same period last year primarily due to favorable working capital requirements and income tax payments. The favorable working capital requirements were primarily driven by receipt of customer payments associated with winter heating season gas sales. In addition, KeySpan's income tax payments were \$74.1 million lower during the nine months ended September 30, 2006, compared to the same period last year.

At September 30, 2006, we had cash and temporary cash investments of \$40.0 million. During the nine months ended September 30, 2006, we repaid \$327.6 million of commercial paper and, at September 30, 2006, \$330.0 million of commercial paper was outstanding at a weighted-average annualized interest rate of 5.38%. We had the ability to borrow up to an additional \$1.2 billion at September 30, 2006, under the terms of our credit facility.

KeySpan has two credit facilities which total \$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% as of 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 September 30, 2006, KeySpan's consolidated indebtedness was 48.3% 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. Upon effectiveness of PUHCA 2005, KeySpan's ability to issue commercial paper was no longer limited by the SEC. Accordingly, subject to compliance with the foregoing conditions, KeySpan is currently able to issue up to \$1.5 billion of commercial paper.

A substantial portion of consolidated revenues are derived from the operations of businesses within the Electric Services segment, that are largely dependent upon two large customers – LIPA and the NYISO. Accordingly, our cash flows are dependent upon the timely payment of amounts owed to us by these counterparties. (See Note 10. to the Consolidated Financial Statements “2006 LIPA Settlement” for information regarding the recent settlement between KeySpan and LIPA regarding the current contractual agreements.)

We satisfy our seasonal working capital requirements primarily through internally generated funds and the issuance of commercial paper. We believe that these sources of funds are sufficient to meet our seasonal working capital needs.

Capital Expenditures and Financing

Construction Expenditures

The table below sets forth our construction expenditures by operating segment for the periods indicated:

<i>(In Millions of Dollars)</i>	Nine Months Ended September 30,	
	2006	2005
Gas Distribution	\$ 288.6	\$ 270.1
Electric Services	58.3	72.8
Energy Investments	5.0	17.8
Energy Services and other	25.7	11.4
	\$ 377.6	\$ 372.1

Construction expenditures related to the Gas Distribution segment are primarily for the renewal, replacement and expansion of the distribution system. Construction expenditures for the Electric Services segment reflect costs to maintain our generating facilities. The increase in capital expenditures for the nine months ended September 30, 2006 compared to the same period last year of \$5.5 million reflects an increase in the Gas Distribution segment due, in part, to the timing of capital main and service work, as well as to upgrades to KeySpan's New York LNG facility. In total, KeySpan anticipates incurring approximately the same amount of construction expenditures in 2006 as it incurred in 2005.

Financing

KeySpan did not engage in any financing activities in the first nine months of 2006, other than commercial paper repayments as noted earlier. However, KeySpan anticipates issuing, subject to execution of definitive agreements, approximately \$400 million Senior Unsecured Notes at KEDNY and approximately \$100 million Senior Unsecured Notes at KEDLI in the fourth quarter of 2006, pursuant to a private placement that is exempt from registration under the Securities Act of 1933. The Notes were priced on October 26, 2006 at 5.55% and are anticipated to be issued with ten year maturities. The net proceeds from the issuance of the Notes will be used by KEDNY and KEDLI to refinance existing intercompany indebtedness and/or for general working capital purposes.

The following table represents the ratings of our long-term debt at September 30, 2006. In 2004 Standard & Poor's reaffirmed its ratings on KeySpan's and its subsidiaries' long-term debt and removed its negative outlook. Further in 2005, Fitch Ratings revised its ratings on KeySpan's and its subsidiaries' long-term debt to positive outlook. Moody's Investor Services, however, continues to maintain its negative outlook ratings on KeySpan's and its subsidiaries' long-term debt.

	Moody's Investor Services	Standard & Poor's	FitchRatings
KeySpan Corporation	A3	A	A-
KEDNY	N/A	A+	A+
KEDLI	A2	A+	A-
Boston Gas	A2	A	N/A
Colonial Gas	A2	A+	N/A
KeySpan Generation	A3	A	N/A

Off-Balance Sheet Arrangements

Guarantees

KeySpan had a number of financial guarantees with its subsidiaries at September 30, 2006. KeySpan has fully and unconditionally guaranteed: (i) \$525 million of medium-term notes issued by KEDLI; (ii) the obligations of KeySpan Ravenswood, LLC, which is the lessee under the \$425 million Master Lease associated with the Ravenswood Facility and the lessee under the \$385 million sale/leaseback transaction for the Ravenswood Expansion including future decommission costs of \$19 million; and (iii) the payment obligations of our subsidiaries related to \$128 million of tax-exempt bonds issued through the Nassau County and Suffolk County Industrial Development Authorities for the construction of two electric-generation peaking facilities on Long Island. The medium-term notes, the Master Lease and the tax-exempt bonds are reflected on the Consolidated Balance Sheet; the sale/leaseback obligation is not recorded on the Consolidated Balance Sheet. Further, KeySpan has guaranteed: (i) up to \$71.4 million of surety bonds associated with certain construction projects currently being performed by former subsidiaries; (ii) certain supply contracts, margin accounts and purchase orders for certain subsidiaries in an aggregate amount of \$77.0 million; and (iii) \$80.3 million of subsidiary letters of credit. These guarantees are not recorded on the Consolidated Balance Sheet. KeySpan's guarantees on certain performance bonds relating to current construction projects of the discontinued mechanical contracting companies will remain in place throughout the construction period for these projects. KeySpan has received an indemnity bond issued by a third party to offset potential exposure related to a significant portion of the continuing guarantee. At this time, 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 such defaults may have on our consolidated results of operations, financial condition or cash flows. (See Note 6 to the Consolidated Financial Statements, "Financial Guarantees and Contingencies" for additional information regarding KeySpan's guarantees.)

Contractual Obligations

KeySpan has certain contractual obligations related to its outstanding long-term debt, outstanding credit facility borrowings, outstanding commercial paper borrowings, operating and capital leases, and demand charges associated with certain commodity purchases. These obligations have remained substantially unchanged since December 31, 2005. (For additional details regarding these obligations see KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Note 6 "Long-Term Debt" and Note 7 "Contractual Obligations, Financial Guarantees and Contingencies" to those Consolidated Financial Statements.)

Discussions of Critical Accounting Policies and Assumptions

In preparing our financial statements, the application of certain accounting policies requires difficult, subjective and/or complex judgments. The circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the impact of matters that are inherently uncertain. Actual effects on our financial position and results of operations may vary significantly from expected results if the judgments and assumptions underlying the estimates prove to be inaccurate.

Below is a discussion of KeySpan's critical accounting policies and assumptions at September 30, 2006. For a more detailed discussion of these policies and assumptions see KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations "Discussion of Critical Accounting Policies and Assumptions."

Valuation of Goodwill

KeySpan records goodwill on purchase transactions, representing the excess of acquisition cost over the fair value of net assets acquired. In testing for goodwill impairment under Statement of Financial Accounting Standards ("SFAS") 142 "Goodwill and Other Intangible Assets," significant reliance is placed upon a number of estimates regarding future performance that require broad assumptions and significant judgment by management. A change in the fair value of our investments could cause a significant change in the carrying value of goodwill. The assumptions used to measure the fair value of our investments are the same as those used by us to prepare annual operating segment and consolidated earnings and cash flow forecasts. In addition, these assumptions are used to set annual budgetary guidelines. At September 30, 2006, KeySpan has \$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.

Accounting for the Effects of Rate Regulation on Gas Distribution Operations

The financial statements of the Gas Distribution segment reflect the ratemaking policies and orders of the New York Public Service Commission ("NYPSC"), the New Hampshire Public Utilities Commission ("NHPU"), and the Massachusetts Department of Telecommunications and Energy ("MADTE").

Four of our six regulated gas utilities (KEDNY, KEDLI, Boston Gas Company and EnergyNorth Natural Gas, Inc.) are subject to the provisions of SFAS 71, "Accounting for the Effects of Certain Types of Regulation." This statement recognizes the actions of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies.

In separate orders issued by the MADTE relating to the Eastern Enterprise acquisition in 2000, the base rates charged by Colonial Gas Company and Essex Gas Company have been frozen at their current levels for a ten-year period ending 2009. Due to the length of these base rate freezes, the Colonial and Essex Gas Companies had previously discontinued the application of SFAS 71.

As is further discussed under the caption "Regulation and Rate Matters," the rate plans previously in effect for KEDNY and KEDLI have expired. The continued application of SFAS 71 to record the

activities of these subsidiaries is contingent upon the actions of regulators with regard to future rate plans. As part of its application for approval of the KeySpan / National Grid plc merger, KeySpan has filed proposed rate plans for KEDNY and KEDLI with the NYPSC. In addition, individual applications for a proposed annual increase in revenues for KEDNY and KEDLI were filed. The ultimate resolution of any future rate plans could have a significant impact on the application of SFAS 71 to these entities and, accordingly, on our financial position, results of operations and cash flows. However, management believes that currently available facts support the continued application of SFAS 71 and that all regulatory assets and liabilities are recoverable or refundable through the regulatory environment.

Pension and Other Postretirement Benefits

KeySpan participates in both non-contributory defined benefit pension plans, as well as other post-retirement benefit (“OPEB”) plans (collectively “postretirement plans”). KeySpan’s reported costs of providing pension and OPEB benefits are dependent upon numerous factors resulting from actual plan experience and assumptions of future experience. Pension and OPEB costs (collectively “postretirement costs”) are impacted by actual employee demographics, the level of contributions made to the plans, earnings on plan assets, and health care cost trends. Changes made to the provisions of these plans may also impact current and future postretirement costs. Postretirement costs may also be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the postretirement costs and benefit obligations. Actual results that differ from our assumptions are accumulated and amortized over ten years.

Historically, we have funded our qualified pension plans in excess of the amount required to satisfy minimum ERISA funding requirements. At September 30, 2006, we had a funding credit balance in excess of the ERISA minimum funding requirements. Although we have presently exceeded ERISA funding requirements, our pension plans, on an actuarial basis, are currently underfunded. Therefore,

for 2006, KeySpan expects to contribute a total of \$120 million to its funded and unfunded post-retirement plans. Future funding requirements are heavily dependent on actual return on plan assets and prevailing interest rates. (In addition to Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations in KeySpan’s Annual Report on Form 10-K for the year ended December 31, 2005, see also Note 4 of those Consolidated Financial Statements, “Postretirement Benefits.”)

Regulation and Rate Matters

Gas Matters

The rate agreements for KEDNY and KEDLI have expired. Under the terms of the KEDNY and KEDLI rate agreements, gas distribution rates and all other provisions will remain in effect until changed by the NYPSC. KeySpan has recently filed proposed rate plans for KEDNY and KEDLI with the NYPSC as part of its application for approval of the KeySpan / National Grid plc merger, as well as individual applications for a proposed annual increase in revenues for KEDNY and KEDLI. See the “Introduction to the Notes to the Consolidated Financial Statements” for additional details on the filings.

Effective November 1, 2003, the MADTE approved a \$25.9 million increase in base revenues for Boston Gas with an allowed return on equity of 10.2% reflecting an equal balance of debt and equity. On January 27, 2004, the MADTE issued its order on Boston Gas Company’s Motion for Recalculation, Reconsideration and Clarification that granted an additional \$1.1 million in base revenues, for a total of \$27 million. The MADTE also approved a Performance Based Rate Plan (the “Plan”) for up to ten years, as well as a true-up mechanism for pension and other postretirement benefit costs under which variations between actual pension and other postretirement benefit costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. This true-up mechanism allows for carrying charges on deferred assets and liabilities at Boston Gas’s weighted-average cost of capital. On October 31, 2006, the MADTE approved a base rate increase of \$8.6 million under the Plan. In addition, an increase of \$2.7 million in the local distribution adjustment clause was approved to recover pension and other postretirement costs subject to further review by the MADTE.

In connection with the Eastern Enterprises acquisition of Colonial Gas in 1999, the MADTE approved a merger and rate plan that resulted in a ten year freeze of base rates to Colonial Gas’s firm customers. The base rate freeze is subject only to certain exogenous factors, such as changes in tax laws, accounting changes, or regulatory, judicial, or legislative changes. Due to the length of the base rate freeze, Colonial Gas discontinued its application of SFAS 71. Essex Gas is also under a ten-year base rate freeze and has also discontinued its application of SFAS 71. EnergyNorth base rates continue as set by the NHPUC in 1993.

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 November 1, 2005. In addition, effective January 1, 2006, Boston Gas was 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. On October 31, 2006, the MADTE granted Boston Gas recovery of \$12 million of the 2005 gas cost component of bad debt write-offs from Boston Gas ratepayers beginning November 1, 2006. This amount will also be recovered through the cost-of-gas adjustment clause.

For an additional discussion of our current gas distribution rate agreements, see KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations "Regulation and Rate Matters."

Electric Matters

KeySpan sells to LIPA all of the capacity and, to the extent requested, energy conversion services from our 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 in accordance with the PSA entered into between KeySpan and LIPA in 1998. The original FERC approved rates, which had been in effect since May 1998, expired on December 31, 2003. On October 1, 2004 the FERC approved a settlement reached between KeySpan and LIPA to reset rates effective January 1, 2004. Under the new agreement, KeySpan's rates reflect a cost of equity of 9.5% with no revenue increase in the first year. The FERC approved updated operating and maintenance expense levels and recovery of certain other costs as agreed to by the parties.

As noted earlier, on February 1, 2006, KeySpan and LIPA entered into (i) an amended and restated Management Services Agreement; (ii) a new Option and Purchase and Sale Agreement, to replace the Generation Purchase Rights Agreement as amended; and (iii) a Settlement Agreement resolving outstanding issues between the parties regarding the 1998 LIPA Agreements. (For a further discussion on the LIPA agreements see Note 10 to the Consolidated Financial Statements "2006 LIPA Settlement," as well as KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations "Electric Services – LIPA Agreements.")

The Energy Policy Act of 2005 and the Public Utility Holding Company Acts of 1935 and 2005

In August 2005, the Energy Policy Act of 2005 (the "Energy Act") was enacted by Congress and signed into law by the President. The Energy Act is a broad based energy bill that places an increased emphasis on the production of energy and promotes the development of new technologies and alternative energy sources by providing 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, effective February 8, 2006, and the transfer of certain holding company oversight from the SEC to FERC pursuant to PUHCA 2005.

Pursuant to PUHCA 2005, the SEC no longer has jurisdiction over our holding company activities, other than those traditionally 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 NYPSC, MADTE and NHPUC, in addition to FERC.

Environmental Matters

KeySpan is subject to various federal, state and local laws and regulatory programs related to the environment. 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. However, environmental cleanup activities related to the three non-utility sites are not subject to rate recovery.

We estimate that the remaining cost of our MGP related environmental cleanup activities, including costs associated with the Ravenswood Generating Station, will be approximately \$372.4 million and we have recorded a related liability for such amount. We have also recorded an additional \$13.4 million liability, representing the estimated environmental cleanup costs related to a former coal tar processing facility. As of September 30, 2006, we have expended a total of \$211.8 million on environmental investigation and remediation activities. (See Note 6 to the Consolidated Financial Statements, "Financial Guarantees and Contingencies.")

Market and Credit Risk Management Activities

Market Risk: KeySpan is exposed to market risk arising from potential changes in one or more market variables, such as energy commodity prices, interest rates, volumetric risk due to weather or other variables. Such risk includes any or all changes in value whether caused by commodity positions, asset ownership, business or contractual obligations, debt covenants, exposure concentration, currency, weather, and other factors regardless of accounting method. We manage our exposure to changes in market prices using various risk management techniques for non-trading purposes, including hedging through the use of derivative instruments, both exchange-traded and over-the-counter contracts, purchase of insurance and execution of other contractual arrangements.

KeySpan is exposed to price risk due to investments in equity and debt securities held to fund benefit payments for various employee pension and other postretirement benefit plans. To the extent that the value of investments held change, or long-term interest rates change, the effect will be reflected in KeySpan's recognition of periodic cost of such employee benefit plans and the determination of contributions to the employee benefit plans.

Credit Risk: KeySpan is exposed to credit risk arising from the potential that our counterparties fail to perform on their contractual obligations. Our credit exposures are created primarily through the sale of gas and transportation services to residential, commercial, electric generation, and industrial customers and the provision of retail access services to gas marketers, by our regulated gas businesses; the sale of commodities and services to LIPA and the NYISO; the sale of power and services to our retail customers by our unregulated energy service businesses; entering into financial and energy derivative contracts with energy marketing companies and financial institutions; and the sale of gas, oil and processing services to energy marketing and oil and gas production companies.

We have regional concentration of credit risk due to receivables from residential, commercial and industrial customers in New York, New Hampshire and Massachusetts, although this credit risk is

spread over a diversified base of residential, commercial and industrial customers. Customers' payment records are monitored and action is taken, when appropriate and in accordance with various regulatory requirements.

We also have credit risk from LIPA, our largest customer, and from other energy and financial services companies. Counterparty credit risk may impact overall exposure to credit risk in that our counterparties may be similarly impacted by changes in economic, regulatory or other considerations. We actively monitor the credit profile of our wholesale counterparties in derivative and other contractual arrangements, and manage our level of exposure accordingly. In instances where counterparties' credit quality has declined, or credit exposure exceeds certain levels, we may limit our credit exposure by restricting new transactions with the counterparty, requiring additional collateral or credit support and negotiating the early termination of certain agreements.

Regulatory Issues and Competitive Environment: We are subject to various other risk exposures and uncertainties associated with our gas and electric operations. The most significant contingency involves the evolution of the gas distribution and electric industries towards more competitive and deregulated environments. The risks associated with KeySpan's gas distribution activities have not changed substantially since December 31, 2005. For additional information regarding these risks see KeySpan's Annual Report on Form 10-K for the year ended December 31, 2005, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations "Market and Credit Risk Management Activities." The following is an update to certain matters related KeySpan's electric operations.

The Ravenswood Generating Station and KeySpan's New York City Operations

On February 9, 2006, the NYISO Operating Committee increased the "in-City" locational capacity requirements (LCR) from 80% to 83% beginning in May 2006 through the period ending April 2007, based in part on the statewide reserve margin of 118% set by the New York State Reliability Council. However, in early March 2006, the NYISO discovered data inconsistencies in the input files used in the Multi Area Reliability Simulation (MARS) computer program that is used to determine the statewide installed reserve margin (Statewide IRM) and the corresponding minimum LCRs for New York City and Long Island. Revisions to the data, and rerunning the MARS computer program resulted in a shift in the relationship between the Statewide IRM and the minimum LCRs. On March 20, 2006, the New York State Reliability Council voted to retain the Statewide IRM of 118% and reported the corresponding revised minimum LCRs to the NYISO. On March 28, 2006, the NYISO Operating Committee approved revised minimum LCRs of 80% and 99% for New York City and Long Island, respectively. For New York City, this action effectively returned the locational requirement to the minimum level used for the last six years (80%) and negated the increase to 83%.

KeySpan appealed this decision to the NYISO Board of Directors claiming the revised study was hastily prepared and that there were historic factors that justified using 83% as the New York City LCR. The NYISO Board of Directors denied KeySpan's appeal on April 3, 2006 and the "in-City" locational capacity requirement beginning May 1, 2006 through the period ending April 30, 2007 is currently 80%.

In addition, for information concerning the pending in-City capacity mitigation proposal, see the discussion in “Item 2 Management’s Discussion and Analysis of Financial Condition and Results of Operations – Electric Services.”

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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. Our gas distribution operations utilize over-the-counter (“OTC”) natural gas and fuel oil swaps to hedge the cash-flow variability of specified portions of gas purchases and sales associated with certain large-volume customers when economically appropriate to do so. Seneca-Upshur utilizes OTC natural gas swaps to hedge cash flow variability associated with forecasted sales of natural gas. The Ravenswood Generating Station uses derivative financial instruments to hedge the cash flow variability associated with the purchase of a portion of natural gas and 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 using OTC electricity swaps.

KeySpan uses market quoted forward prices to value OTC swap contracts.

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. We had 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 noted above regarding sales to certain large-volume customers. As of September 30, 2006, these options, as well as the OTC gas and oil swaps, have expired. The Ravenswood Generating Station 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. Additionally, KeySpan entered into an International SWAP Dealers Association Master Agreement for a fixed for floating unforced capacity financial swap with Morgan Stanley Capital Group Inc., as well as a gas distribution asset optimization contract that employs derivative financial instruments.

The following tables set forth selected financial data associated with these derivative financial instruments noted above that were outstanding at September 30, 2006.

Type of Contract	Year of Maturity	Volumes mmcf	Fixed Price \$	Current Price \$	Fair Value (In \$ Millions)
Gas					
Swaps/Futures - Long Natural Gas	2006	4,101	4.82 - 11.94	4.20 - 7.35	(11.7)
	2007	3,651	9.82 - 11.94	7.20 - 8.76	(5.1)
	2008	360	9.82	7.26 - 9.14	(0.3)
OTC Swaps - Short Natural Gas	2006	683	6.17 - 10.69	4.20 - 7.35	2.5
	2007	2,622	5.86 - 11.54	7.20 - 8.76	(4.6)
	2008	1,596	6.77 - 6.85	7.26 - 9.14	(2.7)
	2009	1,300	7.60 - 10.90	7.02 - 8.89	1.0
					14,313
					(20.9)

Type of Contract	Year of Maturity	Volumes Barrels	Fixed Price \$	Current Price \$	Fair Value (In Millions)
Oil					
Swaps - Long Fuel Oil	2006	51,755	57.90 - 67.60	46.80	(0.8)
	2007	251,812	59.20 - 69.08	53.69 - 58.18	(2.7)
	2008	34,544	67.60	58.18	(0.3)
					338,111
					(3.8)

Type of Contract	Year of Maturity	MWh	Fixed Margin/ Price \$	Current Price \$	Fair Value (In \$ Millions)
Electricity					
Swaps - Energy	2006	471,800	59.90 - 123.00	44.75 - 88.25	11.6
	2007	144,800	97.60 - 150.50	78.92 - 108.69	9.4
					616,600
					21.0

		2006
<i>Change in Fair Value of Derivative Instruments</i>		(In \$ Millions)
Fair value of contracts at January 1,		(18.1)
Net (gains) on contracts realized		(67.1)
Increase in fair value of all open contracts		81.5
Fair value of contracts outstanding at September 30,		(3.7)

<i>(In Millions of Dollars)</i>				
Fair Value of Contracts				
Sources of Fair Value	Mature Within		Total	
	12 Months	Thereafter	Fair Value	
Prices actively quoted	\$ (18.6)	\$ (2.2)	\$ (20.8)	
Local published indicies	17.1	-	17.1	
	\$ (1.5)	\$ (2.2)	\$ (3.7)	

We measure the commodity risk of our derivative hedging instruments (indicated in the above table) using a sensitivity analysis. Based on a sensitivity analysis as of September 30, 2006 a 10% increase/decrease in natural gas prices would decrease/increase the value of derivative instruments maturing in one year by \$5.1 million.

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. The accounting for these derivative instruments is subject to SFAS 71 “Accounting for the Effects of Certain Types of Regulation.” 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.

The following table sets forth selected financial data associated with these derivative financial instruments that were outstanding at September 30, 2006.

Type of Contract	Year of Maturity	Volumes mmcf	Fixed Price (\$)	Current Price (\$)	Fair Value (In \$ Millions)
Swaps	2006	29,636	6.05 - 12.29	5.62 - 7.35	(94.2)
	2007	66,936	6.81 - 12.29	7.20 - 8.76	(159.4)
	2008	11,985	7.16 - 11.64	7.26 - 9.14	(23.2)
		108,557			(276.8)

See Note 4 to the Consolidated Financial Statements “Hedging and Derivative Financial Instruments” for a further description of all our derivative instruments.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined under Exchange Act Rule 13a-15(e) and 15d-15(e)) that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to KeySpan’s management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Any control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective at the reasonable assurance level in alerting them timely to material information required to be included in KeySpan’s

periodic SEC reports.

Furthermore, there has been no change in KeySpan's internal control over financial reporting that occurred during KeySpan's last fiscal quarter, which has materially affected, or is reasonably likely to materially affect, KeySpan's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 6 to the Consolidated Financial Statements "Financial Guarantees and Contingencies".

Item 1A. Risk Factors

Certain statements contained in this Quarterly Report on Form 10-Q concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are other than statements of historical facts, are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Without limiting the foregoing, all statements under the captions "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 3. Quantitative and Qualitative Disclosures About Market Risk" relating to our future outlook, anticipated capital expenditures, future cash flows and borrowings, pursuit of potential future acquisition opportunities and sources of funding, are forward-looking statements. Such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties and actual results may differ materially from those discussed in such statements.

Among the factors that could cause actual results to differ materially are:

- the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement with National Grid plc or the failure of the merger to close for any reason;
- volatility of energy prices used to generate electricity;
- fluctuations in weather and in gas and electric prices;
- general economic conditions, especially in the Northeast United States;
- our ability to manage our cost structure successfully and operate efficiently;
- our ability to successfully contract for natural gas supplies required to meet the needs of our customers;
- implementation of new accounting standards or changes in accounting standards or GAAP which may require adjustments to financial statements;
- inflationary trends and interest rates;

- the ability of KeySpan to identify and make complementary acquisitions, as well as the successful integration of such acquisitions;
- available sources and cost of fuel;
- creditworthiness of counterparties to derivative instruments and commodity contracts;
- the resolution of certain disputes with LIPA concerning each party's rights and obligations under various agreements;
- retention of key personnel;
- federal and state regulatory initiatives that threaten cost and investment recovery and place limits on the type and manner in which we invest in new businesses and conduct operations;
- the impact of federal, state and local utility regulatory policies, legislation and orders on our regulated and unregulated businesses;
- potential write-down of our investment in natural gas properties when natural gas prices are depressed or if we have significant downward revisions in our estimated proved gas reserves;
- competition facing our unregulated Energy Services businesses;
- the degree to which we develop unregulated business ventures, as well as federal, state and local regulatory policies affecting our ability to retain and operate such business ventures profitably;
- a change in the fair value of our investments that could cause a significant change in the carrying value of such investments or the carrying value of related goodwill;
- timely receipts of payments from our two largest customers LIPA and the NYISO;
- changes in the UCAP pricing structure;
- timing of approval of the 2006 LIPA Agreements and;
- other risks detailed from time to time in other reports and other documents filed by KeySpan with the SEC.

For any of these statements, KeySpan claims the protection of the safe harbor for forward-looking information contained in the Private Securities Litigation Reform Act of 1995, as amended. For additional discussion on these risks, uncertainties and assumptions, see "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 3. Quantitative and Qualitative Disclosures About Market Risk."

Item 2. Unregistered Sale of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

(a) Date of Meeting

The Annual Meeting of Stockholders of KeySpan Corporation was held on August 17, 2006.

(b) and (c) Name of Each Director Elected at the Meeting and Description of Each Matter Voted on and Number of Votes Cast

	For	Against	Withheld
1. The proposal to elect directors to serve until the next meeting of stockholders or until their successors are elected.			
Robert B. Catell	141,113,738	—	8,301,560
Andrea S. Christensen	142,856,453	—	6,558,845
Robert J. Fani	143,069,405	—	6,345,893
Alan H. Fishman	133,692,168	—	15,723,130
James R. Jones	142,516,931	—	6,898,367
James L. Larocca	142,674,326	—	6,740,972
Gloria C. Larson	142,588,762	—	6,826,536
Stephen W. McKessy	142,533,304	—	6,881,994
Edward D. Miller	142,520,380	—	6,894,918
Vikki L. Pryor	142,790,782	—	6,624,516
	For	Against	Abstain
2. The proposal to ratify the appointment of Deloitte & Touche LLP as independent registered public accounting firm as auditors of the Company for the fiscal year ending December 31, 2006.	143,871,717	3,332,653	2,210,928
			Non-Vote
			—
	For	Against	Abstain
3. The proposal to adopt the Agreement and Plan of Merger dated February 25, 2006, among National Grid plc, National Grid US8 Inc. and KeySpan Corporation.	109,184,628	7,442,564	2,160,682
			Non-Vote
			30,627,424
	For	Against	Abstain
4. The shareholder proposal to adopt simple majority vote.	65,114,814	48,536,898	5,136,162
			Non-Vote
			30,627,424

Item 5. Other Information

None

Item 6. Exhibits

31.1* Certification of the Chairman and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2* Certification of the Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1* Certification of the Chairman and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2* Certification of the Executive Vice President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

*Filed Herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on behalf of the undersigned there unto duly authorized.

(Registrant)

KEYSPAN CORPORATION

By: /s/Gerald Luterman
Name: Gerald Luterman
Title: Executive Vice President and
Chief Financial Officer

Date: November 3, 2006

/s/ Gerald Luterman
Gerald Luterman
Executive Vice President and
Chief Financial Officer

Date: November 3, 2006

/s/ Theresa A. Balog
Theresa A. Balog
Vice President and
Chief Accounting Officer