Central Hudson

Central Hudson Gas & Electric Corporation
1998 Annual Report & Form 10-K

Central Hudson

A Second Century of Service

The coming year marks a significant milestone in the history of Central Hudson Gas & Electric Corporation. As our Company prepares to commemorate its centennial in 2000 and form a new Holding Company, we are also working to ensure that Central Hudson is a successful competitor in a revolutionized industry. As we embark on our "Second Century of Service," we will build on the strength of Central Hudson's past to ensure the success of its future. On the front cover — where employees form the familiar "C" and "H" of our corporate logo and our new holding company, CH Energy Group, Inc. — and throughout this Annual Report, the men and women of Central Hudson are featured. Through dedication, commitment and demonstrated ability to work together as a team, we intend to make Central Hudson a winner in a competitive marketplace.□

Affirmative Action Policy

It is the policy of Central Hudson Gas & Electric Corporation to provide equal employment opportunities for all persons. Central Hudson is committed to recruit, hire, train and promote persons in all positions, without regard to race, color, creed, religion, age, national origin, disabilities or sex. Central Hudson will ensure that promotional decisions are in accord with principles of equal employment opportunity by imposing only valid requirements for promotional opportunities. All personnel actions, including compensation, benefits, transfers, layoffs, return from layoff, employer-sponsored training, education, tuition assistance, social and recreational programs, will be administered without regard to race, sex, color, creed, religion, age, national origin, or disability.□

Forward-Looking Statements

This Annual Report to Shareholders contains certain "forward-looking statements" within the meaning of, and subject to the safe harbor protection of, the Securities Litigation Reform Act of 1995. A number of important factors could cause actual results to differ materially from those stated in the forward-looking statements. In this regard, reference is made to the caption "FORWARD-LOOKING STATEMENTS" in Pa[illegible] of the Company's Annual Report, on Form 10-K, for the fiscal year ended December [illegible] 1998 which accompanies this Report, the provisions of which are incorporated herein by reference and shall be applicable to this Annual Report to Shareholders.□

Contents

Financial Highlights

	1998	1997	Change
Operating Revenues	$ 503,469,000	$ 520,277,000	-3.2%
Net Income	$52,544,000	$55,086,000	-4.6%
Earnings Per Share	$2.90	$2.97	-2.4%
Average Shares Outstanding	17,034,000	17,435,000	-2.3%
Dividends Declared Per Share	$2.155	$2.135	.9%
Total Assets	$1,316,038,000	$1,252,090,000	5.1%
Electric Sales			
Own Territory (kwh.)	4,535,684,000	4,490,317,000	1.0%
Natural Gas Firm Sales			
(thousands of cubic feet)	9,001,000	10,285,000	-12.4%
Electric Customers			
Own Territory (average)	270,544	266,471	1.5%
Firm Gas Customers (average)	61,970	61,337	1.0%

Report to Shareholders

The year 1998 represented a new beginning for Central Hudson. For the first time, customers had the opportunity to choose their supplier for both electricity and natural gas. At the same time, we established a wholly owned subsidiary, CH Energy Group, Inc., which will become the holding company owner of Central Hudson Gas & Electric Corporation and unregulated energy companies that currently include CH Resources, Inc. and Central Hudson Enterprises Corporation. Through these subsidiaries we have begun to seize new opportunities emerging in regulated and non-regulated markets within and outside the Hudson Valley.

For example, CH Resources, Inc. acquired two 80-megawatt generating plants in upstate New York State which will be used to supply electricity to unregulated wholesale markets. Central Hudson Enterprises Corporation, meanwhile, acquired SCASCO, a full-service retail oil company in Connecticut. SCASCO is developing a customer base to market fuel oil, natural gas, electricity and other energy services in unregulated markets in New England and eastern New York State.

In 1998, we also achieved the financial objectives we set for ourselves in negotiating our comprehensive, three-year Settlement Agreement with the New York State Public Service Commission to govern our transition to competition. First, we achieved the maximum return on equity permitted under the Agreement. Second, we over-earned vs. the maximum level, placing the excess in reserve for recovery of historic costs still on our books at the conclusion of the three-year period. (Absent this planned deferral of earnings, reported earnings would have increased by 1 percent.) And, for the eleventh consecutive year, we increased the Common Stock dividend, by 1% to $2.15 per share. Our strong financial performance has not gone unnoticed. In 1998 we achieved an "A" rating on our senior debt from all four of our rating agencies.

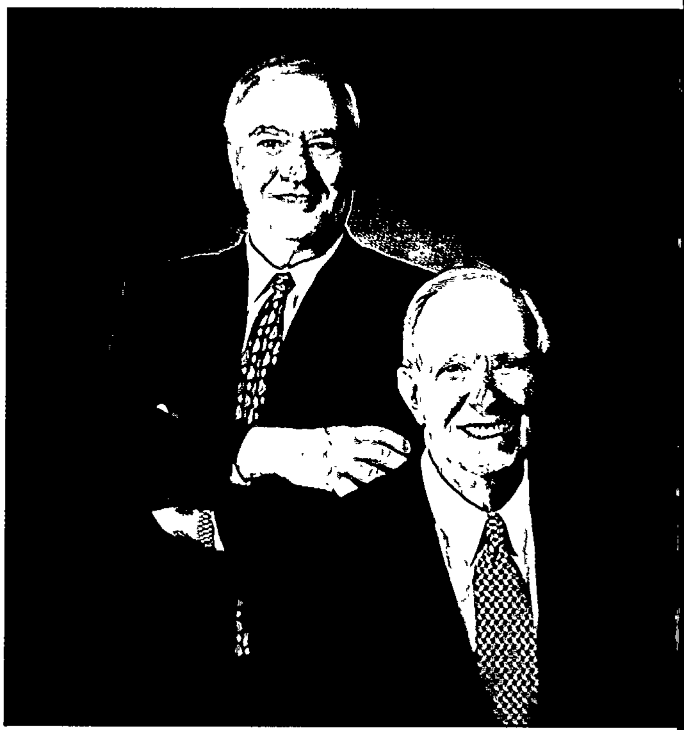
Moody's Investors' Service upgraded the Company's secured debt rating from "A3" to "A2," the midpoint of the A range in the Moody's rating system. It marks the first time since 1980 that Central Hudson has earned that rating from Moody's. The firm stated the upgrade was made "to reflect the significantly stronger operating and financial profile that the Company has developed over a period of several years, which positions it well to cope with the onset of competition."

Although the local economy exhibited many of the characteristics of full recovery and expansion, an unusually warm winter caused a decline in electric and natural gas sales that negatively impacted earnings by $.20 per share. Importantly, we were able to offset this seasonal impact through reduced operating costs. Our ability to do so is a result of our initiatives to enhance productivity and raise quality through improved performance. Throughout Central Hudson we are replacing the traditional functional hierarchy with teams that solve problems and create opportunities. We strive for continuous improvement, measured by a higher level of customer satisfaction, faster response time, and lower prices. We work to apply technology, especially communication and information systems, to improve the production of electricity, the delivery of both natural gas and electricity, and service to customers. We have utilized internal funds to finance our capital additions and improvements and to retire debt. Our capital additions are directed to growing our business and improving our performance.

For the sixth consecutive year, customers in the Mid-Hudson Valley benefitted from stable prices for natural gas and electric service. Overall, Central Hudson's pricing structure remains the lowest in the state. Our low prices, in conjunction with our various economic development and retention rate incentives, have helped to attract new employers to the region, encouraged existing customers to expand, and enabled customers considering relocation to remain here in the Hudson Valley. These programs, some of which have been in effect since 1992, have resulted in nearly $7.5 million of incentives to firms which can be credited with adding nearly 5,500 jobs. In 1998, Central Hudson also made available discounts to our largest industrial customers, resulting in an additional $2.5 million of annual savings. Our favorable electricity prices make Central Hudson competitive not only in the state but also in the Northeast region and nation.

We continue our emphasis on satisfying customers. Responses to our *"How Did We Do?"* survey show that the percentage of customers who are highly satisfied with our service increased from 29 percent in 1997 to 36 percent in 1998.

In 1998, Central Hudson Gas & Electric customers had, for the first time, an opportunity to select their electricity and natural gas supplier. We committed significant resources to present options to our customers. In spite of our efforts and the highest back-out incentive rate in the state, there was limited interest on behalf of residential customers, resulting partially from an apprehension of switching from a known relationship to a new one. But the overwhelming reason was cost. Central Hudson's low prices, which are approximately 20 percent below the state average, do not provide customers with a significant reason to shop. The sale of the Company's generating assets will no doubt further increase the back-out rate and it is expected that competition will contain supply prices. Whether these changes will be sufficient to induce customers to switch their supplier remains uncertain.



Paul J. Ganci
President &
Chief Executive Officer

John E. Mack III
Chairman of the
Board of Directors

One of our challenges in the year and years ahead will be to succeed as an alternate regulated supplier — without assuming a risk that is neither recognized nor rewarded by regulation. This issue, which remains the major unresolved issue in the transition from regulation to true competition, can be described as the future responsibility of the regulated utility which has sold its electric generation and gas supply contracts and yet must serve as the "provider of last resort" — without adequate compensation for the risk.

We have begun to explore opportunities to redeploy our investments to unregulated opportunities, focusing our efforts on energy-related businesses. Currently 8 percent of our equity is invested in unregulated enterprises. With the sale of the Roseton and Danskammer generating plants, significant amounts of capital will be released for reinvestment as we deploy this capital to maximize the potential increase in shareholder value. While we obviously cannot make any guarantees, we expect that because of our strong financial condition and conservative dividend policy, that any reduction in earnings resulting from our new business development activities will not impact our ability to maintain the current level of dividend.

In 1998, we created an executive team, who along with Mr. Ganci, will focus our attention on opportunities that are developing in both regulated and unregulated energy markets. This team consists of Mr. Carl E. Meyer, Executive Vice President of Operations; Mr. Allan R. Page, Executive Vice President of Energy Resources & Development; Mr. Arthur R. Upright, Senior Vice President of Regulatory Affairs, Financial Planning & Accounting; and Mr. Steven V. Lant, Chief Financial Officer, Treasurer & Corporate Secretary.

As we begin to prepare for our "Second Century of Service," we will continue to build on the strength and reputation of Central Hudson and the competence of our employees to create highly satisfied customers and grow our business.

Creating Satisfied Customers Today

Central Hudson Gas & Electric Corporation will remain the regulated company responsible for the transmission and distribution of electricity and natural gas to the communities of the Mid-Hudson Region which we have historically served. It's a responsibility we take very seriously — striving always to provide ever-higher levels of service, as well as reliable, low-cost energy.

As an organization, we are constantly challenged to seek out the right technology, to find the better way, and to extend that additional courtesy to our customers. Here are just a few examples of the ways that Central Hudson employees are working to create highly satisfied customers and increase our effectiveness:

Working Foreman Gary VanAken & Associate Engineer Steven Vincent

• We're investing to ensure the reliability and efficiency of our transmission and distribution systems and to provide for load growth. For example, we are allocating $40 million to upgrade two transmission lines which carry electricity to Ulster County. And in Greene County, we have invested $3.5 million to expand the North Catskill Substation (left) and install three new circuits — dramatically improving the reliability of electric service in the surrounding communities of Greene and Albany counties.

• In our Customer Call Center (right), we strive continuously to improve our effectiveness and the quality of our service. We have provided state-of-the-art computer and communication systems, the integration of which mean quicker response and the ability to handle up to 40,000 calls per hour during emergencies. Through training, teamwork and self-assessment, our representatives strive constantly to improve performance.

Customer Service Representative Karen Coratti

• We're developing new technology to instantaneously locate the cause of service interruptions via computer, eliminating the need for crews to physically search for them. Data is being gathered (right) that will enable us to identify the individual transformers and fuses that serve each customer. When integrated within our customer data base in 2000, the information will allow the computer to automatically identify trouble even before customers call to report the interruption — speeding our assessment and response.

Associate Engineer Bill McFarland

At Central Hudson, we embrace every opportunity to improve our performance, thereby increasing the quality and competitiveness of our products and services. That's because we recognize that the key to future success depends on customer loyalty — earned by a combination of proven, reliable performance and low prices. Several initiatives illustrate how we're seeking to continuously enhance the products and services we deliver in order to create highly satisfied customers:

Meter Reader Jeanne Kropp

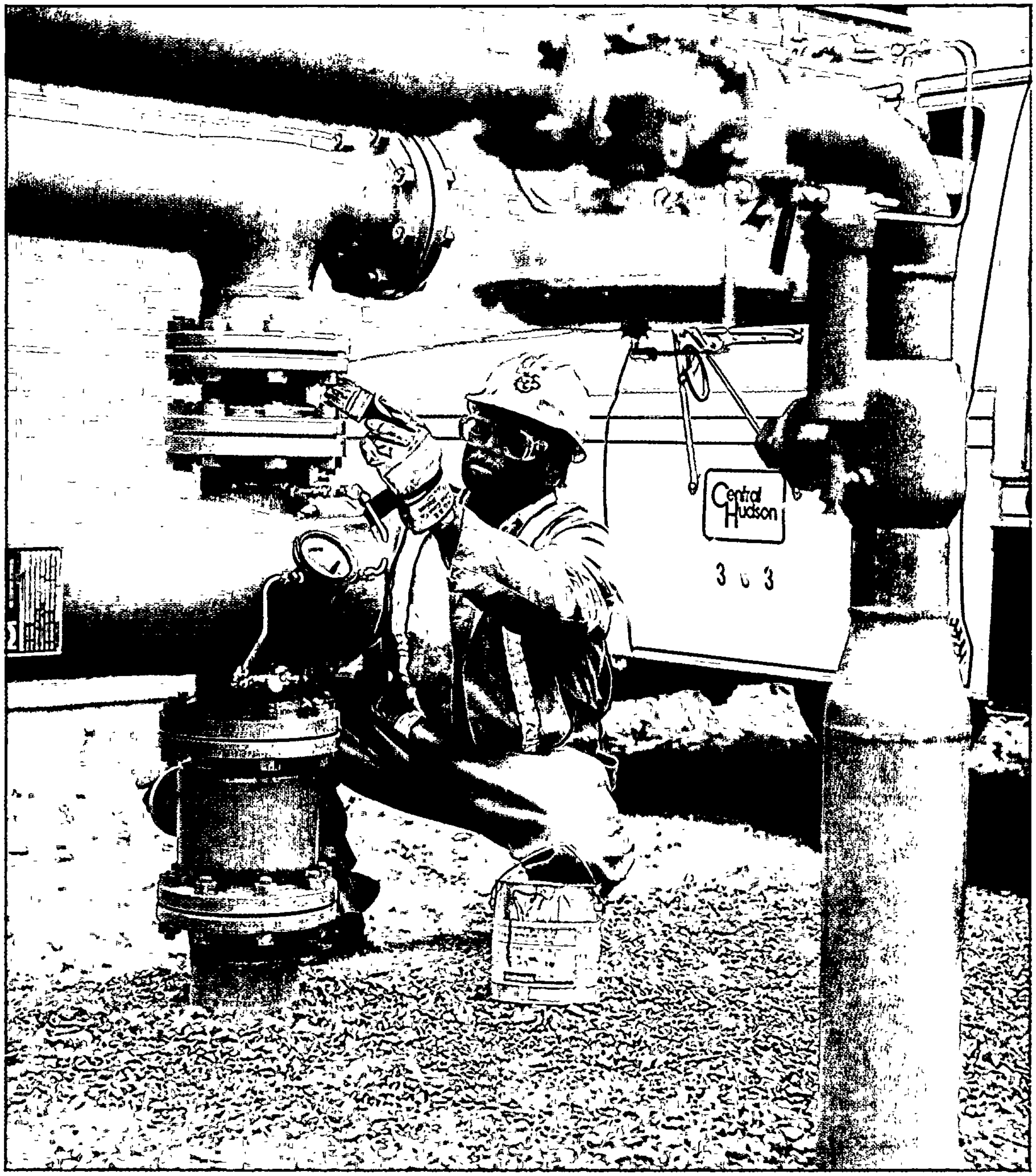
• We're using state-of-the-art satellite global positioning technology to plot longitude and latitude readings for each of the 334,000 electric and natural gas meters (right) in our regulated service territory. These locations will then be integrated with a computerized mapping system to determine the most efficient meter-reading routes. Completion of the effort, scheduled for 1999, will produce direct labor savings and reduce the number of estimated meter readings. We've also instituted a program to install new seals on electric meters as part of our effort to minimize the theft of our service.

• Last year marked the first time in the near-century long history of our Company that customers could buy their electricity from a supplier other than Central Hudson. The first phase of our Customer Choice Plan — which resulted from our Settlement Agreement with the Public Service Commission during its proceeding to introduce competition to our state's electric industry — began in September 1998. The second phase (which includes up to 16 percent of customers) took effect in January 1999, with Phases 3 and 4 to be implemented in January of 2000 and 2001, respectively. On July 1, 2001, all customers will have the ability to choose their electricity supplier.

Line Foreman Bob Stern with the Geyer family of Newburgh

Though we continue to conduct a comprehensive information program to educate our customers about their choice options, residential participation in the program has been limited — due in part to our long-standing emphasis on quality relationships and our low pricing structure. For the sixth straight year, our full-service electricity prices remained the lowest in New York State, and among the lowest in the northeast region of the United States.

We've worked hard, through continuous cost control and performance improvement, to retain that competitive position in one of the most expensive electric markets in the United States. We have also worked hard to satisfy our customers and to earn their loyalty and business; customers like the Geyer family of Newburgh (left), who visited the annual Open House at one of our division offices last fall. While our industry is changing dramatically, we intend to retain our commitment to safe, reliable energy delivered at the lowest possible price to the neighbors we serve.



Gas Mechanic Jim Smith

• A portion of our natural gas business has been deregulated for more than five years. Initially, only larger users purchased their natural gas supplies from unregulated suppliers. But more recently, even smaller users have been given the opportunity to combine their supply requirements and buy from alternate suppliers. How can we be successful in this new environment, where we have become only a transportation company for some customers? By increasing the reliability of our system — and the amount of natural gas (and resulting revenues) flowing through it.

We've replaced portions of our natural gas infrastructure and connected new businesses and residences to our system (above). Importantly, with the enthusiastic commitment of our field and marketing forces, we have reduced the cost and time to complete new gas installations. During the last five years we've spent $21 million on improvements which enabled us to connect more than 3,300 new natural gas customers. Our efforts have been rewarded through increased customer satisfaction and improved earnings.□

Growing our Business for Tomorrow

Expanding sales of electricity and natural gas within our regulated service territory is a key component of our growth strategy for the future. Much of the task falls within our Marketing and Economic Development divisions. Consider:

Associate Systems Analyst Barbara MacIsaac

• Low electricity prices were cited as a primary reason why San Francisco-based *The Gap, Inc.* chose to locate the warehouse and distribution center for its *Old Navy* subsidiary in Fishkill, Dutchess County. The center, when complete, will mean increased electric sales of 10 megawatts and revenues of more than $1 million annually. A total of 1,100 full-time jobs and as many as 200 part-time, seasonal positions will be created.

• The latest in energy products and services is just a mouse click away, thanks to Central Hudson's new on-line Energy Depot (above). It's a fast, fun, efficient way to purchase products and services. Central Hudson's Web Site (www.cenhud.com) now also allows customers to obtain up-to-the-minute information regarding their account. And, a pilot program is underway to test customers' ability to receive and pay their Central Hudson bill on line.

• A new product — The Central Hudson Advisor — was launched in 1998. The Advisor (below) automatically reports an electric service interruption via computerized telephone interconnection to Central Hudson *and* either the customer or a third party anywhere in the continental United States. It's a product that provides peace of mind to individuals who own vacation homes within our service territory; those concerned about the safety of someone who is elderly or disabled; and even small business owners who rely upon data collection and security information. There is a one-time activation fee and a small monthly charge for the service.

Marketing Specialist Cathy Doyle with the Frost family of Beacon

Deregulation of the electric industry means the function of generating electricity must be organizationally separated from the functions of transmitting and distributing that energy. When we auction our Roseton and Danskammer electric generating stations by 2001, their output will no longer be reserved for our customers. In the interim, we are working to increase the value and use of these plants. Our Power Marketing Division has become a sophisticated trading operation vital to keeping rates down and maximizing shareholders' return through wholesale electric and gas sales. Wholesale sales grew to $32.8 million in 1998, and represented 8 percent of total electric sales.

Chief Control Operator Joseph Kerrick

• Innovative agreements to turn the natural gas supplies of marketers into electricity sold to third parties outside our service territory produced revenues in excess of $1.2 million in 1998. These "tolling" or "merchant plant" agreements have proven to be effective ways to maximize the value of our plants (above). And for the first time ever, call options were sold to energy marketers on Central Hudson's two Greene County gas-fired turbine jets (right) during the summer of 1998.

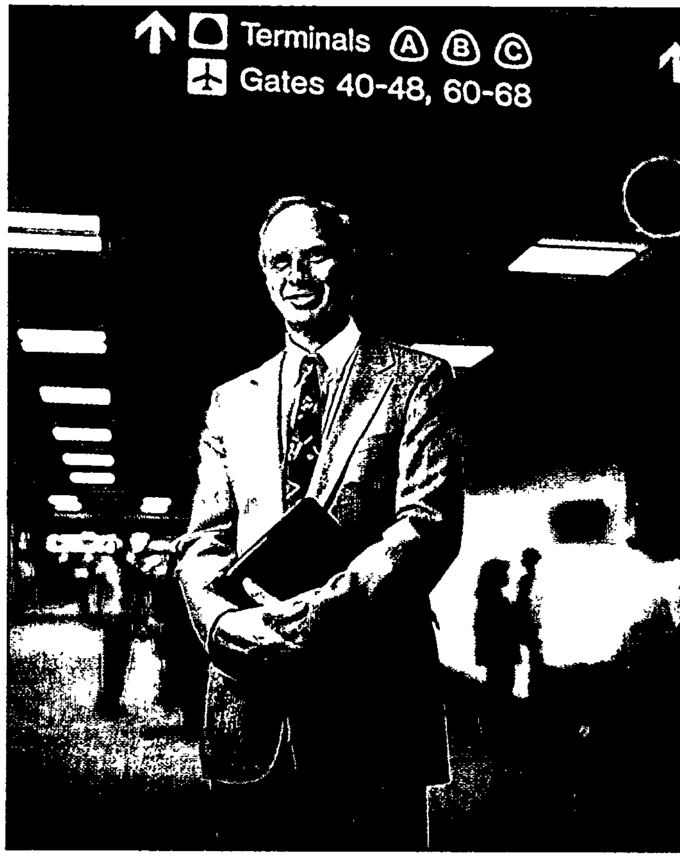
Manager of Energy Resources Diane Seitz

• And, we realized our first electricity sales outside the boundaries of our traditional service territory to approximately 80 large customers throughout New York State last year. Included among them was catalog-giant *Lillian Vernon Corporation* in New Rochelle (left). "I travel the world shopping for unique products at great prices for my 21 million customers. So when we needed an energy company for our new corporate headquarters, I shopped with the same eye for value. Central Hudson fit the bill," said Vernon.

In the future, electricity sales outside the regulated service territory will become an increasingly important part of the business plan of our subsidiary, Central Hudson Enterprises Corporation.

Director of Business Development Services Tom Biskup and (right) David Hochberg, Vice President of Public Affairs, Lillian Vernon Corp. of New Rochelle

Central Hudson Enterprises Corporation, our wholly owned subsidiary, has specialized in energy-related engineering services — primarily outside the boundaries of our historic Hudson Valley service territory — since its formation in 1984. Now, in response to the deregulation of our industry, Central Hudson Enterprises Corporation is seizing exciting new business opportunities evolving both inside and outside of New York State. Here are some examples of how the subsidiary is helping to grow our business for tomorrow:



Central Hudson Enterprises Corporation Retail Accounts Manager Dennis Rigstad

Central Hudson Enterprises Corporation Manager of Engineering Mike Mosher

• Throughout New England, New York, New Jersey and Pennsylvania, Central Hudson Enterprises Corporation has earned a solid reputation for providing high-quality, on-time, energy-related engineering services. Retrofitting lighting, replacing HVAC systems and installing co-generation facilities are some of the firm's design specialities. Among the many large commercial customers served by our subsidiary have been numerous school districts, Macy's, the New York Institute of Technology, the New York Port Authority, and Newark Airport (top left), where engineers helped save 40 percent on energy bills when redesigning Terminal B.

SCASCO Fuel Oil Driver Mark Lampagnana with Customer Karen Ramson of Colebrook, Connecticut

• During 1998, Central Hudson Enterprises Corporation acquired SCASCO, one of northwest Connecticut's largest full-service, fuel oil distributorships (above). In the short-term, the acquisition provides the ability to market natural gas to the 5,000 existing customers of the 80-year-old firm. But by next year, when Connecticut opens its electric utility industry to competition, it will provide a base from which to market electricity to customers throughout that state.

• In another exciting development in 1998, Central Hudson Enterprises Corporation took swift advantage of changes within our industry to develop as a successful electricity marketer, providing energy deliveries, billing and customer service. During Phase I of our Customer Choice Plan, the subsidiary supplied electricity to 24 large business accounts within Central Hudson's service territory, including the Culinary Institute of America in Hyde Park (left). Planning is underway to participate in additional phases within Central Hudson's service territory as well as retail access programs opening elsewhere in New York and other states.□

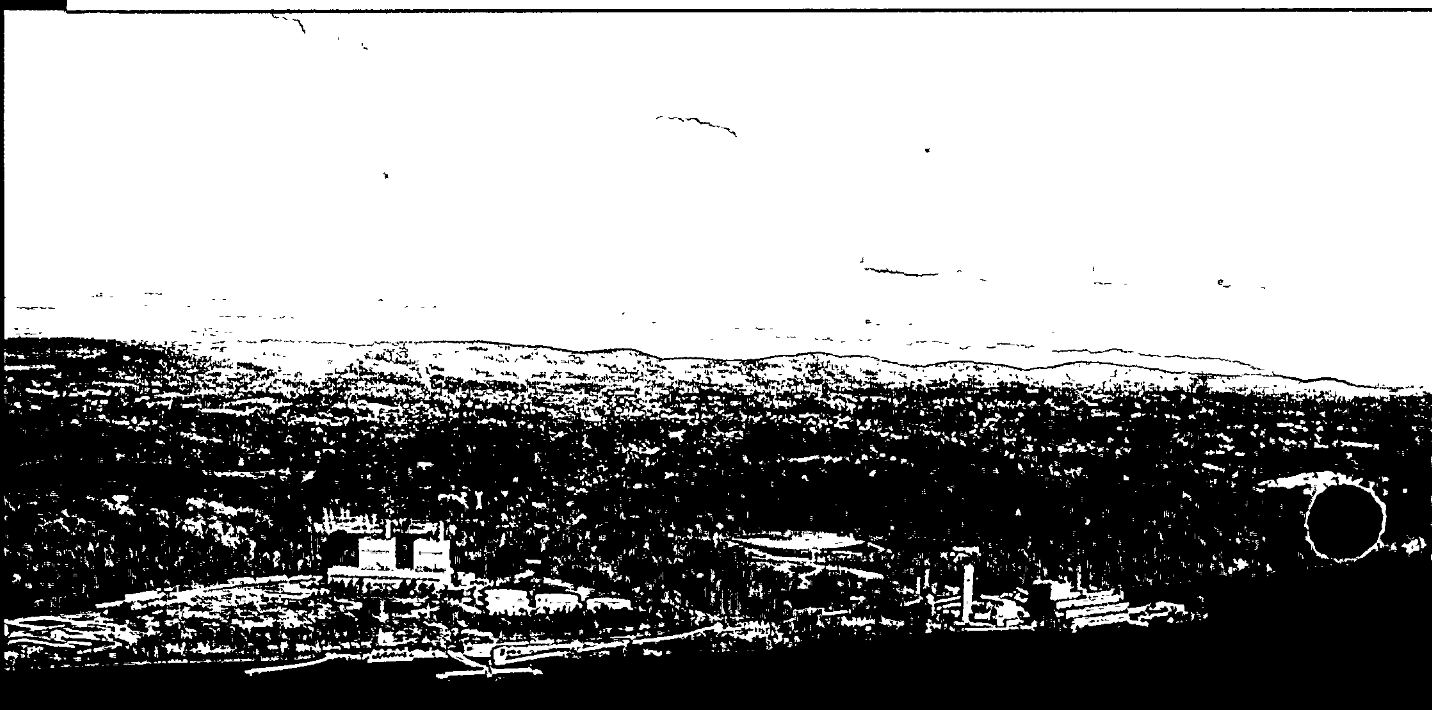
Generation Asset Update

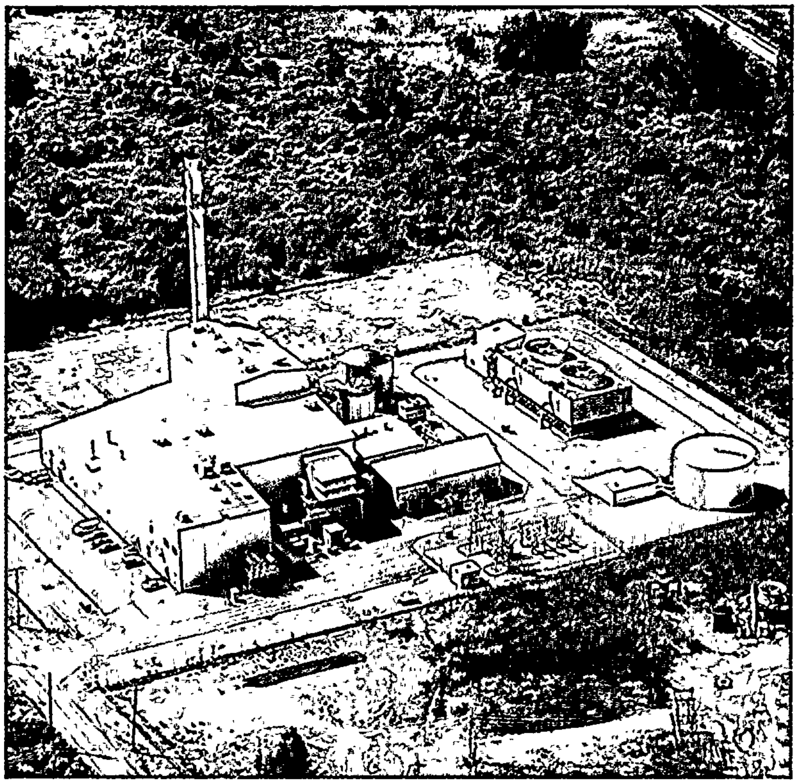
As a result of our Settlement Agreement and your approval at the Special Meeting of Shareholders conducted in September 1998, we will form a holding company during 1999. The creation of CH Energy Group, Inc. will provide us with the arms-length oversight and flexibility necessary to successfully separate our regulated and unregulated businesses (including generation subsidiaries). Our restructuring agreement also requires us to auction our existing fossil-fuel electric generating plants no later than June 30, 2001. Here is an update on some of the critical developments affecting our generation assets:

• The Danskammer and Roseton electric generating stations (the latter of which we own 35 percent and manage on behalf of co-tenants Consolidated Edison and Niagara Mohawk) continue to operate as safe, well-run, environmentally compliant plants. Thanks to increased availability, improved operational flexibility, and lower fuel prices, both facilities set impressive performance standards during 1998. Roseton's output increased dramatically from the previous year and new records were set for both electricity generation and number of days of continuous operation at Danskammer. Two additional milestones were achieved at Danskammer this year: a million tons of coal were used to produce electricity and a record amount of fly ash was recycled off-site into such beneficial products as road materials and concrete.

• We have retained the right to bid in the auction for the Danskammer and Roseton plants (below) through our unregulated CH Resources, Inc. subsidiary. A thorough assessment of that option is being conducted by a task force of employees designated as a "buy team." Meanwhile, a team of Central Hudson employees has been designated as a "sell team." Importantly, the behavior of employees on both sides is guided through a strict Code of Conduct. And an independent consulting firm has been engaged to oversee the auction process to ensure that all eligible bidders are given equitable consideration — and that the highest-value bidder is selected.

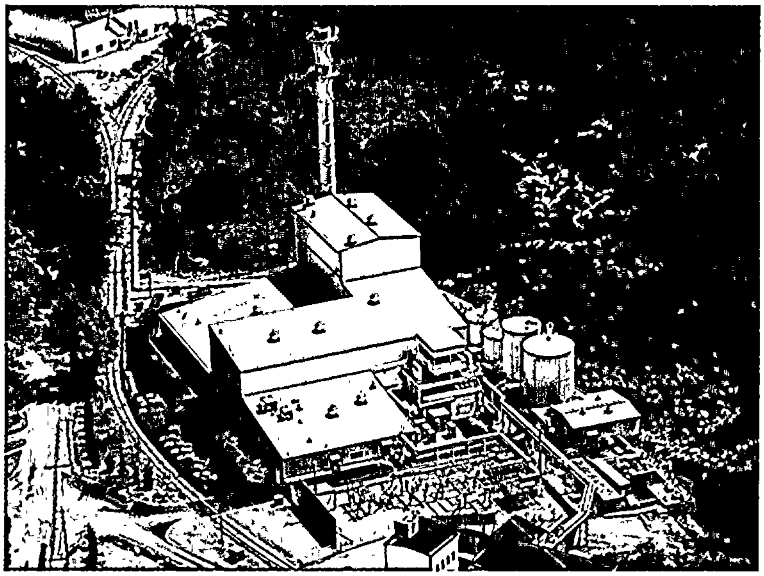
Roseton & Danskammer Generating Stations, Newburgh, New York





• Our CH Resources, Inc. subsidiary, which was formed in 1980, purchased two upstate New York electric generating plants during 1998. One (top right) is in the Village of Solvay (near Syracuse) and the second (bottom right) is located in the Village of Beaver Falls (east of Watertown). The plants went on line in 1994 and 1995, respectively, and each has a rated capacity of 80 megawatts.

The output from these facilities will be sold at the wholesale level to our wholly owned, unregulated subsidiary Central Hudson Enterprises Corporation and to other energy services companies. The electricity they generate will also be sold into the region's wholesale electric market through the New York Power Pool or the newly formed Independent System Operator.



The purchase of these two cost-competitive, highly efficient plants is a key building block in growing our unregulated business to take advantage of changes in our industry. As customers throughout the Northeastern region of the United States obtain the right to select their energy supplier, these two plants will permit CH Resources, Inc. to successfully market competitively priced electricity to the developing market of customer choice.

Two Newly Acquired Electric Generating Facilities in Solvay (top) and Beaver Falls, New York

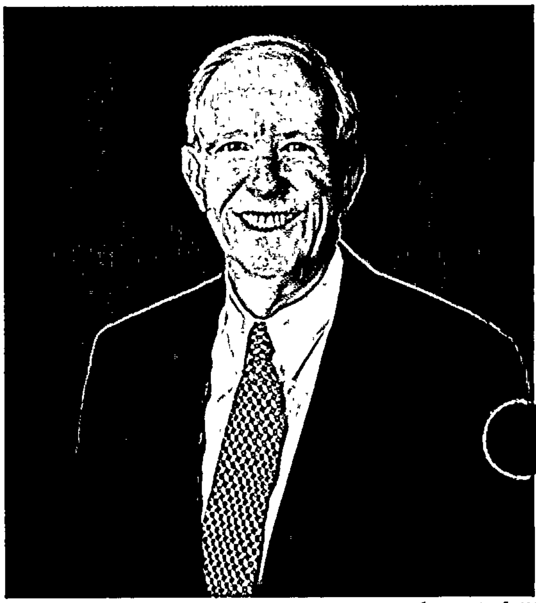
• CH Resources, Inc. has also participated in several generation plant auctions in the Northeast. Along with Executive Vice President of Energy Resources and Development Allan R. Page, a team (left) is working to develop the subsidiary into a niche player capable of owning or managing other generation assets. □

Executive Vice President of Energy Resources and Development Allan R. Page and employees

Chairman's Profile

After 40 years of dedicated service to Central Hudson, John E. Mack III will step down as Chairman of the Board of Directors in April 1999. As he will remain a member of the Board, the Central Hudson organization will continue to benefit from his guidance — realizing that as we embrace our "Second Century of Service" it was Mr. Mack who nurtured a corporate culture which encourages every employee to do what is right on behalf of our customers.

Mr. Mack joined Central Hudson in 1958 in the Finance & Accounting Group. He served in several positions within the accounting, financial, and personnel functions of the Company prior to being promoted to Personnel Director in 1970. He was promoted to Assistant Vice President-Corporate Services in 1972, Vice President-Corporate Services in 1974, Vice President-Customer Services in 1976, Executive Vice President in 1979, and was elected to the Board of Directors in 1981. Elected President in 1982, he was appointed President and Chief Executive Officer on April 1, 1986; on April 4, 1989 he was elected Chairman of the Board and Chief Executive Officer.



John E. Mack III

He has served as a director of the Edison Electric Institute and a member of the American Gas Association, trade organizations of the utility industry. He has also been a member of the executive committees of the New York Power Pool and The Energy Association of New York State. He served as President of the Empire State Electric Energy Research Corporation and as a member of the New York State Energy Research and Development Authority.

His contributions also include service to many local, non-profit institutions. Among them are Marist College, Mount Saint Mary College, the Astor Home for Children, the New York State and Poughkeepsie Salvation Army advisory boards, and the Catharine Street Community Center. He has also served The New York Business Development Corporation, the Dutchess County Healthcare Alliance, Mid Hudson Health, the Hudson Valley Film & Video Office, the Hudson Valley Council Boy Scouts of America and Mid Hudson Pattern for Progress. In addition, Mr. Mack has volunteered on behalf of the Berkshire-Taconic Foundation, Saint Francis Hospital, Dutchess County United Way, the Mid Hudson Civic Center, the Orange County Partnership, the Dutchess County Chapter of the American Heart Association and many others. He also chaired the City of Poughkeepsie's 1987 Tricentennial Celebration Committee.

Though Mr. Mack will take leave of the Company on a day-to-day basis in April, he will leave behind a legacy of business growth with financial integrity; a tradition of customer service; and an uncompromising commitment to honesty — all of which will ensure our future success. We are indebted to him for his dedication and his example. He will be missed. □

Corporate & Stock Information

Annual Meeting

The Annual Meeting of holders of Common Stock will be held on Tuesday, April 27, 1999 at 10:30 a.m. at the Corporation's General Offices, 284 South Avenue in Poughkeepsie, New York. The management welcomes the personal attendance of shareholders at this meeting. A summary report of the meeting will be mailed to all shareholders of record at a later date.

Financial & Statistical Report

A comprehensive, 10-year financial and statistical supplement to this Annual Report will be available to shareholders attending the Annual Meeting. Copies may also be obtained by writing or calling Steven V. Lant, Chief Financial Officer, Treasurer and Secretary at 284 South Avenue, Poughkeepsie, NY 12601; telephone: (914) 486-5254.

Common Stock Purchase Plan

Central Hudson offers a Stock Purchase Plan under which all potential investors may conveniently purchase common stock and reinvest cash dividends. All brokerage and other fees to acquire shares are paid by the Corporation. To participate, contact Paul J. Gajdos, Director of Office Services and Shareholder Relations at (914) 486-5204 or First Chicago Trust Company of New York at (800) 428-9578. Copies of reports or information noted above may also be requested via our Web Site at www. cenhud.com.

Multiple Copies of this Report

Shareholders who receive multiple copies of this Annual Report may, if they choose, reduce the number mailed by calling First Chicago Trust Company of New York at (800) 428-9578.

Common Stock Market Price & Dividends Paid Per Share

	1998			1997		
	High	Low	Dividend	High	Low	Dividend
1st Quarter	$43 3/4	$39 5/8	$.535	$ 33 3/8	$ 30 1/2	$ .53
2nd Quarter	46	38 7/8	.535	34 3/4	29 3/4	.53
3rd Quarter	47 1/16	40 7/8	.54	35 7/8	32 1/8	.535
4th Quarter	45 1/8	39 7/8	.54	43 7/8	34 11/16	.535

- **Analysts & Institutional Investors:**
  Contact Steven V. Lant, Chief Financial Officer, Treasurer and Secretary; telephone: (914) 486-5254.

- **Transfer Agent & Registrar, Common and Preferred Stocks/Shareholder:**
  First Chicago Trust Company of New York, P.O. Box 2500, Jersey City, NJ 07303-2500; telephone (800) 428-9578 between 8:30 a.m. and 7 p.m. weekdays or www.fctc.com.

- **Internet:**
  This Annual Report, our SEC filings and the Prospectus for our Stock Purchase Plan (as well as other information about the Company) is available by accessing our Web Site at www.cenhud.com.

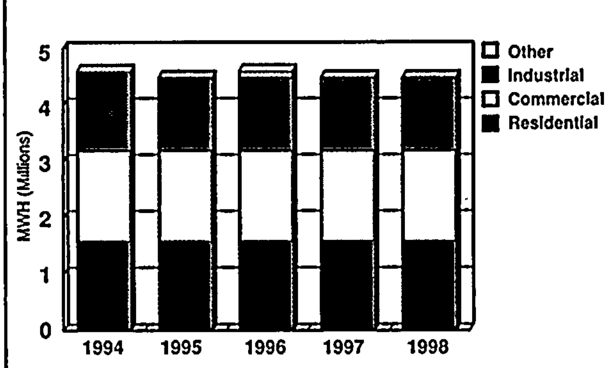
- **Stock Exchange Listing:**
  Common: NY Stock Exchange; Symbol: CNH

- **General Counsel:**
  Gould & Wilkie
  One Chase Manhattan Plaza
  New York, NY 10005

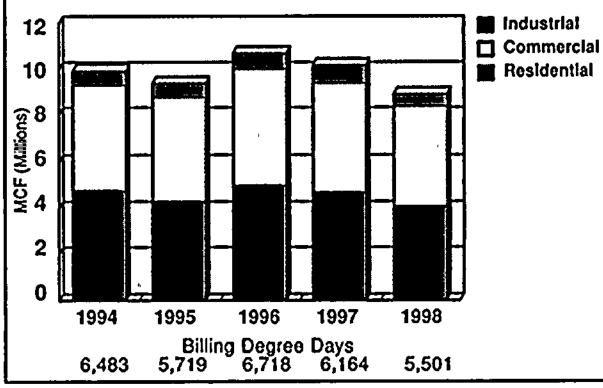
- **Independent Accountants:**
  PricewaterhouseCoopers LLP
  1177 Avenue of the Americas
  New York, NY 10036

Financial Profile

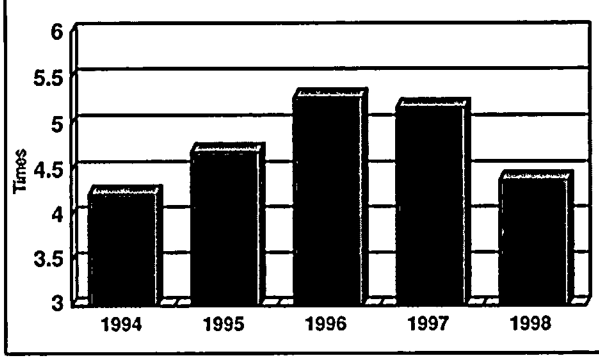
Electric Sales



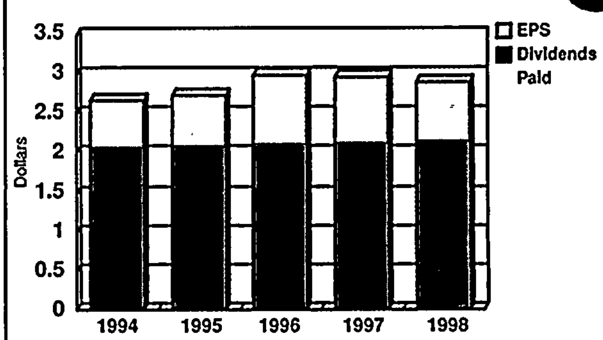
Firm Gas Sales



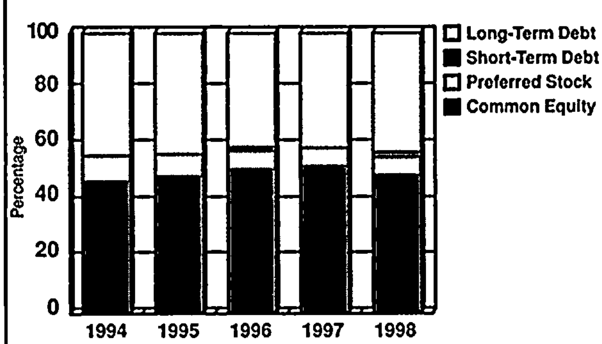
Ratio of Funds From Operations To Total Interest Charges



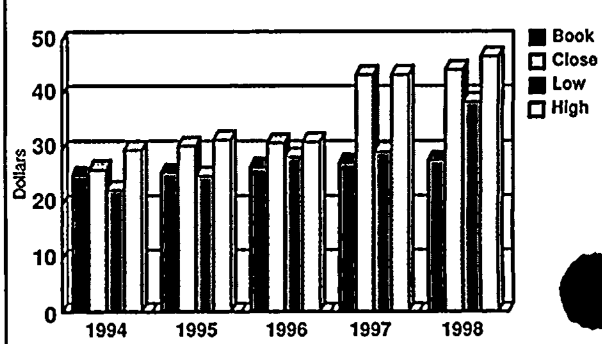
EPS & Dividends



Capitalization Ratios



Common Stock Prices



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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended .... December 31, 1998

Commission file number 1-3268

CENTRAL HUDSON GAS & ELECTRIC CORPORATION

(Exact name of registrant as specified in its charter)

New York	14-0555980
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
284 South Avenue, Poughkeepsie, New York	12601-4879
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (914) 452-2000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class on which registered	Name of each exchange
Common Stock, $5.00 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Title of each class
Cumulative Preferred Stock:
4 1/2% Series
4.75% Series

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 X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant as of February 18, 1999, was $628,112,741 based upon the lowest price at which Registrant's Common Stock was traded on such date, as reported on the New York Stock Exchange listing of composite transactions.

The number of shares outstanding of Registrant's Common Stock, as of February 18, 1999, was 16,862,087.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of Registrant's Annual Report to Shareholders, for the fiscal year ended December 31, 1998, are incorporated by reference in Parts I, II and IV of this Report.

Registrant's definitive Proxy Statement, to be dated March 1, 1999, and to be used in connection with its Annual Meeting of Shareholders to be held on April 27, 1999, is incorporated by reference in Part III hereof.

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Part I

Forward Looking Statements

This Form 10-K Report and the documents incorporated by reference may contain statements which, to the extent they are not recitations of historical fact, constitute "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 ("Reform Act"). These statements will contain words such as "believes," "expects," "intends," "plan," and other similar words. All such forward-looking statements are intended to be subject to the safe harbor protection provided by the Reform Act. A number of important factors affecting the Company's business and financial results could cause actual results to differ materially from those stated in the forward-looking statements. Those factors include weather, energy supply and demand, developments in the legislative, regulatory and competitive environment, electric and gas industry restructuring and cost recovery, future market prices for energy, capacity and ancillary services, nuclear industry regulation, the outcome of pending litigation, and certain environmental matters, particularly ongoing development of air quality regulations and hazardous waste remediation requirements.

ITEM 1

Business

Generally

Registrant ("Company") is a gas and electric corporation formed on December 31, 1926, as a consolidation of several operating utilities which had been accumulated under one management during the previous 26 years. The Company generates, purchases and distributes electricity, and purchases and distributes gas. The Company, in the opinion of its general counsel, has, with minor exceptions, valid franchises, unlimited in duration, to serve a territory extending about 85 miles along the Hudson River and about 25 to 40 miles east and west from such River. The southern end of the territory is about 25 miles north of New York City, and the northern end is about 10 miles south of the City of Albany. The territory, comprising approximately 2,600 square miles, has a population estimated at 622,000. Electric service is available throughout the territory, and natural gas service is provided in and about the cities of Poughkeepsie, Beacon, Newburgh and Kingston and in certain outlying and intervening territories. The number of Company employees, at December 31, 1998, was 1,149.

The Company's territory reflects a diversified economy, including manufacturing industries, research firms, farms, governmental agencies, public and private institutions, resorts, and wholesale and retail trade operations.

For information concerning revenues and operating income before taxes and operating profits and information regarding assets for the electric, gas, and other segments, which are currently the significant industry segments of the Company, see Note 10 - "Segments and Related Information" of the Notes to the Financial Statements referred to in Item 8 hereof (each such Note being hereinafter called the "Note").

In 1998, the competitive market place continued to develop for electric utilities and certain electric customers were given the opportunity to purchase energy and related services from sources other than their local utility. These opportunities also exist today for natural gas customers.

See Item 7 hereof under the caption "Competition/ Deregulation" and Note 2 - "Regulatory Matters" hereof for a discussion of the Amended and Restated Settlement Agreement ("Agreement") reached between the Company and the Public Service Commission of the State of New York ("PSC") in the PSC's Competitive Opportunities Proceeding, which Agreement may affect future operations of the Company. See the caption "Holding Company Restructuring" in Note 2 - "Regulatory Matters" hereof for a discussion of the proposed holding company restructuring of the Company.

Rates

Generally: The electric and gas rates of the Company applicable to service supplied to retail customers within the State of New York are regulated by the PSC. Transmission rates and rates for electricity sold for resale in interstate commerce are regulated by the Federal Energy Regulatory Commission ("FERC").

The Company's present full-service retail rate structure consists of various service classifications covering residential, commercial and industrial customers. During 1998, the average price of electricity to such customers was 8.45 cents per kilowatt-hour ("kWh"), representing a 1.2% decrease from the 1997 average price.

Rate Proceedings - Electric and Gas: For information regarding the Company's most recent electric and gas cases filed with the PSC, see Item 7 hereof under the caption "Rate Proceedings."

Cost Adjustment Clauses: For information with respect to the Company's electric and gas cost adjustment clauses, see Note 1 - "Summary of Significant Accounting Policies" hereof under the caption "Rates, Revenues and Cost Adjustment Clauses."

Regulation

Generally: The Company is subject to regulation by the PSC with respect to, among other things, service rendered (including the rates charged), major transmission facility siting, accounting procedures and issuance of securities.

Certain of the Company's activities, including accounting and the acquisition and disposition of certain property, are subject to regulation by the FERC, under the Federal Power Act, by reason of the Company's transmission and sales for resale of electric energy in interstate commerce.

The Company is not subject to the provisions of the Natural Gas Act.

In the opinion of general counsel for the Company, the Company's major hydroelectric facilities are not required to be licensed under the Federal Power Act.

Purchased Electric Power Generation: Pursuant to the provisions of the federal Public Utility Regulatory Policies Act of 1978 ("PURPA"), and the New York Public Service Law ("NYPSL"), the Company is required to enter into long-term contracts to purchase electric power generated by small hydro, alternative energy and cogeneration facilities which meet qualification standards established by such statutes and the regulatory programs promulgated thereunder. With respect to facilities qualified under PURPA, the Company must pay its avoided cost (the cost the Company would otherwise incur to generate the increment of power purchased) for electric power purchased from qualified facilities. As of December 31, 1998, the Company's avoided cost at the 115 kilovolt ("kV") transmission level was approximately 3.0 cents per kWh.

Construction Program and Financing

For estimates of construction expenditures, internal funds available, mandatory and optional redemption of long-term securities, and working capital requirements for the two-year period 1999-2000, see the subcaption "Construction Program" in Item 7 hereof under the caption "Capital Resources and Liquidity."

For a discussion of the Company's capital structure, financing program and short-term borrowing arrangements, see Notes 5, 6 and 7 "Short-term Borrowing Arrangements," "Capitalization - Capital Stock" and "Capitalization - Long-term Debt," respectively, and Item 7 hereof under the subcaptions "Capital Structure," "Financing Program" and "Short-Term Debt" of the caption "Capital Resources and Liquidity."

The Company's Certificate of Incorporation and its various debt instruments do not contain any limitations upon the issuance of authorized, but unissued, preferred stock and common stock or of unsecured short-term debt.

The Company's various debt instruments include limitations as to the amount of additional funded indebtedness which the Company can issue. The Company believes such limitations will not impair its ability to issue any or all of the debt described under the above-referenced subcaption "Financing Program."

Fuel Supply and Cost

The Company's two primary fossil fuel-fired electric generating stations are the Roseton Steam Electric Generating Plant ("Roseton Plant") (described in Item 2 hereof under the subcaptions "Electric - General" and "Electric - Roseton Plant") and the Danskammer Point Steam Electric Generating Station ("Danskammer Plant") (referred to in Item 2 hereof under the subcaption "Electric - General"). Units 1 and 2 of the Roseton Plant are fully equipped to burn both residual oil and natural gas. Units 1 and 2 of the Danskammer Plant, which are equipped to burn residual oil or natural gas, are operated when economical. Units 3 and 4 of the Danskammer Plant, which are operated predominantly, are capable of burning coal, natural gas, or residual oil.

For the 12 months ended December 31, 1998, the sources and related costs of electric generation for the Company were as follows:

Sources of Generation	Aggregate Percentage of Energy Generated	Costs in 1998 ($000)
Purchased Power	22.4%	$ 40,441
Coal	40.1	43,289
Gas	5.5	8,190
Nuclear	10.4	2,984
Oil	19.3	27,892
Hydroelectric	2.3	450
	100.0%	
Fuel Handling Costs		1,729
Deferred Fuel Cost		286
		$125,261

Residual Oil: At December 31, 1998, there were 403,369 barrels of fuel oil in inventory in Company-owned tanks for use in the Danskammer and Roseton Plants, which aggregate amount represents an average daily supply for 20 days. The total oil storage capacity as of December 31, 1998, for these Plants was 16,251 and 1,079,000 barrels, respectively. The Company's share of the Roseton Plant's oil storage capacity is 377,650 barrels.

During 1998, there were no purchases of fuel oil made for the Danskammer Plant.

During 1998, the Roseton Plant's fuel oil requirements were supplied under both firm and spot market contracts. The prices under the firm contract were determined on the basis of published market indices in effect at the time of delivery. The term of the firm contract became effective on September 1, 1996, and continued through its expiration on August 31, 1998. This contract was replaced with the Company making spot market purchases.

Coal: In order to provide for its future requirements for coal to be burned in Units 3 and 4 at the Danskammer Plant, the Company, effective January 1, 1997, entered into two supply contracts for the purchase of an aggregate of 720,000 tons per year of low sulfur (0.7% maximum) coal.

One contract provides for the delivery of coal by water from sources in Venezuela and Colombia, South America. As required by this contract, the base price of purchases under this contract are renegotiated by the parties on an annual basis. The contract, as last renegotiated, now covers the term from January 1, 1998 through December 31, 2001.

The second contract, which provided for the delivery of domestic coal by rail, expired on December 31, 1998. The base price of purchases was fixed for the term of that contract. The Company, effective January 1, 1999 through December 31, 2001, has entered into another supply contract from sources in Venezuela and Colombia and a third contract which provides for the delivery of domestic coal by water or rail. All three contracts can be terminated effective December 31, 2000, with six months' written notice to the supplier. The base price is fixed for 1999 with annual reopeners which provide for rates to be renegotiated by all parties thereafter.

The Company has also entered into a long-term rail contract for the delivery of coal. This contract covers the period January 1, 1997 - December 31, 2001. During the first two years of this contract, rail rates are fixed and thereafter such rates will be negotiated by the parties.

The Company also purchased during 1998 approximately 172,600 tons of its coal supply on the spot market.

Nuclear: For information regarding fuel reloading at Unit No. 2 of the Nine Mile Point Nuclear Station ("Nine Mile 2"), of which the Company owns a 9% interest, see Item 7 hereof under the subcaption "Nuclear Operations" of the caption "Results of Operations."

Environmental Quality

The Company is subject to regulation by federal, state and, to some extent, local authorities with respect to the environmental effects of its operations, including regulations relating to air and water quality, aesthetics, levels of noise, hazardous wastes, toxic substances, protection of vegetation and wildlife and limitations on land use. In connection with such regulation, certain permits are required with respect to the Company's facilities, which permits have been obtained and/or are in the renewal process. Generally, the principal environmental areas and requirements to which the Company is subject are as follows:

Air: State regulations affecting the Company's existing electric generating plants govern the sulfur content of fuel used therein, the emission of particulate matter and certain other pollutants therefrom and the visibility of such emissions. In addition, federal and state ambient air quality standards for sulfur dioxide ("SO_2"), nitrogen oxides ("NO_x") and suspended particulates must be complied with in the area surrounding the Company's generating plants. Based on the operation of its continuous emission stack monitoring systems and its ambient air quality monitoring system in the area surrounding the Roseton and Danskammer Plants, the Company believes that present air quality standards for NO_x, SO_2 and particulates are satisfied in those areas.

However, beginning in 1997 the New York State Department of Environmental Conservation ("NYSDEC"), began an initiative seeking penalties from all New York electric utilities for past opacity variances and requiring various opacity reduction measures and stipulated penalties for future excursions after execution of a consent order. Each New York State electric utility, including the Company, is in the process of negotiating, or has negotiated, the various terms and conditions of a draft consent order with the NYSDEC. The Company's Danskammer Plant and the Roseton Plant are the subject of these negotiations. The outcome of this matter is uncertain at this time; however, the Company believes that the amount of any civil penalty payment and implementation of an opacity reduction program, in the aggregate, will not be material.

The Danskammer Plant burns coal having a maximum sulfur content of 0.7%, fuel oil having a maximum sulfur content of 1% and natural gas. The sulfur content of the oil burned at the Roseton Plant is limited by stipulation with, among others, the NYSDEC, to an amount not exceeding 1.5% maximum and 1.3% weighted annual average. Such sulfur content limitation at the Roseton Plant can be modified by the NYSDEC in the event of technological changes at such Plant, provided that the SO_2 and NO_x emissions are limited to that which would have been generated by the use of oil with a sulfur content of 1.3% on a weighted annual average. Natural gas is also burned at the Roseton Plant.

For more information on the impact of the Clean Air Act Amendments of 1990 ("CAA Amendments") on the Company's efforts to attain and maintain national ambient air quality standards for emissions from its fossil-fueled electric power plants, the proposal of the federal Environmental Protection Agency ("EPA") to modify emission standards for NO_x and suspended particulates, and the proposal of the NYSDEC to modify NO_x standards for generating facilities operating in New York State, see Note 9 - "Commitments and Contingencies," hereof under the caption, "Environmental Matters - Clean Air Act Amendments."

Except as set forth above, the Company is unable to predict the effect (including cost) of these programs on its power plant operations since the details of the CAA Amendments are yet to be completely established by implementing regulations to be issued over a period of years by the EPA and the NYSDEC.

Water: The Company is required to comply with applicable state and federal laws and regulations governing the discharge of pollutants into receiving waters.

The discharge of any pollution into navigable waterways is prohibited except in compliance with a permit issued by the EPA under the National Pollutant Discharge Elimination System ("NPDES") established under the Clean Water Act. Likewise, under the New York Environmental Conservation Law industrial waste cannot be discharged into state waters without a State Pollutant Discharge Elimination System ("SPDES") permit issued by the NYSDEC. Issuance of a SPDES permit satisfies the NPDES permit requirement.

The Company has received SPDES permits for both the Roseton Plant and the Danskammer Plant, its Eltings Corners maintenance and warehouse facility, and its Rifton Recreation and Training Center. The SPDES permits for the Roseton and Danskammer Plants expired on October 1 and November 1, 1992, respectively, and such permit renewal applications are pending before the NYSDEC.

The Roseton Plant application is currently being reviewed in a NYSDEC proceeding. The subject of the restriction on use of water for cooling purposes at that Plant (as referred to in Item 3 hereof under the caption "Environmental Litigation") is being considered in that proceeding.

It is the Company's belief that the expired SPDES permits continue in full force and effect pending issuance of the new SPDES permits.

For further discussion of the Company's compliance with the Clean Water Act and the Company's SPDES permit renewal proceeding, see Note 9 - "Commitments and Contingencies," hereof under the caption "Environmental Matters - Clean Water Act Compliance."

Toxic Substances and Hazardous Wastes: The Company is subject to state and federal laws and regulations relating to the use, handling, storage, treatment, transportation and disposal of industrial, hazardous and toxic wastes.

The NYSDEC, in 1986, added to the New York State Registry of Inactive Hazardous Waste Disposal Sites ("Registry") six locations at which gas manufacturing plants owned or operated by the Company or by predecessors to the Company were once located. Two other sites, which formerly contained gas manufacturing plants, have been identified by the Company. The Company studied these eight sites to determine whether they contain any hazardous wastes which could pose a threat to the environment or public health and, if such wastes were located at such sites, to determine the remedial actions which may be appropriate.

All of these eight sites were studied using the Phase I guidelines of the NYSDEC and five such sites were studied using the more extensive Phase II guidelines of the NYSDEC. As a result of these studies, the Company concluded that no remedial actions were required at any of these sites. In 1991, the NYSDEC advised the Company that four of the six sites had been deleted from such Registry. In 1992, the NYSDEC advised the Company that the two remaining sites listed on the Registry had been deleted from the Registry. The NYSDEC also indicated that such deletions of the sites were subject to reconsideration in the future, at which time new analytical tests may be required to determine whether or not wastes on site are hazardous. If, as a result of such potential new analytical tests, or otherwise, remedial actions were ultimately required at these sites by the NYSDEC, the cost thereof could have a material adverse effect (the extent of which cannot be reasonably estimated) on the financial condition of the Company if the Company could not recover all, or a substantial portion thereof, through insurance and rates.

For a discussion of litigation filed by the City of Newburgh, New York against the Company involving one of the Company's eight former manufactured gas sites and a recent ruling related thereto, see Note 9 - "Commitments and Contingencies," hereof under the subcaption "Environmental Matters - Former Manufactured Gas Plant Facilities."

In August 1992, the NYSDEC notified the Company that the NYSDEC suspected that the Company's offices at Little Britain Road in New Windsor, New York, may constitute an inactive hazardous waste disposal site. As a result of the NYSDEC's review of a site assessment report prepared by the Company's consultant submitted to the NYSDEC in 1996, the Company agreed to perform additional testing, which testing detected a limited amount of subsurface soil contamination near one corner of the site and contaminants in the ground water beneath the site. Operations conducted on the site by the Company since it purchased the property in 1978 are not believed to have contributed to either the soil or the ground water contamination. The Company and the NYSDEC have reached an agreement in principle that the Company will conduct a voluntary clean-up of the site in terms to be further negotiated between the parties. The Company can make no (i) prediction regarding what action the NYSDEC may take with regard to the reports, or (ii) prediction as to the outcome of recovery attempts against third parties by the Company. However, the Company believes that the cost of such site assessment and remediation, if any, will not be material.

Other: The Company's expenditures attributable, in whole or in substantial part, to environmental considerations totaled $8.7 million in 1998, of which approximately $.5 million related to capital projects and $8.2 million were charged to expense. It is estimated that in 1999 the total of such expenditures will be approximately $9.5 million. The Company is not involved as a defendant in any court litigation with respect to environmental matters and, to the best of its knowledge, no litigation against it is threatened with respect thereto, except with respect to the litigation described in Item 3 "Legal Proceedings" hereof under the subcaption "Environmental Litigation - Newburgh Manufactured Gas Site," and as described in Note 9 - "Commitments and Contingencies," hereof under the subcaption "Environmental Matters - Former Manufactured Gas Plant Facilities."

Other Matters

Labor Relations: The Company has agreements with the International Brotherhood of Electrical Workers ("IBEW") for its 801 unionized employees, representing production and maintenance employees, customer representatives, service workers and clerical employees (excluding persons in managerial, professional or supervisory positions), which agreements were renegotiated effective July 1, 1998. An agreement with Locals 2218 and 320 Non-Production Plant Workers continues through April 30, 2003, and an agreement with IBEW Local 320 Production Plant Workers expires on August 31, 2003. The agreements provide for an average annual general wage increase of 3.0% and certain additional fringe benefits.

Affiliates:

CH Energy Group, Inc.: CH Energy Group, Inc. is a wholly-owned subsidiary of the Company formed in April 1998. Effective upon a one-for-one share exchange expected to occur during the first half of 1999, a holding company restructuring will be effected so that CH Energy Group, Inc. will become the holding company parent corporation of the Company and its then wholly-owned subsidiaries (with the exception of Phoenix Development Company, Inc.) identified below. For further information regarding the holding company restructuring, see Item 7 hereof under the captions "Competition/Deregulation - Competitive Opportunities Proceeding Settlement Agreement" and Note 2 - "Regulatory Matters" hereof under the captions "Competitive Opportunities Proceeding Settlement Agreement" and "Holding Company Restructuring."

Central Hudson Enterprises Corporation: Central Hudson Enterprises Corporation ("CHEC") is engaged in the business of marketing electric, gas and oil related services to retail and wholesale customers; conducting energy audits; providing services including, but not limited to, the design, financing, installation and maintenance of energy conservation measures and generation systems for private businesses, institutional organizations and governmental entities; and participating in cogeneration, small hydro, alternative fuel and energy production projects and services. During 1998, CHEC formed Scasco, Inc. ("SCASCO"), a Connecticut corporation, as CHEC's wholly owned subsidiary. In August 1998, SCASCO purchased the assets of a fuel oil business located in Connecticut, for the purpose of expanding the customer base of CHEC and SCASCO and providing additional energy-based services. This expansion continued during February 1999, when SCASCO purchased Island Sound Commercial Energy Sales, Inc., a business which holds contracts to sell natural gas to customers in Connecticut and Rhode Island, to be SCASCO's wholly owned subsidiary.

CH Resources, Inc.: CH Resources, Inc. is a wholly-owned subsidiary of the Company established to hold real property for generating electricity and for other uses of the Company, directly or indirectly through one or more of its affiliates. In December 1998, CH Resources acquired an 80 megawatt ("MW") combined cycle gas turbine facility in Solvay, New York and in December 1998, it acquired an 80 MW combined cycle gas turbine facility in Beaver Falls, New York.

CH Syracuse Properties, Inc.: In December 1998, CH Resources, Inc. established CH Syracuse Properties, Inc., a wholly-owned subsidiary of CH Resources, Inc., to lease real property.

Phoenix Development Company, Inc., and Greene Point Development Corporation: These corporations, are wholly-owned subsidiaries of the Company, established to hold or lease real property for the future use of the Company, or to participate in energy-related ventures. Currently, the assets held by these subsidiaries are not material.

Executive Officers of the Company

The names of the current officers of the Board of Directors and the executive officers of the Company, their positions held and business experience during the past five (5) years and ages (at December 31, 1998) are as follows:

Officers of the Board	
Name of Officer, Age and Position Held	Principal Occupation or Employment and Positions and Offices with the Company during the past five (5) years
John E. Mack, III, 64, Chairman of the Board; Chairman of the Executive, Retirement and Finance Committees	Present positions, except Chairman of the Board since August 1, 1998; Chairman of the Board and Chief Executive Officer,December 1993-July 31, 1998; Chairman of the Committee on Finance, April 1996
Jack Effron, 65, Chairman of Committee on Compensation and Succession	Present position since April 1994; President of EFCO Products, a bakery ingredients corporation; member of the St. Francis Health Care Foundation; Chairman of the Chief Executive's Network for Manufacturing of the Council of Industry of Southeastern New York
Heinz K. Fridrich, 65, Chairman of the Committee on Audit	Present position since April 1995; Courtesy Professor, University of Florida at Gainsville since 1994; Board of Trustees, Mount St. Mary College
Executive Officers of the Company	
Paul J. Ganci, 60, President and Chief Executive Officer	Present position since August 1, 1998; President and Chief Operating Officer, December 1993-July 31, 1998
Carl E. Meyer, 51, Executive Vice President - Operations	Present position since April 1998; Senior Vice President - Customer Services, April 1996-April 1998; Vice President - Customer Services, December 1993-April 1996
Allan R. Page, 51, Executive Vice President - Energy Resources & Development	Present position since April 1998; Senior Vice President - Corporate Services, April 1996-April 1998; Vice President - Corporate Services, December 1993-April 1996
Ronald P. Brand, 60, Senior Vice President - Engineering, Environmental Affairs & Special Projects	Present position since November 1998; Vice President - Engineering and Environmental Affairs, December 1993-November 1998
Joseph J. DeVirgilio, Jr., 47, Senior Vice President - Corporate Services and Administration	Present position since November 1998; Vice President - Human Resources and Administration, December 1993-November 1998
Arthur R. Upright, 55, Senior Vice President - Regulatory Affairs, Financial Planning and Accounting	Present position since November 1998; Assistant Vice President - Cost & Rate and Financial Planning, February 1994-November 1998; Manager, Cost & Rate and Financial Planning, December 1993-February1994
James P. Lovette, 49, Vice President - Fossil Production	Present position since November 1998; Assistant Vice President - Fossil Production, October 1997-November 1998; Plant Superintendent, December 1993-November 1997

Executive Officers of the Company *continued*	
Name of Officer, Age and Position Held	Principal Occupation or Employment and Positions and Offices with the Company during the past five (5) years
Steven V. Lant, 41, Chief Financial Officer, Treasurer and Corporate Secretary	Present position since November 1998; Treasurer and Assistant Corporate Secretary, December 1993-November 1998
Donna S. Doyle, 50, Controller	Present position since April 1995; Assistant Controller, April 1994-April 1995; Manager of Taxes Budgets & Customer Acctg., December 1993-April 1995
Gladys L. Cooper, 47, Assistant Vice President Governmental Relations	Present position since September 1995; leave of absence for educational purposes, December 1993-September 1995; Corporate Secretary, December 1993-April 1994
John C. Checklick, 50, Assistant Vice President - Customer Services	Present position since November 1998; Manager of Customer Services, December 1993-November1998

There are no family relationships existing among any of the executive officers of the Company. Each of the above executive officers is elected or appointed annually by the Board of Directors.

ITEM 2

Properties

Electric

General: The net capability of the Company's electric generating plants as of December 31, 1998, the net output of each plant for the year ended December 31, 1998, and the year each plant was placed in service or rehabilitated are as set forth below:

Electric Generating Plant	Type of Fuel	Year Placed In Service	(MW) *Net Capability (97-98) Summer	Winter	1998 Unit Net Output (MWh)
Danskammer Plant **	Residual Oil, Natural Gas and Coal	1951-1967	492	502	2,721,238
Roseton Plant (35% share)**	Residual Oil and Natural Gas	1974	425	404	1,320,329
Neversink Hydro Station	Water	1953	23	22	64,232
Dashville Hydro Station	Water	1920	5	5	13,995
Sturgeon Pool Hydro Station	Water	1924	16	16	58,229
High Falls Hydro Station	Water	1986	3	4	7,701
Coxsackie Gas Turbine ("GT")	Kerosene or Natural Gas	1969	19	24	2,554
So. Cairo GT	Kerosene	1970	19	21	1,532
Nine Mile 2 Plant (9% share)	Nuclear	1988	103	104	653,322
		Total	1,105	1,102	4,843,132

* *Reflects maximum one-hour net capability of the Company's ownership of generation resources and, therefore, does not include firm purchases or sales.*

** *Plants subject to auction based on the Agreement as described in Item 7 hereof under the caption "Competition/Deregulation - Competitive Opportunities Proceeding Settlement Agreement" and in Note 2 - "Regulatory Matters" hereof under the caption "Competitive Opportunities Proceeding Settlement Agreement."*

The Company has a contract with the Power Authority of the State of New York ("PASNY") which entitles the Company to 49 MW net capability from the Blenheim-Gilboa Pumped Storage Hydroelectric Plant through 2002.

See Item 1 hereof, under the caption "Regulation" and the subcaption "Purchased Electric Power Generation," with respect to alternative electric power generation interconnected with the Company's system.

The Company owns 83 substations having an aggregate transformer capacity of 4.5 million kVa. The transmission system consists of 588 pole miles of line and the distribution system of 7,277 pole miles of overhead lines and 860 trench miles of underground lines.

Load and Capacity: The Company's maximum one-hour demand within its own territory, for the year ended December 31, 1998, occurred on July 22, 1998, and amounted to 900 MW. The Company's maximum one-hour demand within its own territory, for that part of the 1998-1999 winter capability period through February 18, 1999, occurred on January 14,1999 and amounted to 825 MW.

Based on current projections of peak one-hour demands for the 1999 summer capability period, the Company estimates that it will have capacity available to satisfy its projected peak demands plus the estimated installed reserve generating capacity requirements which it is required to maintain as a member of the New York Power Pool ("NYPP"), described herein.

The Company plans to divest its Roseton and Danskammer Plants under the terms of the Agreement. This divestiture is likely to occur between late 1999 and mid-2001.

For further information regarding the Agreement, see Item 7 hereof under the caption "Competition/Deregulation" and Note 2 - "Regulatory Matters" hereof. Following such divestiture, the Company will no longer own sufficient capacity to serve the peak demands of its transmission and distribution customers and may need to rely on purchased capacity from third party providers to meet such demands not satisfied.

See the caption "New York Power Pool/Independent System Operator," of this Item for further information regarding the termination of the NYPP and the formation of the Independent System Operator ("ISO") to coordinate reliability and transmission of New York State's bulk power systems.

The following table sets forth the amounts of any excess capacity by summer and winter capability periods for 1999 and 2000:

Capability Period	Forcasted Peak Total Delivery Rqts. (MW) (1)	Forcasted Peak Full Service Rqts. Only (2)	Peak Plus Installed Reserve of 18% (MW)(3)	Available Capacity (MW)	Excess of Capacity over Peak Plus NYPP Installed Reserve Requirements (MW) (3)	Percent (3)
1999 Summer	910	860	1,015	1,149	134	13.2
1999-2000 Winter	845	800	1,015*	1,169	134	15.2

* *Summer period peak plus reserve requirements carry over to the following winter period.*

(1) *Total delivery requirements include requirements for both full service (delivery and energy) and retail access (delivery only) customers*
(2) *Excludes retail access customer requirements*
(3) *Based on full service requirements*

Roseton Plant: The Roseton Plant is located in the Company's franchise area at Roseton, New York, and is owned by the Company, Consolidated Edison Company of New York, Inc. ("Con Edison") and Niagara Mohawk Power Corporation ("Niagara Mohawk") as tenants-in-common. The Roseton Plant, placed in commercial operation in 1974, has a generating capacity of 1,200 MW consisting of two 600 MW generating units, both of which are capable of being fired either by residual oil or natural gas (see subcaption below entitled "Gas - Sufficiency of Supply and Future Gas Supply"). The Company is acting as agent for the owners with respect to operation of the Roseton Plant. Generally, the owners share the costs and expenses of the operation of such Plant in accordance with their respective ownership interests.

The Company, under a 1968 agreement, has the option to purchase the interests of Niagara Mohawk (25%) and of Con Edison (40%) in the Roseton Plant in December 2004. The exercise of this option is subject to PSC approval. However, by agreement dated March 30, 1994, between the Company and Niagara Mohawk, Niagara Mohawk was given, among other things, an option to retain its 25% interest in the Roseton Plant, provided that Niagara Mohawk exercises such option by May 31, 1999.

As part of Niagara Mohawk's restructuring plan, the PSC, in May 1998, authorized Niagara Mohawk to divest its fossil-fueled and hydroelectric generating assets by auction by mid-1999, except that the auction of Niagara Mohawk's interest in the Roseton Plant was permitted by the PSC to be delayed to be coordinated with the Company's auction of that Plant. Con Edison has agreed to divest and transfer certain of its electric generating assets (including its interest in the Roseton Plant) to unregulated entities, including third parties and Con Edison affiliates, by the end of 2002. The Company, Niagara Mohawk and Con Edison adopted Principles of Agreement on October 7, 1998, concluding that a joint auction of the Roseton Plant will maximize proceeds from the sale, and that the cotenants intend to enter into an agreement whereby the Company will conduct the auction sale on behalf of the cotenants in coordination with the auction of the Company's adjacent Danskammer Plant, which Agreement was accepted by the PSC by order issued and effective December 18, 1998. For additional information with respect to the Company's obligation to divest itself of its interest in the Roseton and Danskammer Plants, see Item 7 hereof under the caption "Competition/Deregulation - Competitive Opportunities Proceeding Settlement Agreement" and Note 2 - "Regulatory Matters," under the caption "Competitive Opportunities Settlement Agreement."

The 345 kV transmission lines and related facilities to connect the Roseton Plant with other points in the system of the Company and with the systems of Con Edison and Niagara Mohawk to the north and west of such Plant are 100%-owned by the Company. The share of each of the parties in the output of the Roseton Plant is transmitted over these lines pursuant to a certain transmission agreement relating to such Plant, which provides, among other things, for compensation to the Company for such use by the other parties. In addition, the Company has contract rights which entitle the Company to the lesser of 300 MW, or one quarter of the capacity in a 345 kV transmission line owned by PASNY, which connects the Roseton Plant with a Con Edison substation to the east of such Plant in East Fishkill, New York. In exchange for these rights, the Company agreed to provide PASNY capacity in the 345 kV transmission lines the Company owns from the Roseton Plant, to the extent it can do so after satisfying its obligations to Con Edison and Niagara Mohawk.

Nine Mile 2 Plant: For a discussion of the Company's ownership interest in, costs for, and certain operating matters relating to the Nine Mile 2 Plant, see Item 7 hereof under the subcaption "Nuclear Operations," Note 3 - "Nine Mile 2 Plant," and Note 1 - "Summary of Significant Accounting Policies," under the subcaption "Jointly-Owned Facilities."

New York Power Pool/Independent System Operator

The Company is a member of the NYPP consisting of the major investor-owned electric utility companies in the State, Long Island Lighting Company ("LILCO"), a subsidiary of the Long Island Power Authority ("LIPA"), and PASNY. The members of the NYPP, by agreement, provide for coordinated operation of their bulk power electric systems with the objectives of using the most economical source of electricity, for the maintenance of a reserve margin equal to at least 18% of each member's forecasted peak load and for the sale and interchange of electric generating capability and energy among such members. The members of the NYPP also provide for the cooperative development of long-range plans for the expansion on an integrated basis of the bulk power supply system for New York State, compatible with environmental standards, and appropriately related to interstate and international capacity and reliability considerations.

As part of the ongoing discussions regarding the restructuring of the electric industry in New York State referred to in Item 7 hereof under the caption "Competition/Deregulation," proposals have been made to terminate the NYPP and establish the following: In a filing with FERC, dated January 31, 1997, the member systems of the NYPP proposed a new market structure that included as its key elements the establishment of an ISO, the New York State Reliability Council ("NYSRC"), and the New York Power Exchange ("NYPE"). The ISO, NYSRC and NYPE will collectively replace the NYPP.

By order dated June 30, 1998, FERC conditionally authorized the establishment of the ISO and, by order dated January 27, 1999, FERC conditionally accepted, with modifications, the proposed ISO tariff and the proposed market rules of the ISO and granted the request for market-based rates. The January 27, 1999, order calls for public hearings on certain aspects of the proposed rates and provides for settlement judge proceedings. Future filings with FERC will be required to obtain FERC approval of the transfer of control of all necessary facilities to the ISO; any such transfer would not involve the transfer of ownership of such assets.

The ISO's principal mission will be to maintain the reliability of the New York State bulk power systems and to provide transmission service on a comparable and non-discriminatory basis. The ISO will be open to buyers, sellers, consumers, and transmission providers; each of these groups would be represented on the Board of Directors of the ISO, which is proposed to be a not-for-profit New York corporation. The NYSRC's mission will be to promote and preserve the reliability of the bulk power system within New York State, through its primary responsibility for the promulgation of reliability rules; the ISO will develop the procedures necessary to operate the system within these reliability rules. The NYSRC is to be governed by a committee comprised of transmission providers and representatives of buyers, sellers, and consumer and environmental groups. The NYPE will provide a vehicle through which buyers and sellers can participate in the markets for energy, capacity and ancillary services. For more information on the ISO, see caption "Independent System Operator" in Note 2 - "Regulatory Matters" hereof.

Gas

General: The Company's gas system consists of 161 miles of transmission pipelines and 986 miles of distribution pipelines.

During 1998, natural gas was available to firm gas customers at a price competitive with that of alternative fuels. As compared to 1997, in 1998, firm retail gas sales, normalized for weather, decreased by 1% and the average number of firm gas customers increased by 1% or 633. Sales to interruptible customers decreased 22% in 1998 as compared to 1997. As compared to 1997, in 1998, firm retail transportation sales, normalized for weather, increased by 983% due to the average number of customers using firm retail transportation service increasing to 31 customers. In total, as compared with 1997 normalized, firm gas sendout increased by 1% in 1998.

For further information regarding the Company's incentive arrangements for interruptible gas sales, see Item 7 hereof under the subcaption "Interruptible Gas Sales."

For the year ended December 31, 1998, the total amount of gas purchased from all sources was 16,962,360 million cubic feet ("Mcf."), which includes 369,067 Mcf. purchased directly for use as a boiler fuel at the Roseton Plant.

The Company also owns two propane-air mixing facilities for emergency and peak shaving purposes located in Poughkeepsie and in Newburgh, New York. Each facility is capable of supplying 8,000 Mcf. per day with propane storage capability adequate to provide maximum facility sendout for up to three consecutive days.

Sufficiency of Supply and Future Gas Supply: The peak daily demand for natural gas by the Company's customers for the year ended December 31, 1998, occurred on December 30, 1998, and amounted to 91,070 Mcf. The Company's peak-day gas capability in 1998 was 116,865 Mcf. The peak daily demand for natural gas by the Company's customers for that part of the 1998-1999 heating season through February 18, 1999, occurred on January 14, 1999, and amounted to 109,676 Mcf.

Other: FERC permits non-discriminatory access to the pipeline facilities of interstate gas pipeline transmission companies subject to the jurisdiction of FERC under the Natural Gas Act. This rule allows access to such pipelines by the pipeline transmission company's customers enabling them to transport gas purchased directly from third parties and spot sources through such pipelines. Such access also permits industrial customers of gas distribution utilities to connect directly with the pipeline transmission company and to contract directly with the pipeline transmission companies to transport gas, thereby by-passing the distribution utility. None of the Company's customers have elected this by-pass option.

The PSC has authorized New York State distribution gas utilities to transport customer-owned gas through their facilities upon request of a customer. Currently, interstate pipeline transmission companies are located in certain areas where the Company provides retail gas service (the Towns of Carmel, Pleasant Valley, Coxsackie, and LaGrange in New York State).

For a discussion of the PSC proceeding relating to issues associated with the restructuring of the natural gas market, see Item 7 hereof under the subcaption "Natural Gas - PSC Restructuring Policy Statement" of the caption "Competition/ Deregulation."

Other Matters

The Danskammer Plant and the Roseton Plant and all of the other principal generating plants and important property units of the Company are held by it in fee simple, except (1) certain rights-of-way, and (2) a portion of the property used in connection with the hydroelectric plants of the Company consisting of flowage or other riparian rights. The Company's present interests in the Roseton Plant and the Nine Mile 2 Plant are owned as undivided interests as a tenant-in-common with the other utility owners thereof. Certain of the properties of the Company are subject to rights-of-way and easements which do not interfere with the Company's operations. In the case of certain distribution lines, the Company owns only a part interest in the poles upon which its wires are installed, the remaining interest being owned by telephone companies. Certain electric transmission facilities owned by others are used by the Company pursuant to long-term contractual arrangements.

All of the physical properties of the Company, other than property such as material and supplies excluded in the Company's First Mortgage Bond Indenture ("Mortgage") and its franchises, are subject to the lien of the Mortgage under which all of its Mortgage Bonds are outstanding. Such properties are from time to time subject to liens for current taxes and assessments which the Company pays regularly as and when due.

During the three-year period ended December 31, 1998, the Company made gross property additions of $139.4 million and property retirements and adjustments of $32.5 million, resulting in a net increase (including Construction Work in Progress) in utility plant of $106.9 million, or 7.4%.

ITEM 3

Legal Proceedings

Asbestos Litigation: For a discussion of litigation against the Company involving asbestos, see Note 9 - "Commitments and Contingencies," hereof under the caption "Asbestos Litigation."

Environmental Litigation: Roseton Plant: On March 23, 1992, in an action brought in 1991 by the Natural Resources Defense Council, Inc., the Hudson River Fisherman's Association and Scenic Hudson, Inc., a Consent Order was approved by the Supreme Court of the State of New York, Albany County.

Such Consent Order provides for certain operating restrictions at the Roseton Plant relating to the use of river water for plant cooling purposes, which restrictions have not, and are not expected to impose material additional costs on the Company. The Consent Order was extended until February 1, 1998, by agreement of the parties and Court approval. The Consent Order has since lapsed; however, both parties continue to consider themselves bound by its terms. For a description of the pending NYSDEC proceeding involving the renewal of the SPDES permit for the Roseton Plant, see Item 1 hereof under the subcaption "Environmental Quality - Water," and Note 9 - "Commitments and Contingencies," under the caption "Environmental Matters - Clean Water Act Compliance." For a description of the Company's negotiations with the NYSDEC on a Consent Order for alleged opacity violations, see Item 1 hereof under the subcaption "Environmental Quality - Air."

Newburgh Manufactured Gas Site: For a discussion of litigation filed against the Company by the City of Newburgh, New York, on May 26, 1995, in the United States District Court, Southern District of New York, and the Company's response thereto, see Note 9 - "Commitments and Contingencies," under the subcaption "Environmental Matters - Former Manufactured Gas Plant Facilities."

Catskill Incident: An explosion occurred in a dwelling in the Company's gas service territory in Catskill, New York in November 1992 which resulted in personal injuries, the death of an occupant and property damage. Lawsuits have been commenced against the Company arising out of such incident, including the following which could be material to the Company:

By complaint, dated February 2, 1994, Carl Fatzinger, as executor of the estate of Mildred Fatzinger, and Virginia Fatzinger commenced an action in the Supreme Court of the State of New York, Greene County, against the Company and two other defendants. The complaint sought an unspecified amount of compensatory and punitive damages based on theories of negligence, absolute liability and gross negligence for the death of Mildred Fatzinger, personal injuries to Virginia Fatzinger and property damage alleged to have been caused by said explosion.

By complaint, dated October 18, 1993, and filed in the Supreme Court of the State of New York, Greene County, Frank Reyes commenced an action against the Company for unspecified personal injuries and property damage alleged to have been caused by said explosion. The complaint seeks $2 million in compensatory damages and $2 million in punitive damages from the Company, based on theories of negligence and gross negligence.

The Fatzinger lawsuit was settled by the Company in January 1999 in an amount that is not material to the Company. With regard to the Reyes litigation, the Company believes that it has adequate insurance with regard to the claims for compensatory damages. The Company's insurance, however, does not extend to punitive damages. If punitive damages were ultimately awarded in the Reyes lawsuit, such award could have a material adverse effect on the financial condition of the Company. At this time, the Company can make no prediction as to any other litigation which may arise out of this incident.

Wappingers Falls Incident: Two consecutive fires and explosions occurred on February 12, 1994, destroying a residence and commercial establishment in the Village of Wappingers Falls, New York, in the Company's service territory. Lawsuits have been commenced against the Company arising out of such incident, including the following:

On August 31, 1994, the Company was served with a summons and complaint in an action brought by John DeLorenzo against the Company and the Village of Wappingers Falls in the Supreme Court of the State of New York, County of Dutchess. The complaint seeks unspecified amounts of damages, based on a theory of negligence, for personal injuries and property damage alleged to have been caused by the incident.

On March 9, 1995, the Company was served with a summons and complaint in an action brought by Cengiz Ceng, individually and as executor under the last will and testament of Nizamettin Ceng, and Tarkan Thomas Ceng against the Company and the Village of Wappingers Falls in the Supreme Court of the State of New York, County of Dutchess. The complaint seeks recovery of $250,000 from the Company, based on the theory of negligence, for property damages alleged to have been caused by the incident.

The above lawsuits have been consolidated into one action against the Company; however, no trial date has been set.

The Company continues to investigate these claims and presently has insufficient information on which to predict their outcome. The Company believes that it has adequate insurance with regard to the claims for compensatory damages; however, the Company's insurance does not extend to punitive damages. If punitive damages were ultimately awarded, in any of these lawsuits, such award(s) could have a material adverse effect on the financial condition of the Company. At this time, the Company can make no prediction as to any other litigation which may arise out of this incident.

ITEM 4

Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter of the Company's fiscal year covered by this Report.

Part II

ITEM 5

Market For The Company's Common Equity and Related Stockholder Matters

For information regarding the market for the Company's common stock and related stockholder matters, see Item 7 hereof under the captions "Capital Resources & Liquidity - Financing Program" and "Common Stock Dividends and Price Ranges" and Note 6 - "Capitalization - Capital Stock."

Pursuant to applicable statutes and its Certificate of Incorporation, the Company may pay dividends on shares of Preferred and Common Stock only out of surplus.

For information on the Company's program to repurchase some of its issued and outstanding common stock pursuant to a program approved by the PSC, see Item 7 hereof under the subcaption "Financing Program."

ITEM 6

Selected Financial Data

*Five-Year Summary of Consolidated Operations and Selected Financial Data**
(In Thousands)

	1998	1997	1996	1995	1994
Operating Revenues					
Electric	$ 418,507	$ 416,429	$ 418,761	$ 409,445	$ 411,082
Gas	84,962	103,848	95,210	102,770	104,586
Total	503,469	520,277	513,971	512,215	515,668
Operating Expenses					
Operations	266,472	284,714	267,779	274,665	274,497
Maintenance	26,904	27,574	28,938	29,440	32,716
Depreciation and amortization	45,560	43,864	42,580	41,467	40,380
Taxes, other than income tax	63,458	64,879	66,145	66,709	66,899
Federal income tax	29,775	29,190	32,700	29,040	28,043
Total	432,169	450,221	438,142	441,321	442,535
Operating Income	71,300	70,056	75,829	70,894	73,133
Other Income					
Allowance for equity funds used during construction	585	387	466	986	866
Federal income tax	1,148	2,953	1,632	353	1,237
Other - net	6,865	8,079	4,815	8,886	6,296
Total	8,598	11,419	6,913	10,225	8,399
Income before Interest Charges	79,898	81,475	82,742	81,119	81,532
Interest Charges	27,354	26,389	26,660	28,397	30,603
Net Income	52,544	55,086	56,082	52,722	50,929
Premium on Preferred Stock Redemption-Net	-	-	378	169	-
Dividends Declared on Cumulative Preferred Stock	3,230	3,230	3,230	4,903	5,127
Income Available for Common Stock	49,314	51,856	52,474	47,650	45,802
Dividends Declared on Common Stock	36,567	37,137	37,128	36,459	35,541
Amount Retained in the Business	12,747	14,719	15,346	11,191	10,261
Retained Earnings - beginning of year	120,540	105,821	90,475	79,284	69,023
Retained Earnings - end of year	$ 133,287	$ 120,540	$ 105,821	$ 90,475	$ 79,284
Common Stock					
Average shares outstanding (000s)	17,034	17,435	17,549	17,380	17,102
Earnings per share on average shares outstanding	$2.90	$2.97	$2.99	$2.74	$2.68
Dividends declared per share	$2.155	$2.135	$2.115	$2.095	$2.075
Book value per share (at year-end)	$28.00	$27.61	$26.87	$25.96	$25.34
Total Assets	$1,316,038	$1,252,090	$1,249,106	$1,250,092	$1,250,781
Long-term Debt	356,918	361,829	362,040	389,245	389,364
Cumulative Preferred Stock	56,030	56,030	56,030	69,030	81,030
Common Equity	472,180	477,104	471,709	454,239	436,731

* *This summary should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in Item 8 of this Form 10-K Report.*

ITEM 7

Management's Discussion And Analysis Of Financial Condition And Results Of Operations

COMPETITION/DEREGULATION

General

The Company remains subject to regulation for retail rates by the PSC and wholesale rates by the FERC. However, as a result of competition/deregulation initiatives and policy changes instituted by these agencies, the Company is experiencing increased electric and gas competition.

Competitive Opportunities Proceeding Settlement Agreement

For a discussion of the Company's Agreement, approved by the PSC in its Competitive Opportunities Proceeding, and a discussion of the impact of the Agreement on the Company's Accounting Policies, see the caption "Competitive Opportunities Proceeding Settlement Agreement" in Note 2 "Regulatory Matters" hereof.

Formation of Holding Company

For information with respect to the Company's proposed holding company restructuring see the caption "Holding Company Restructuring" in Note 2 - "Regulatory Matters" hereof.

FERC - Electric

On April 24, 1996, the FERC released Order Nos. 888 and 889, promoting wholesale competition between public utilities by providing open access, non-discriminatory transmission services. The Orders have the effect of (i) requiring electric utilities to open their transmission lines to wholesale competitors, while allowing recovery of certain "stranded costs," (ii) requiring electric utilities to establish electronic systems to share information about available transmission capacity, subject to certain standards of conduct, and (iii) requiring certain functional separation of power marketing from other operations. The Company duly filed its open access transmission tariff ("OATT") with FERC, as required by Order No. 888, which tariff has been approved by FERC. Under the OATT, the Company must offer transmission service to wholesale customers on a basis that is comparable to that which it provides itself. The Company is also required to offer and/or provide certain ancillary services which contribute to the reliability and security of the transmission system. For information with respect to filings with the FERC to terminate the NYPP and establish an ISO, see the caption "Independent System Operator" in Note 2 - "Regulatory Matters" hereof.

Natural Gas-PSC Restructuring Policy Statement

On November 3, 1998, the PSC, by Order, issued its "Policy Statement Concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment" which sets forth the PSC's view of how best to ensure a competitive market for natural gas in New York State. That Order requires local distribution companies ("LDCs") to cease assigning capacity to migrating customers no later than April 1, 1999, and indicates LDCs will be provided a reasonable opportunity to recover strandable capacity costs. LDCs will also be required to develop individual plans to effectuate the changes required by the PSC. Each LDC must address gas supply and stranded cost strategies, rates, and customer education. In such Order, the PSC also identified several generic issues related to the gas industry which must be addressed. The PSC has indicated a desire to address these issues through collaborative sessions on a state-wide basis.

THE YEAR 2000 ISSUE

Overview

Over the last several decades, certain computer systems and programs were designed to identify the year with two digits. Such systems may read dates in the year 2000 and thereafter as if those dates represent the year 1900 or thereafter. As a result, errors may occur if computers cannot distinguish between 1900 and 2000. All mainframe and personal computers, and related system, application code and process control systems using embedded chip technology have a potential for being adversely affected by the use of two digit definitions for the identification of the year component of date information. These include corporate business applications, facilities maintenance and operation systems, energy generation, control and distribution processes, customer service and support activities and the equipment related to the support of these activities. If such adverse effects are not successfully remediated before December 31, 1999, interruption to electric and/or natural gas service could occur, with attendant lost revenues and adverse customer relations impacts.

At the Company, the Year 2000 problem project ("Project") is a high priority undertaking, encompassing all aspects of the Company's operations. The Project focuses on mission critical systems affecting delivery of service to the Company's customers and business critical applications necessary for the operational and financial stability of the Company. The Project is currently on schedule with implementation projected to be completed by June 1999. A Project Committee comprised of Company officers reports directly to the Chief Executive Officer on a monthly basis on the status of its efforts to assess and remediate any of the Company's Year 2000 problems.

The Company is actively engaged in the coordination and remediation of Year 2000 problems potentially affecting interconnection affiliations, electric transmission grid impact planning, service reliability and emergency and operational requirements with the North American Electric Reliability Council ("NERC") and NYPP. The Company has combined with domestic and international electric utilities in developing and sharing information through the Electric Power Research Institute ("EPRI") data base addressing Year 2000 problem assessment, testing and remediation of digital and embedded systems. Under the NERC guidelines, the Company's remediation is scheduled for completion by July 1999. The PSC has accepted the NERC guidelines and schedule. The Company has joined in similar initiatives to facilitate Year 2000 problem solving among electric and gas utilities under the auspices of the Edison Electric Institute ("EEI") and American Gas Association ("AGA"), respectively.

The Company has not experienced any significant Year 2000 problems to date nor does it anticipate problems which may impact the Company's ability to provide uninterrupted service to its customers. However, given the complexity of Year 2000 problems and the Company's technology sensitive industry, even the most comprehensive and intensive program cannot guarantee that an unforeseen problem will not occur. Therefore, all Company operational emergency, disaster recovery and contingency plans currently in place are being reviewed against potential Year 2000 problem impacts. A Year 2000 problem contingency plan to deal with any unanticipated problems which may occur will be in place by the summer of 1999 and will address the reasonably likely worst-case scenarios. This contingency plan will identify supplemental staffing required to manually operate critical systems and intervene to resolve unanticipated problems. The Company also plans for an independent, external review and assessment of all Project activities in the second quarter of 1999.

Scope & Status

The Project began in 1995 to determine the potential for the Year 2000 problem to interrupt the Company's ability to provide reliable electric and gas services to its customers. The Project Committee was established to address the issues and established Year 2000 problem Project teams for each of the Company's operating areas to address the following key components:

1. Computer hardware and software operating systems and infrastructure;
2. Information applications, including customer service, financial and human resource systems;
3. Telecommunication systems;
4. Digital systems and devices with embedded processors such as power instrumentation, controls and metering; and
5. Major suppliers.

The part of the Project dealing with the inventory and assessment of all known Company mission critical and business critical systems has been completed. These items are those believed by the Company to affect the delivery of service to the customer, the integrity of the environment, the financial and operational infrastructure of the Company and the safety of individuals.

The part of the Project dealing with the remediation, testing and implementation of required modifications to Company assets to eliminate Year 2000 problems and achieve Year 2000 compliant status is on, or ahead of, schedule. The design, development and testing of Company contingency planning is following the guidelines for content and completeness as issued by the NERC.

The process of identifying and prioritizing critical suppliers, has been completed with evaluation of supplier status currently in progress. To identify the Company's critical suppliers the Company's materials control and fuels procurement personnel reviewed those materials and services required for support of mission and business critical activities. These results were reviewed with management and formed the basis of direct written requests to suppliers for information on their Year 2000 compliance. Evaluation of responses to those requests will determine future verification procedures. Validation of supplier compliance may include on-site verification of their Year 2000 readiness information, including individual and/or industry compliance test results. Supplier contingency planning is scheduled to be developed concurrently and as part of the Company's overall contingency planning.

Costs

Total Project costs for all activities, including inventory, remediation and testing required to become Year 2000 compliant are not deemed material nor significant relative to the Company's financial position. It is expected that all Project expenditures will be paid for by the Company from its normal operating and maintenance budgets.

Of a total Project estimate of $3.0 million approximately $1.4 million has been expended through December, 1998, including $814,400 of internal labor charges. The Company does not expect final Project costs to exceed this estimate; however, no assurances can be given.

Risks

The reasonably likely worst-case scenario should the Company and/or its suppliers fail to correct a material Year 2000 problem is an interruption in the Company's ability to deliver electric and/or gas service to customers, thereby adversely impacting the ability of major customers to continue effective operations. If such interruption extended for a lengthy period of time, it could result in a loss of revenue that could have a material adverse effect on the Company's financial position. Additionally, Year 2000-related problems could disrupt the operations of major customers, reducing their use of Company services or their ability to pay for such services. However, it is expected that any potential impact to the Company specifically related to a Year 2000 problem-induced business failure for any of its customers would not differ from an extended Company service interruption attributable to physical service failures, weather events or natural disaster. The Company believes that the completion of the Project as scheduled will significantly reduce the possibility of significant interruptions to its normal business operations; however, no assurance can be given.

RATE PROCEEDINGS

Electric

See the caption "Competitive Opportunities Proceeding Settlement Agreement" in Note 2 hereof.

Gas

The Company currently does not have a gas rate case on file with the PSC. Management will continue to monitor the financial position of its gas business to determine the necessity of filing a gas rate case in the future.

CAPITAL RESOURCES AND LIQUIDITY

Construction Program

As shown in the Consolidated Statement of Cash Flows, the cash expenditures related to the Company's construction program amounted to $45.1 million in 1998, a $1.6 million increase from the $43.5 million expended in 1997. As shown in the table below, cash construction expenditures for 1999 are estimated to be $50.7 million, an increase of $5.6 million compared to 1998 expenditures.

In 1999, the Company expects to satisfy its external funding requirements, either through short-term borrowings or issuances of medium-term notes.

Estimates of construction expenditures, internal funds available, mandatory and optional redemption or repurchase of long-term securities, and working capital requirements for the two-year period 1999-2000 are set forth by year in the following table:

	1999	2000	Total 1999-2000
		(In Thousands)	
Construction Expenditures*	$ 50,700	$ 49,100	$ 99,800
Internal Funds Available	55,200	45,200	100,400
Excess of Construction Expenditures over Internal Funds	(4,500)	3,900	(600)
Mandatory Redemption of Long-term debt	20,100	35,100	55,200
Optional Redemption or Purchase of Long-term debt	37,600	-	37,600
Other Cash Requirements	3,000	19,000	22,000
Total Cash Requirements	$ 56,200	$ 58,000	$114,200

** Excluding the equity portion of Allowance for Funds Used During Construction ("AFDC"), a noncash item.*

Estimates of construction expenditures are subject to continuous review and adjustment, and actual expenditures may vary from estimates. These construction expenditures include capitalized overheads, nuclear fuel and the debt portion of AFDC and assume that the planned divestiture of the Roseton and Danskammer Plants occurs on January 1, 2000. The actual date of divestiture is likely to occur at some future date in 2000.

Included in the 1999 construction expenditures are expenditures which are required to comply with the Clean Air Act and related Amendments of 1990.

As shown in the table above, it is presently estimated that funds available from internal sources will finance 100% of the Company's cash construction expenditures in 1999 and 92% in 2000. During this same two-year period, total external financing requirements are projected to amount to $114.2 million, of which $55.2 million is related to the mandatory redemption of long-term securities and $37.6 million is related to the optional redemption of long-term securities.

Capital Structure

Over the period 1989-1996, the Company worked to increase its common equity ratio to a target range of 50% to 52%, which it achieved in 1996. As a result of the ratio exceeding this target range during 1997, the Company instituted a common stock repurchase program, which enabled the Company to both maintain the target equity ratio and enhance earnings per share in 1998. The Company reached the target equity ratio through the retention of a portion of its earnings, original issuances of its common stock under its Dividend Reinvestment Program ("DRP") and its Customer Stock Purchase Plan ("CSPP") (both of which have since been superseded, effective January 1, 1997, by the Company's Stock Purchase Plan described in this Item 7 under the caption "Financing Program," below and in Note 6 - "Capitalization - Capital Stock" hereof) and redemptions of debt and preferred stock. However, the common equity ratio target range of 50% to 52% was established under a "vertically integrated" structure in effect prior to the effectiveness of the Agreement, (described in Note 2 - "Regulatory Matters" hereof under the caption "Competitive Opportunities Proceeding Settlement Agreement"). The Agreement requires that the Company divest itself of its fossil-fueled generation and permits the Company to establish a holding company structure which will allow the Company to invest in unregulated business ventures. Divesture of its fossil-fueled generation and the formation of the holding company structure will require that the Company reevaluate its common equity ratio target. The target equity ratio may be reduced in view of a potentially lower level of business risk after such divestiture. This reduction may make additional equity capital available to invest in unregulated business ventures.

The increase in the common equity ratio has contributed to the significant improvement in the Company's interest coverage ratios as shown under the caption "Financial Indices" in this Item 7. The Company's interest coverage ratios have also improved due to the refinancing of a portion of its debt at lower interest rates. Despite a tightening of bond rating criteria applied to the electric utility industry, the Company has maintained or improved its senior secured debt ratings since 1991. During 1998, Moody's Investors Service, Inc., upgraded the Company's senior debt rating from "A3" to "A2." The Company's other bond ratings, which were reaffirmed during 1998, are "A" by Standard & Poor's Corporation, Duff & Phelps Credit Rating Co. and Fitch/IBCA Investors Service. The Company's continuing goal is to achieve and maintain bond ratings at the "A" level.

Under the terms of the Agreement, the Company may invest up to $100 million in unregulated businesses prior to the formation of a holding company structure, which formation is contemplated to become effective in the first half of 1999. After its formation, such holding company structure will be free to invest in new businesses subject only to the terms of the Agreement. Pursuant to the terms of the Agreement, the Company has invested an additional $25.5 million of equity capital in unregulated ventures.

Set forth below is certain information with respect to the Company's capital structure at the end of 1998, 1997 and 1996:

	Year-end Capital Structure		
	1998	1997	1996
Long-term debt	41.0%(a)	40.5%	40.1%
Short-term debt	1.9	-	1.7
Preferred stock	6.1	6.3	6.2
Common equity	51.0	53.2	52.0
	100.0%	100.0%	100.0%

(a) Excludes $16.7 million of bonds issued through the New York Energy Research and Development Authority ("NYSERDA") on December 2, 1998, discussed below under the subcaption "Financing Program."

Financing Program

By an Order issued and effective December 4, 1996, the PSC granted the Company authorization to issue and sell, through December 31, 1999, up to an additional $40 million of securities which can be comprised of medium term notes or common stock solely or a combination of medium term notes and common stock. The December 1996 Order also authorizes the Company to acquire, through December 31, 1999, not more than 2.5 million shares of its issued and outstanding common stock. The Company also received approval to combine its DRP, its CSPP and its Employee Stock Purchase Plan ("ESPP") into a new Stock Purchase Plan, which was done effective January 1, 1997. The Stock Plan can be either an original issue plan or an open market purchase plan. The Stock Purchase Plan is currently an open-market purchase plan.

Pursuant to the aforementioned PSC authorization, the Company, in January 1997, instituted a common stock repurchase program primarily for the purpose of managing its common equity ratio. Since inception of such program, the Company repurchased through December 31, 1998, 692,900 shares of its common stock. As a result of such program and the issuance of incremental debt, the Company's common equity ratio declined to 51.0% at December 31, 1998. In view of the price per share of common stock, cash flow and opportunities to reinvest in the Company's business or invest in new unregulated businesses, the Company has suspended this program, effective December 31, 1998. However, the Company will continue to reevaluate reactivation of its repurchase program on a quarterly basis.

Under the terms of the Agreement, prior to the formation of a new holding company structure, the Company may transfer up to $100 million from its regulated utility business to its unregulated businesses, of which approximately $25.5 million has been transferred as of December 31, 1998. The Company may, pursuant to this authorization, issue, no later than June 30, 2001, up to $100 million of new securities, including up to one million shares of common stock. This authorization is separate from the securities issuance authorization under the PSC's December 1996 Order discussed above. Following the formation of the holding company structure contemplated under the Agreement, the holding company may issue new securities in furtherance of its business plan.

On September 8, 1998, the Company issued and sold a $15 million tranche of its unsecured Medium-Term Notes, Series B, under its medium-term note program pursuant to said PSC Order of December 1996. Such notes bear a fixed annual interest rate of 5.93%, mature on September 10, 2001, and are not redeemable at the option of the Company prior to maturity. The net proceeds to the Company from the sale of such notes were $14,947,500 or 99.65% (before deducting expenses).

On December 2, 1998, the Company refinanced the 8.375% series of pollution control bonds issued on its behalf in 1988 in the aggregate principal amount of $16.7 million by NYSERDA (the "1988 NYSERDA Bonds") by refunding the 1988 NYSERDA Bonds with the proceeds of the issuance and sale on that date of $16.7 million aggregate principal amount of a new series of NYSERDA Bonds (the "1998 NYSERDA Bonds"). The redemption date for the 1988 NYSERDA Bonds is March 1, 1999. The 1998 NYSERDA Bonds have the same maturity date (December 1, 2028) as the 1988 NYSERDA Bonds they refunded; however, the 1998 NYSERDA Bonds have multi-modal features, which allows the Company in certain circumstances to convert the 1998 NYSERDA Bonds from time to time to and from certain interest rate modes (variable and fixed) of varying lengths, at the end of which the 1998 NYSERDA are subject to mandatory tender and purchase and may be remarketed, or their interest rate to a fixed rate may be converted until maturity. During certain variable interest rate modes, the 1998 NYSERDA Bonds are subject to optional tender and purchase by their holders and may be remarketed. The 1998 NYSERDA Bonds are insured as to payment of principal and interest as they become due by a municipal bond insurance policy issued by Ambac Assurance Corporation and purchased by the Company. The 1998 NYSERDA Bonds were issued initially in a term rate mode for five years, ending on November 30, 2003, during which period they will bear interest at the fixed annual rate of 4.20%. Upon their mandatory tender for purchase on December 1, 2003, the Company will have the option to convert the 1998 NYSERDA Bonds to an alternate interest rate mode or to bonds bearing a fixed rate of interest for the remainder of their term as described above.

On January 15, 1999, the Company issued and sold a $20 million tranche of its unsecured Medium-Term Notes, Series C, under its medium term note program pursuant to said PSC Order of December 1996. Such notes bear a fixed annual interest rate of 6.00%, mature on January 15, 2009, and are not redeemable at the option of the Company prior to maturity. The net proceeds to the Company from the sale of such notes were $19,875,000 or 99.875% (before deducting expenses). Such proceeds were applied to the payment at maturity on January 15, 1999, of a $20,000,000 tranche of the Company's unsecured Medium-Term Notes, Series A, that bore interest at a fixed annual interest rate of 5.38%.

If interest rates are favorable, the Company may redeem its 6 1/4% NYSERDA Bonds ($4.1 million) at par and its 7 3/8% NYSERDA Bonds ($33.4 million) at 103%.

For more information with respect to the Company's financing program in general, see Note 6 - "Capitalization - Capital Stock" and Note 7 - "Capitalization - Long-Term Debt."

Short-Term Debt

As more fully discussed in Note 5 - "Short-Term Borrowing Arrangements" hereof, the Company has a revolving credit agreement with four commercial banks for borrowing up to $50 million through October 23, 2001. In addition, the Company has several committed and uncommitted bank facilities ranging from $.5 million to $50 million from which it may obtain short-term financing. Such agreements give the Company competitive options to minimize its cost of short-term borrowing. Authorization from the PSC limits the amount the Company may have outstanding at any time under all of its short-term borrowing arrangements to $52 million in the aggregate.

As part of its establishing a holding company structure, CH Energy Group, Inc., the proposed holding company has established a revolving credit agreement with three commercial banks for borrowing up to $50 million through December 4, 2001. No borrowings are permitted under such agreement until the share exchange establishing CH Energy Group, Inc. as a holding company has been effected.

RESULTS OF OPERATIONS

The following discussion and analysis includes an explanation of the significant changes in revenues and expenses when comparing 1998 to 1997 and 1997 to 1996. Additional information relating to changes between these years is provided in the Notes.

Earnings

Earnings per share of common stock are shown after provision for dividends on preferred stock and are computed on the basis of the average number of common shares outstanding during the year. The number of common shares, the earnings per share and the rate of return earned on average common equity are as follows:

	1998	1997	1996
Average shares outstanding (000s)	17,034	17,435	17,549
Earnings per share	$ 2.90	$ 2.97	$ 2.99
Return earned on common equity per financial statements*	10.3%	10.8%	11.1%

** Return on equity for regulatory rate-making purposes differs from these figures.*

Earnings per share in 1998 when compared to 1997 decreased $.07 per share. This decrease resulted primarily from the net effect of $.11 for non-recurring items recorded in 1998 and 1997. The 1998 non-recurring items are the final provision for the non-recoverable portion of a purchased power contract and the gain on the sale of a subsidiary asset. Non-recurring items in 1997 included the recording of tax adjustments from the favorable settlement of various Internal Revenue Service ("IRS") audits and the initial provision for the non-recoverable portion of a purchased power contract. Also contributing to the decrease was increased depreciation of $.07 on the Company's plant and equipment and decreased net operating revenues of $.07. The reduction in net operating revenues includes a reduction in gas net operating revenues of $.05 resulting primarily from a decrease in usage by residential, commercial and industrial customers due to milder weather. Heating billing degree days, as compared to 1997, were 11% lower in 1998.

These decreased earnings in 1998 were partially offset by the favorable earnings impact of decreased operation and maintenance expenses of $.11, of which $.10 is a reduction in employee compensation due to fewer employees and associated fringe benefits and the favorable impact of the Company's common stock repurchase program of $.07. The reduction in compensation is primarily due to a reduction in the number of employees.

Earnings per share in 1997, when compared to 1996 results, decreased $.02 per share. This decrease resulted substantially from a $.13 reduction in electric and gas net operating revenues (including fuel costs and purchased electricity) attributable largely to decreased sales resulting primarily from a decrease in usage by residential and industrial electric customers and residential and commercial gas customers due to unseasonable weather experienced in 1997. Heating billing degree days were 8% lower and cooling degree days were 16% lower, when 1997 results were compared to 1996. The effect of these unseasonable weather conditions alone reduced earnings by an estimated $.22, despite a 1% increase in the number of customers. Also contributing to the decrease in 1997 earnings were decreased electric earnings related to regulatory incentive programs based on fuel costs and energy efficiency of $.10, largely due to the reduced availability of purchased power at a cost below the Company's fossil-fueled generation, and increased depreciation expense of $.07 on the Company's plant and equipment.

Partially offsetting these decreases in 1997 earnings was a $.09 increase resulting from the net effect of two non-recurring items as follows: the 1997 recording of tax adjustments from the favorable settlement of various IRS audits and the 1997 provision for the non-recoverable portion of a purchased power contract. Other items which impacted earnings favorably included: decreased uncollectible accounts of $.05, avoided interest expense from the optional redemption in May 1996 of the Company's 8 3/4% Series $30 million First Mortgage Bonds of $.04 and $.10 due to the combined effect of various other items including a decrease in interest expense and an increase in interest and dividend income.

The Company has established a projection for earnings in calendar year 1999 of $2.79 per share. This projected level, which is $.11 per share below the actual 1998 level of $2.90 per share, reflects the planned transfer of equity capital from regulated utility operations to unregulated affiliates in stages over the course of the year. These transfers will fund expansion of unregulated affliates into new competitive energy markets to take advantage of opportunities expected to develop due to industry restructuring. However, these transfers are projected to result in a modest reduction in earnings per share in 1999 as the new operations mature. As a result of the Company's strong financial condition and conservative dividend policy, the Company expects that any resulting reduction in earnings as new business development activities mature will not impact the Company's ability to maintain the current level of dividend, although no assurances can be given.

Operating Revenues

Total operating revenues decreased $16.8 million (3%) in 1998 as compared to 1997 and increased $6.3 million (1%) in 1997, as compared to 1996.

See the table below for details of the variations:

	Increase or (Decrease) from Prior Year					
	1998			1997		
	Electric	Gas	Total	Electric	Gas	Total
	(In Thousands)					
Customer sales	$ 770	$(12,797)	$(12,027)	$(7,860)	$ 2,624	$(5,236)
Sales to other utilities	6,991	561	7,552	4,840	(2,290)	2,550
Fuel cost adjustment.	1,743	(8,172)	(6,429)	(291)	8,846	8,555
Deferred revenues	(7,013)	1,563	(5,450)	675	(1,125)	(450)
Miscellaneous	(412)	(42)	(454)	304	583	887
Total.	$ 2,079	$(18,887)	$(16,808)	$(2,332)	$ 8,638	$ 6,306

Sales

The Company's sales vary seasonally in response to weather. Generally electric revenues peak in the summer and gas revenues peak in the winter.

Sales of electricity within the Company's service territory increased 1% in 1998 and decreased 3% in 1997. Electric sales in 1998 to residential, commercial and industrial customers each increased 1%. In 1997, electric sales decreased 3% due primarily because of a decrease in usage by residential and industrial customers largely due to the unseasonable weather conditions experienced in 1997, when compared to 1996.

Firm sales of natural gas (which excludes interruptible and transportation sales) decreased 12% in 1998 due primarily to a decrease in usage by residential and commercial customers largely due to the unseasonable weather conditions experienced in 1998. In addition, firm sales to industrial customers decreased due substantially to a decrease in usage by a large industrial customer and the conversion of a number of industrial customers to transportation service. Firm sales of natural gas in 1997 decreased 5% due primarily to a decrease in usage by residential and commercial customers.

Changes in sales from last year by major customer classification, including interruptible gas sales, are set forth below. Also indicated are the changes related to energy delivery service:

	% Increase (Decrease) from Prior Year			
	Electric (MWh)		Gas (Mcf)	
	1998	1997	1998	1997
Residential	1	(2)	(11)	(6)
Commercial	1	-	(9)	(6)
Industrial	1	(6)	(32)	11
Interruptible	N/A	N/A	(22)	111
Energy Delivery Service				
Electric (a)	N/A	N/A	N/A	N/A
Gas - Firm Customers	N/A	N/A	869	(a)
- Interruptible	N/A	N/A	(3)	74

(a) - Prior year was zero.

Residential and Commercial Sales: Residential electric and gas sales are primarily affected by the growth in the number of customers and the change in customer usage. In 1998, sales of electricity to residential customers increased 1% due to an increase in usage per customer. Commercial sales increased 1% resulting from the net effect of a 2% increase in the number of customers and a 1% decrease in usage per customer. Unseasonable weather conditions (billing degree days were 11% lower) contributed to the decrease in residential and commercial sales of gas. Sales of gas to residential customers decreased 11% due to the net effect of a 12% decrease in usage per customer due to unseasonable weather conditions and a 1% increase in the number of customers. Commercial sales decreased 9% due to the net effect of a 12% decrease in usage per customer and a 3% increase in the number of customers.

In 1997, residential electric and gas sales and commercial gas sales decreased primarily because of a decrease in customer usage largely due to the unseasonable weather experienced in the Company's service territory in 1997. Heating billing degree days were 8% lower and cooling degree days were 16% lower in 1997 than in the prior year.

Industrial Electric Sales: In 1998, as compared to 1997, industrial electric sales increased 1%. In 1997, as compared to 1996, industrial electric sales decreased 6% primarily due to a decrease in usage by a large industrial customer.

Industrial Gas Sales: In 1998, firm gas sales to industrial customers decreased 32% primarily because of a decrease in usage by a large industrial customer and the conversion of a number of industrial customers to firm transportation service. Firm gas sales to industrial customers for 1997 increased 11% primarily because of increased usage by a large industrial customer.

Interruptible Gas Sales: In 1998, interruptible gas sales decreased 22% largely due to a decrease in boiler gas usage for electric generation. Interruptible gas sales increased 111% in 1997, due largely to an increase in natural gas sold for use as a boiler fuel at the Roseton Plant. The use of gas as a boiler fuel at the Roseton Plant is dependent upon its economic benefit as compared to the use of oil for generation or the purchase of electricity to meet the Company's load requirements. Due to sharing arrangements, as described in the caption "Incentive Arrangements" of Item 7 hereof that are in place for interruptible gas sales and transportation of customer-owned gas, variations from year to year typically have a minimal impact on earnings.

Electric Delivery Service: The phase-in of retail access for residential, commercial and small industrial customers began in 1998 as part of the Agreement. As a result of .1% of the Company's customers moving from purchases of electricity from the Company within the Company's franchise area to purchases from energy marketers (retail access), 53 million kWh of electricity was delivered to retail access customers in 1998.

Transportation of Customer-Owned Gas: The volume of customer-owned gas transported for firm customers increased 869% in 1998 due to an increase in the number of customers switching from full gas supply to firm transportation service which had no material revenue impact on the Company. No volumes of gas were transported in 1996 for firm customers. Transported gas for interruptible customers decreased 3% in 1998 due to a decrease in usage by a large industrial customer. In 1997, transported gas for interruptible customers increased 74% due to an increase in usage by a large industrial customer.

Incentive Arrangements

Pursuant to certain incentive formulas approved by the PSC, the Company either shares with its customers, certain revenues and/or cost savings exceeding defined predetermined levels, or is penalized in some cases for shortfalls from the targeted levels or defined performance standards.

Incentive formulas are in place for fuel cost variations, sales of electricity and gas to other utilities, interruptible gas sales, capacity release transactions and customer satisfaction.

The net results of these incentive formulas were to increase pretax earnings by $1.0 million, $700,000 and $2.9 million during 1998, 1997, and 1996, respectively.

Operating Expenses

Changes from the prior year in the components of the Company's operating expenses are listed below:

	Increase or (Decrease) from Prior Year			
	1998		1997	
	Amount	%	Amount	%
	(In Thousands)			
Operating Expenses:				
Fuel and purchased electricity	$ 3,280	3	$ 7,584	7
Purchased natural gas	(16,550)	(27)	10,878	22
Other expenses of operation	(4,972)	(5)	(1,527)	(2)
Maintenance	(670)	(2)	(1,364)	(5)
Depreciation and amortization	1,696	4	1,284	3
Taxes, other than income tax	(1,421)	(2)	(1,266)	(2)
Federal income tax	585	2	(3,510)	(11)
Total	$(18,052)	(4)	$ 12,079	3

The most significant elements of operating expenses are fuel and purchased electricity in the Company's electric department and purchased natural gas in the Company's gas department. Approximately 30% in 1998 and 29% in 1997 of every revenue dollar billed by the Company's electric department was expended for the combined cost of fuel used in electric generation and purchased electricity. The corresponding figures in the Company's gas department for the cost of purchased gas were 53% and 59%, respectively.

In an effort to keep the cost of electricity at the lowest reasonable level, the Company purchases energy from sources such as other member companies of the NYPP, Canadian hydro sources and energy marketers whenever energy can be purchased at a unit cost lower than the incremental cost of generating the energy in the Company's plants.

Purchased natural gas decreased $16.6 million (27%) in 1998 largely due to lower firm and interruptible gas sales, including gas used as a boiler fuel. Other expenses of operations decreased $5.0 million (5%) in 1998 resulting from decreased employee compensation due to fewer employees and associated fringe benefits. In 1997, fuel and purchased electricity increased $7.6 million (7%) primarily because of a 3% increase in total system sales which includes sales to other utilities. Purchased natural gas increased $10.9 million (22%) in 1997 primarily because of higher interruptible gas sales including gas used as a boiler fuel at the Roseton Plant.

See Note 4 - "Federal Income Tax," hereof for an analysis and reconciliation of the federal income tax.

Other Income and Interest Charges

Other income (excluding AFDC) decreased $3.0 million (27%) in 1998 and increased $4.6 million (71%) in 1997. The 1998 decrease resulted primarily from interest refunded in 1997 from the settlement of various IRS audits. The 1997 increase was due primarily to interest refunded in 1997 from the settlement of various IRS audits and the 1996 charges associated with the optional redemption of the 8 3/4% Series of First Mortgage Bonds.

Total interest charges (excluding AFDC) increased $1.0 million (4%) in 1998 primarily because of an increase in borrowings, and $533,000 (2%) in 1997.

The following table sets forth some of the pertinent data on the Company's outstanding debt:

	1998	1997	1996
		(In Thousands)	
Long-term debt:			
Debt retired	$ 90	$ 85	$ 30,000
Outstanding at year-end*:			
Amount (including current portion)	396,998	363,744	364,026
Effective rate	6.56%	6.78%	6.70%
Short-term debt:			
Average daily amount outstanding	$ 1,171	$ 1,692	$ 5,477
Weighted average interest rate	5.51%	5.54%	5.59%

**Including debt of subsidiaries of $9.0 million in 1998, $7.4 million in 1997, and $7.6 million in 1996.*

See Note 5 - "Short-Term Borrowing Arrangements" and Note 7 - "Capitalization - Long-Term Debt" hereof for additional information on short-term and long-term debt of the Company.

Nuclear Operations

The Nine Mile 2 Plant is owned, as tenants-in-common, by the Company, Niagara Mohawk, New York State Electric & Gas Company ("NYSEG"), LILCO, a subsidiary of LIPA, and Rochester Gas and Electric Corporation ("Rochester"). Niagara Mohawk operates the Nine Mile 2 Plant.

The Company owns a 9% interest of the Nine Mile 2 Plant, which is discussed in Note 3 - "Nine Mile 2 Plant."

The Company's share of operating expenses, taxes and depreciation pertaining to the operation of the Nine Mile 2 Plant are included in the Company's financial results. For both 1998 and 1997, the actual cost of operations was less than the allowable Nine Mile 2 Plant operation and maintenance expenses provided in Supplement No. 5 to the 1990 Settlement Agreement, as approved by the PSC. In both 1998 and 1997, the underruns were entirely deferred for the future benefit of customers (see Note 2 - "Regulatory Matters").

The Company has continued to participate actively in the management, operations and accounting committees for the Nine Mile 2 Plant and will continue to do so in the future.

On October 12, 1996, Niagara Mohawk and Rochester announced plans to establish a joint nuclear operating company to be known as New York Nuclear Operating Company ("NYNOC"). NYNOC was envisioned to assume full responsibility for operation of all the nuclear plants in New York State, including the Nine Mile 2 Plant, Niagara Mohawk's Unit No. 1 of the Nine Mile Point Nuclear Station and Rochester's Ginna Nuclear Plant. Since that time NYNOC has been organized as a New York Limited Liability Company with three members: Niagara Mohawk, Rochester, and Consolidated Edison Company of New York, Inc. Although not a member, the New York Power Authority has participated in the development of plans to implement NYNOC. It is expected that NYNOC could contribute to maintaining a high level of operational performance, contribute to continued satisfactory Nuclear Regulatory Commission ("NRC") regulatory compliance, provide opportunities for continued cost reductions and provide the basis for satisfactory economic regulation by the PSC. The initial work associated with plans for implementation of NYNOC was completed in 1998. No substantial further work on its implementation is anticipated until completion of the PSC proceeding regarding the future of nuclear power plants in New York State (as described below). Sufficient information is not available for the Company to make an assessment of such plans or whether it would consent to such plans to the extent that the Nine Mile 2 Plant is affected. Until such assessment can be made, the Company can take no position with respect to such plans.

On or about June 15, 1998, NYSEG, one of the owners of the Nine Mile 2 Plant, commenced an action against Niagara Mohawk (which is the operator of the Nine Mile 2 Plant) in Supreme Court of the State of New York, Tompkins County, demanding, among other things, judgment to (i) enjoin Niagara Mohawk from transferring operating responsibility of the Nine Mile 2 Plant to NYNOC; and (ii) declare that Niagara Mohawk may not transfer its operational responsibility for the Nine Mile 2 Plant to NYNOC without NYSE&G's consent. The Company can make no prediction as to the outcome of this litigation.

Niagara Mohawk and NYSE&G publicly announced in January 1999 plans to pursue the sale of their nuclear assets, including their interest in the Nine Mile 2 Plant. The Company can make no prediction as to whether or not any such sale will occur, or if such sale occurs, the effect on the Company's interest in the Nine Mile 2 Plant or its operations.

On August 27, 1997, the PSC Staff issued a "Notice Soliciting Comments on Nuclear Generation" requesting comments and alternative approaches by interested parties on a "Staff Report on Nuclear Generation" ("Nuclear Report"). The Nuclear Report concludes that nuclear generation along with non-nuclear generation facilities, should be subject to the discipline of market-based pricing.

On March 20, 1998, the PSC initiated a proceeding to examine a number of issues raised by the Nuclear Report and the comments received in response to it. In reviewing the Nuclear Report and parties' comments, the PSC: (a) adopted as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, with parties challenging that premise having to bear a substantial burden of persuasion, (b) characterized the proposals in the Staff paper as by and large consistent in concept with the PSC's goal of a competitive, market-based electricity industry, (c) questioned PSC Staff's position that would leave funding and other decommissioning responsibilities with the sellers of nuclear power interests and (d) indicated interest in the potential for the NYNOC to benefit customers through efficiency gains and directed pursuit of that matter in this nuclear generating proceeding or separately upon the filing of a formal NYNOC proposal. The proceeding is expected to be completed in 1999.

A decommissioning study for the Nine Mile 2 Plant was completed in 1995. The study's estimate of the cost to decommission the Plant is significantly higher than previous estimates. The Company believes that decommissioning costs, if higher than currently estimated, will ultimately be recovered in rates, although no such assurance can be given. However, future developments in the utility industry, including the effects of deregulation and increasing competition could change this conclusion. The Company cannot predict the outcome of these developments. For further information on decommissioning, see Note 3 - "Nine Mile 2 Plant."

The NRC issued a policy statement on the Restructuring and Economic Deregulation of the Electric Utility Industry ("Policy Statement") in 1997. The Policy Statement addresses NRC's concerns about the adequacy of decommissioning funds and about the potential impact on operational safety and reserves to the NRC the right, in highly unusual situations where adequate protection of public health and safety would be compromised, to consider imposing joint and several liability on minority co-owners when one or more co-owners have defaulted on their contractual obligations. On December 28, 1998, the NRC announced commencement of a rulemaking proceeding initiated by a group of utilities which are non-operating joint owners of nuclear plants. These utilities request that the enforcement provisions of the NRC regulations be amended to clarify NRC policy regarding the potential liability of joint owners if other joint owners become financially incapable of bearing their share of the burden for safe operation or decommissioning of a nuclear power plant. Current NRC regulations allow a utility to set aside decommissioning funds annually over the estimated life of a plant. In addition to the above Policy Statement, the NRC is proposing to amend its regulations on decommissioning funding to reflect conditions expected from deregulation of the electric power industry. The Company is unable to predict how such increased stringency may affect the results of operations or financial condition of the Nine Mile 2 Plant.

On July 5, 1998, the Nine Mile 2 Plant completed its sixth refueling outage, which commenced on May 2, 1998. It is scheduled to commence its seventh refueling outage March 1, 2000.

Other Matters

New Accounting Standards: In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). This Statement establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Any gain or loss resulting from changes in such fair value is required to be recognized in earnings to the extent the derivatives are not effective as hedges. SFAS 133 is effective for fiscal years beginning after June 15, 1999, and is effective for interim periods in the initial year of adoption. The Company currently does not own any derivative instruments; however, the Company intends to implement an energy trading risk management program in 1999 to manage the price risks associated with fuel purchases for generation, natural gas purchases for native load customers, and wholesale power transactions. The Company may utilize various financial instruments, such as, futures, options, swaps, caps, floors and collars to stabilize the price volatility of these commodities. At this time, the Company cannot assess the impact that the proposed hedging program would have on its financial position or results of operations.

In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear plant decommissioning. Over the past two years, this exposure draft has been the source of continual debate. The FASB has committed to completing this project and is proceeding toward issuance of another exposure draft (expected in the second quarter of 1999). If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. The Company can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition of the Company.

Other Issues: On an ongoing basis, the Company assesses environmental issues which could impact the Company and its customers. Note 3 - "Nine Mile 2 Plant" and Note 9 - "Commitments and Contingencies" discuss current environmental issues affecting the Company, including (i) the 1995 decommissioning cost study of the Nine Mile 2 Plant, (ii) the Clean Water Act and Clean Air Act Amendments of 1990, which require control of emissions from fossil-fueled electric generating units, (iii) asbestos litigation cases, and (iv) a legal action filed in 1995 against the Company by the City of Newburgh, New York.

FINANCIAL INDICES

Selected financial indices for the last five years are set forth in the following table:

	1998	1997	1996	1995	1994
Pretax coverage of total interest charges:					
Including AFDC	3.83x	3.94x	4.08x	3.68x	3.38x
Excluding AFDC	3.54x	3.69x	3.83x	3.43x	3.15x
Funds from Operations	4.39x	5.18x	5.29x	4.69x	4.24x
Pretax coverage of total interest charges and preferred stock dividends	3.27x	3.37x	3.47x	2.97x	2.74x
Percent of construction expenditures financed from internal funds	100%	100%	100%	100%	100%
AFDC and Mirror CWIP* as a percentage of income available for common stock	17%	13%	13%	16%	16%
Effective tax rate	35%	32%	36%	35%	35%

* *Refer to Note 2 - "Regulatory Matters" under the caption "Summary of Regulatory Assets and Liabilities" and the subcaption "Deferred Finance Charges - Deferred Nine Mile 2 Plant Costs" for a definition of Mirror CWIP.*

COMMON STOCK DIVIDENDS AND PRICE RANGES

The Company and its principal predecessors have paid dividends on its common stock in each year commencing in 1903, and the common stock of the Company has been listed on the New York Stock Exchange since 1945. The price ranges and the dividends paid for each quarterly period during the Company's last two fiscal years are as follows:

	1998			1997		
	High	Low	Dividend	High	Low	Dividend
1st Quarter	$43 3/4	$39 5/8	$.535	$33 3/8	$30 1/2	$.53
2nd Quarter	46	38 7/8	.535	34 3/4	29 3/4	.53
3rd Quarter	47 1/16	40 7/8	.54	35 7/8	32 1/8	.535
4th Quarter	45 1/8	39 7/8	.54	43 7/8	34 11/16	.535

On June 26, 1998, the Company increased its quarterly dividend rate to $.54 per share from $.535 in 1997. On June 27, 1997, the Company increased its quarterly dividend rate to $.535 per share from $.53 per share.

Any determination with regard to future dividend declarations, and the amounts and dates of such dividends, will depend on the circumstances at the time of consideration of such declaration. One such consideration will be the effect on the Company of the proposed holding company restructuring described in this Item 7 under the caption "Competition/Deregulation."

The number of registered holders of common stock as of December 31, 1998, was 21,416. Of these, 20,836 were accounts in the names of individuals with total holdings of 5,132,676 shares, or an average of 246 shares per account. The 580 other accounts, in the names of institutional or other non-individual holders, for the most part, hold shares of common stock for the benefit of individuals.

ITEM 7A

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company intends to implement an energy trading risk management program in 1999 to manage the price risks associated with fuel purchases for generation, natural gas purchases for native load customers, and wholesale power transactions. The Company may utilize various financial instruments, such as, futures, options, swaps, caps, floors and collars to stabilize the price volatility of these commodities. At this time, the Company cannot assess the impact that this proposed hedging program would have on its financial position or results of operations.

ITEM 8

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Supplementary Data

Supplementary data is included in "Selected Quarterly Financial Data (Unaudited)" referred to in I above and reference is made thereto.

Report of Independent Accountants

PRICEWATERHOUSECOOPERS

To the Board of Directors and Shareholders of Central Hudson Gas & Electric Corporation

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Central Hudson Gas & Electric Corporation and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP
New York, New York
January 29, 1999

Statement Of Management's Responsibility

Management is responsible for the preparation, integrity and objectivity of the consolidated financial statements of Central Hudson Gas & Electric Corporation and its subsidiaries (collectively, the Company) as well as all other information contained in this Form 10-K Report. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and, in some cases, reflect amounts based on the best estimates and judgements of the Company's Management, giving due consideration to materiality.

The Company maintains adequate systems of internal control to provide reasonable assurance, that, among other things, transactions are executed in accordance with Management's authorization, that the consolidated financial statements are prepared in accordance with generally accepted accounting principles and that the assets of the Company are properly safeguarded. The systems of internal control are documented, evaluated and tested by the Company's internal auditors on a continuing basis. Due to the inherent limitations of the effectiveness of internal controls, no internal control system can provide absolute assurance that errors will not occur. Management believes that the Company has maintained an effective system of internal control over the preparation of its financial information including the consolidated financial statements of the Company as of December 31, 1998.

Independent accountants were engaged to audit the consolidated financial statements of the Company and issue their report thereon. The Report of Independent Accountants, which is presented above, does not limit the responsibility of Management for information contained in the consolidated financial statements and elsewhere in this Form 10-K Report.

The Company's Board of Directors maintains a Committee on Audit which is composed of Directors who are not employees of the Company. The Committee on Audit meets with Management, its Internal Auditing Manager, and its independent accountants several times a year to discuss internal controls and accounting matters, the Company's consolidated financial statements, the scope and results of the audits performed by the independent accountants and the Company's Internal Auditing Department. The independent accountants and the Company's Internal Auditing Manager have direct access to the Committee on Audit.

John E. Mack III
JOHN E. MACK III
Chairman of the Board

Donna S. Doyle
DONNA S. DOYLE
Controller
January 29, 1999

Consolidated Balance Sheet

At December 31, (In Thousands)	1998	1997
ASSETS		
Utility Plant		
Electric	$1,222,743	$1,193,735
Gas	158,165	151,222
Common	94,271	91,522
Nuclear fuel	42,317	37,262
	1,517,496	1,473,741
Less: Accumulated depreciation	597,383	560,304
Nuclear fuel amortization	35,381	33,059
	884,732	880,378
Construction work in progress	43,512	52,413
Net Utility Plant	928,244	932,791
Other Property and Plant	19,059	1,089
Investments and Other Assets		
Prefunded pension costs	40,218	23,536
Other	18,209	13,869
Total Investments and Other Assets	58,427	37,405
Current Assets		
Cash and cash equivalents	10,499	9,054
Accounts receivable from customers - net of allowance for doubtful accounts; $2.4 million in 1998 and $2.8 million in 1997	45,564	49,643
Accrued unbilled utility revenues	15,233	16,229
Other receivables	4,555	2,073
Materials and supplies, at average cost:		
Fuel	11,797	11,920
Construction and operating	11,790	12,180
Special deposits and prepayments	34,823	14,210
Total Current Assets	134,261	115,309
Deferred Charges		
Regulatory assets (Note 2)	149,261	139,236
Unamortized debt expense	5,062	5,002
Other	21,724	21,258
Total Deferred Charges	176,047	165,496
TOTAL ASSETS	$1,316,038	$1,252,090

The Notes to Consolidated Financial Statements are an integral part hereof.

At December 31, (In Thousands)	1998	1997
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common Stock Equity		
Common stock, $5 par value (Note 6)	$87,775	$ 87,775
Paid-in capital (Note 6)	284,465	284,465
Retained earnings	133,287	120,540
Reacquired capital stock (Note 6)	(27,143)	(9,398)
Capital stock expense	(6,204)	(6,278)
Total Common Stock Equity	472,180	477,104
Cumulative Preferred Stock (Note 6)		
Not subject to mandatory redemption	21,030	21,030
Subject to mandatory redemption	35,000	35,000
Total Cumulative Preferred Stock	56,030	56,030
Long-term Debt (Note 7)	356,918	361,829
Total Capitalization	885,128	894,963
Current Liabilities		
Current maturities of long-term debt	39,507	1,317
Notes payable	18,000	-
Accounts payable	23,591	24,368
Dividends payable	9,913	10,052
Accrued taxes and interest	6,334	3,240
Accrued vacation	4,400	4,339
Customer deposits	4,248	4,001
Other	7,932	6,545
Total Current Liabilities	113,925	53,862
Deferred Credits and Other Liabilities		
Regulatory liabilities (Note 2)	81,065	81,271
Operating reserves	5,995	6,582
Other	27,251	10,019
Total Deferred Credits and Other Liabilities	114,311	97,872
Deferred Income Tax (Note 4)	202,674	205,393
Commitments and Contingencies (Notes 2,3 and 9)		
TOTAL CAPITALIZATION AND LIABILITIES	$1,316,038	$1,252,090

The Notes to Consolidated Financial Statements are an integral part hereof.

Consolidated Statement of Income

Year Ended December 31, (In Thousands)	1998	1997	1996
Operating Revenues			
Electric	$418,507	$416,429	$418,761
Gas	84,962	103,848	95,210
Total Operating Revenues	503,469	520,277	513,971
Operating Expenses			
Operation:			
Fuel used in electric generation	84,688	66,117	58,874
Purchased electricity	40,573	55,864	55,523
Purchased natural gas	44,964	61,514	50,636
Other expenses of operation	96,247	101,219	102,746
Maintenance	26,904	27,574	28,938
Depreciation and amortization (Note 1)	45,560	43,864	42,580
Taxes, other than income tax	63,458	64,879	66,145
Federal income tax (Note 4)	29,775	29,190	32,700
Total Operating Expenses	432,169	450,221	438,142
Operating Income	71,300	70,056	75,829
Other Income			
Allowance for equity funds used during construction (Note 1)	585	387	466
Federal income tax (Note 4)	1,148	2,953	1,632
Other - net	6,865	8,079	4,815
Total Other Income	8,598	11,419	6,913
Income before Interest Charges	79,898	81,475	82,742
Interest Charges			
Interest on long-term debt	23,115	23,097	23,617
Other interest	3,639	2,647	2,626
Allowance for borrowed funds used during construction (Note 1)	(324)	(261)	(523)
Amortization of expense on debt	924	906	940
Total Interest Charges	27,354	26,389	26,660
Net Income	52,544	55,086	56,082
Premium on Preferred Stock Redemptions - Net	-	-	378
Dividends Declared on Cumulative Preferred Stock	3,320	3,230	3,230
Income Available for Common Stock	$49,314	$ 51,856	$ 52,474
Common Stock:			
Average shares outstanding (000s)	17,034	17,435	17,549
Earnings per share on average shares outstanding	$2.90	$2.97	$2.99

Consolidated Statement of Retained Earnings

Year Ended December 31, (In Thousands)	1998	1997	1996
Balance at beginning of year	$120,540	$105,821	$ 90,475
Net Income	52,544	55,086	56,082
Premium on Preferred Stock Redemption - Net	-	-	378
Dividends declared:			
On cumulative preferred stock	3,230	3,230	3,230
On common stock ($2.155 per share 1998; $2.135 per share 1997; $2.115 per share 1996)	36,567	37,137	37,128
Total Dividends Declared	39,797	40,367	40,358
Balance at end of year	$133,287	$120,540	$105,821

The Notes to Consolidated Financial Statements are an integral part hereof.

Consolidated Statement of Cash Flows

Year Ended December 31, (In Thousands)	1998	1997	1996
Operating Activities			
Net Income	$52,544	$ 55,086	$ 56,082
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization including nuclear fuel amortization	49,011	48,348	47,073
Deferred income taxes,	(116)	14,077	17,848
Allowance for equity funds used during construction	(585)	(387)	(466)
Nine Mile 2 Plant deferred finance charges, net	(4,855)	(4,855)	(4,855)
Provisions for uncollectibles	2,639	3,493	4,336
Accrued pension costs	(12,277)	(8,555)	(6,757)
Deferred gas costs	1,072	3,475	(4,861)
Deferred gas refunds	(1,640)	1,695	(1,556)
Other - net	4,888	7,233	4,039
Changes in current assets and liabilities, net:			
Accounts receivable and unbilled utility revenues	(46)	(4,420)	(6,338)
Materials and supplies	513	3,995	(505)
Special deposits and prepayments	(20,613)	(770)	(781)
Accounts payable	(777)	(1,769)	1,704
Accrued taxes and interest	3,094	(2,107)	(2,477)
Other current liabilities	1,695	(61)	602
Net cash provided by operating activities	74,547	114,478	103,088
Investing Activities			
Additions to plant	(45,661)	(43,868)	(49,860)
Allowance for equity funds used during construction	585	387	466
Net additions to plant	(45,076)	(43,481)	(49,394)
Subsidiaries' fixed asset additions	(19,460)	-	-
Nine Mile 2 Plant decommissioning trust fund	(868)	(868)	(1,008)
Other - net	(801)	396	(526)
Net cash used in investing activities	(66,205)	(43,953)	(50,928)
Financing Activities			
Proceeds from issuance of:			
Long-term debt	35,250	2,000	3,090
Common stock	-	-	1,817
Net borrowings (repayments) of short-term debt	18,000	(15,600)	15,600
Retirement and redemption of long-term debt	(2,466)	(2,282)	(30,779)
Retirement and redemption of cumulative preferred stock	-	-	(13,000)
Premium on preferred stock redemption	-	-	(378)
Dividends paid on cumulative preferred and common stock	(39,936)	(40,426)	(40,489)
Issuance and redemption costs	-	-	736
Reacquired capital stock	(17,745)	(9,398)	-
Net cash used in financing activities	(6,897)	(65,706)	(63,403)
Net Change in Cash and Cash Equivalents	1,445	4,819	(11,243)
Cash and Cash Equivalents at Beginning of Year	9,054	4,235	15,478
Cash and Cash Equivalents at End of Year	$10,499	$ 9,054	$ 4,235
Supplemental Disclosure of Cash Flow Information			
Interest paid	$24,002	$ 24,309	$ 25,184
Federal income taxes paid	26,900	17,111	15,875

The Notes to Consolidated Financial Statements are an integral part hereof.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Central Hudson Gas & Electric Corporation (the "Company"), and its subsidiaries. Intercompany balances and transactions have been eliminated.

The Company's subsidiaries are each directly or indirectly wholly owned and are comprised of landholding, cogeneration, fuel oil, electric generating or energy management companies. The net income of the Company's subsidiaries is reflected in the Consolidated Statement of Income as other non-operating income.

Effective April 24, 1998, the Company formed a wholly-owned subsidiary named CH Energy Group, Inc., which, after a one-for-one share exchange, will become the holding company parent of the Company and its existing subsidiaries (with the exception of Phoenix Development Company, Inc.). See Note 2 - "Regulatory Matters," under the caption "Holding Company Restructuring" for further details.

Rates, Revenues and Cost Adjustment Clauses

Electric and gas retail rates are regulated by the Public Service Commission of the State of New York ("PSC"). Transmission rates, facilities charges and rates for electricity sold for resale in interstate commerce are regulated by the Federal Energy Regulatory Commission ("FERC").

Revenues are recognized on the basis of cycle billings rendered monthly or bimonthly. Estimated revenues are accrued for those customers billed bimonthly whose meters are not read in the current month.

The Company's tariff for retail electric service includes a fuel cost adjustment clause pursuant to which electric rates are adjusted to reflect changes in the average cost of fuels used for electric generation and in certain purchased power costs, from the average of such costs included in base rates. The Company's tariff for gas service contains a comparable clause to adjust gas rates for changes in the price of purchased natural gas.

Utility Plant

The costs of additions to utility plant and replacements of retired units of property are capitalized at original cost. The Company's share of the costs of Unit No. 2 of the Nine Mile Point Nuclear Station ("Nine Mile 2") Plant are capitalized at original cost, less the disallowed investment of $169.3 million which was recorded in 1987. Capitalized costs include labor, materials and supplies, indirect charges for such items as transportation, certain taxes, pension and other employee benefits, and Allowance for the Cost of Funds Used During Construction ("AFDC"), a non-cash item. Replacement of minor items of property is included in maintenance expenses.

The original cost of property, together with removal cost, less salvage, is charged to accumulated depreciation at such time as the property is retired and removed from service.

Jointly Owned Facilities

The Company has a 9%, or 103 megawatt ("MW"), undivided interest in the 1,143 MW Nine Mile 2 Plant (see Note 3 - "Nine Mile 2 Plant") and a 35%, or 420 MW, undivided interest in the 1,200 MW Roseton Electric Generating Station ("Roseton Plant").

The Company's share of the respective investments in the Nine Mile 2 Plant and the Roseton Plant, as included in its Consolidated Balance Sheet at December 31, 1998 and 1997, were:

	1998	1997
	(In Thousands)	
Nine Mile 2 Plant		
Plant in service	$315,358	$316,123
Accumulated depreciation	(77,178)	(70,202)
Construction work in progress	2,132	1,032
Roseton Plant		
Plant in service	$135,197	$134,555
Accumulated depreciation	(80,486)	(77,438)
Construction work in progress	213	571

Allowance For Funds Used During Construction

The Company's regulated utility plant includes AFDC, which is defined in applicable regulatory systems as the net cost of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. The concurrent credit for the amount so capitalized is reported in the Consolidated Statement of Income as follows: the portion applicable to borrowed funds is reported as a reduction of interest charges while the portion applicable to other funds (the equity component, a noncash item) is reported as other income. The AFDC rate was 8.5% in 1998 and 8.0% in 1997 and 7.5% in 1996.

For a discussion of the effect of the Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation ("SFAS 71"), as issued by the Financial Accounting Standards Board ("FASB"), on the Company's fossil-fueled generating plants, see Note 2 - "Regulatory Matters," under the caption "Impact of Amended Settlement Agreement on Accounting Policies." Accordingly, beginning in 1998, significant capital projects relating to the fossil-fueled generating plants include capitalized interest instead of AFDC. For 1998 no such projects met the criteria for capitalized interest.

Depreciation and Amortization

For financial statement purposes, the Company's depreciation provisions are computed on the straight-line method using rates based on studies of the estimated useful lives and estimated net salvage value of properties, with the exception of the Nine Mile 2 Plant which is depreciated on a remaining life amortization method. The year 2026, which is the year in which the Nine Mile 2 Plant operating license expires, is used as the end date in the development of the remaining life amortization. The Company performs depreciation studies on a continuing basis and, upon approval by the PSC, periodically adjusts the rates of its various classes of depreciable property.

The Company's composite rates for depreciation were 3.2% in 1998, 3.16% in 1997 and 3.13% in 1996 of the original cost of average depreciable property. The ratio of the amount of accumulated depreciation to the cost of depreciable property at December 31 was 39.6% in 1998, 38.2% in 1997 and 36.5% in 1996.

For federal income tax purposes, the Company uses an accelerated method of depreciation and generally uses the shortest life permitted for each class of assets.

The cost of the Nine Mile 2 Plant nuclear fuel assemblies and components is amortized to operating expense based on the quantity of heat produced for the generation of electric energy.

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, the Company considers temporary cash investments with a maturity when purchased of three months or less to be cash equivalents.

Federal Income Tax

The Company and its wholly-owned subsidiaries file a consolidated federal income tax return. Federal income taxes are allocated to operating expenses and other income and deductions in the Consolidated Statement of Income. Federal income taxes are deferred under the liability method in accordance with Financial Accounting Standard No. 109, "Accounting for Income Taxes," ("SFAS 109"). Under the liability method, deferred income taxes are provided for all differences between financial statement and tax basis of assets and liabilities. Additional deferred income taxes and offsetting regulatory assets or liabilities are recorded to recognize that income taxes will be recoverable or refundable through future revenues.

Use of Estimates

Preparation of the financial statements in accordance with generally accepted accounting principles includes the use of estimates and assumptions by management that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amount of revenues and expenses during the reporting period. Actual results may differ from those estimates.

New Accounting Standards and Other FASB Projects

Derivatives and Hedging Accounting: In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). This Statement establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Any gain or loss resulting from changes in such fair value is required to be recognized in earnings to the extent the derivatives are not effective as hedges. SFAS 133 is effective for fiscal years beginning after June 15, 1999, and is effective for interim periods in the initial year of adoption. The Company currently does not own any derivative instruments; however, the Company intends to implement an energy trading risk management program in 1999 to manage the price risks associated with fuel purchases for generation, natural gas purchases for native load customers, and wholesale power transactions. The Company may utilize various financial instruments, such as, futures, options, swaps, caps, floors, and collars to stabilize the price volatility of these commodities. At this time, the Company cannot assess the impact that the proposed hedging program would have on its financial position or results of operations.

Plant Decommissioning: In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear plant decommissioning. Over the past two years, this exposure draft has been the source of continual debate. The FASB has committed to completing the project and is proceeding toward issuance of another exposure draft (expected in the second quarter of 1999). If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. The Company can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition of the Company.

NOTE 2 - REGULATORY MATTERS

Competitive Opportunities Proceeding Settlement Agreement

In response to the May 1996 Order of the PSC issued in its generic Competitive Opportunities Proceeding ("Proceeding"), the Company, the PSC Staff and certain other parties entered into an Amended and Restated Settlement Agreement, dated January 2, 1998, ("Agreement"). The PSC approved the Agreement by its final Order issued and effective June 30, 1998.

Shortly after the PSC issued its May 1996 Order, the Company and other electric utilities filed a court challenge to such Order. In addition, the Public Utility Law Project ("PULP") filed a similar appeal. Both appeals are stayed at this time. Subsequently, in December 1998, PULP filed an additional appeal with respect to such Order approving the Company's restructuring settlement. The Company has moved to dismiss this second appeal. The matter remains pending at this time and the Company can make no prediction as to the potential outcome of these matters.

The Agreement generally includes the following provisions: (i) continuation of a basic electric rate freeze, along with a phase-in of retail access, for residential, commercial and small industrial customers through June 2001; (ii) a 5% reduction in base electric rates for large industrial customers; (iii) a 10.6% return on equity ("ROE") cap with excess earnings, if any, deferred for stranded cost mitigation (at December 31, 1998, the Company recorded an estimated regulatory liability of $651,000 due to excess earnings); (iv) a reasonable opportunity to recover all prudently incurred strandable costs, defined as "production expenditures of the company made in fulfilling its obligation to serve and provide safe, reliable electric service to customers within its franchise territory which are not expected to be recoverable in a competitive electricity market"; (v) functional separation of the Company's Danskammer Steam Generating Station ("Danskammer Plant") and its interest in the Roseton Plant in 1998; (vi) transfer of title by an auction of the Company's Danskammer Plant and its interest in the Roseton Plant to be completed by June 30, 2001, (an affiliate of the Company can bid, and the PSC reserved its authority to require an auction and transfer of the Company's fossil-fueled electric generating assets prior to June 30, 2001, if such action is found by the PSC to be in the public interest); (vii) approval to effect a holding company restructuring not later than June 30, 2001, which holding company initially would own the Company and all but one of the Company's existing wholly-owned subsidiaries; and (viii) permission for the Company to transfer up to $100 million of equity from the Company to unregulated affiliates prior to such holding company restructuring.

In addition, the PSC directed the PSC Staff to provide assurance that the Company does not incur imprudent generation costs which could be avoided by divestiture of fossil-fueled electric generating assets prior to June 30, 2001, and added a provision dealing with mergers and acquisitions; namely, pursuant to a petition filed jointly or individually by the Company, the Company will have the flexibility to retain, on a cumulative basis, all savings associated with an acquisition or merger with another utility for a period of five years from the date of closing of any merger or acquisition up to the amount of the acquisition premium paid over the lesser of book value or fair market value of assets merged or acquired, and savings in excess of the recovery will be disposed of by the PSC.

The consideration received by the Company in an auction, referred to in (vi) of the second preceding paragraph above, would, up to the net book value of the assets sold, be available for investment in unregulated operations without PSC approval. Any excess over such net book value will be required to be used to offset the Company's fossil-fueled generation related regulatory assets and, to the extent of any remaining consideration, to reduce the book cost of the Company's investment in the Nine Mile 2 Plant. In the event that the sale price of any such assets is below the Company's then current net book value, the difference will be preserved for recovery as strandable cost. The Company's potential strandable costs are those prior utility investments and commitments that may not be recoverable in a competitive energy market. Examples include any unrecovered cost of the Company's fossil-fueled generating plants (resulting from the auction process) and net generation related regulatory assets. During the period ending June 30, 2001, the Company will continue to recover its potential electric strandable costs in the rates it charges its transmission and distribution customers. Following June 2001, the Company will be given a reasonable opportunity to recover, through a non-bypassable charge to customers, all prudently incurred, verifiable and appropriately mitigated electric strandable costs. The net book value of the Company's fossil generating assets at December 31, 1998, represented approximately 18% of net utility plant.

In the event that no Company affiliate elects to bid in its auction, the Company will retain, prior to application of the consideration described in the immediately preceding paragraph, 10% of the proceeds in excess of the book value of the Company's fossil-fueled generation assets, not to exceed in the aggregate $17.5 million.

After such divestiture, the Company expects to be obligated to continue to serve a portion of its electric customers. The Company cannot predict the amount of such service which it will be obligated to provide or the cost or availability of electricity to satisfy its service obligations.

Holding Company Restructuring

Effective April 24, 1998, the Company formed a wholly-owned subsidiary named CH Energy Group, Inc. which, after a one-for-one share exchange, will become the holding company parent of the Company and its then existing subsidiary companies (with the exception of Phoenix Development Company, Inc.). The Company has received approval from its shareholders, the PSC, the FERC, and the Nuclear Regulatory Commission ("NRC") to form such holding company. While no specific date has been established, it is expected that the holding company restructuring will occur some time during the first half of 1999. This will allow the Company to coordinate closely with such restructuring the transfer of up to $100 million in equity (as authorized by the PSC under the Agreement) from the Company to unregulated operations, of which approximately $25.5 million has been transferred as of December 31, 1998. Initially, the holding company (CH Energy Group, Inc.) will own, as first tier subsidiaries, the Company and its existing subsidiaries, as described in the subcaption "Affiliates" under the caption in Item 1 "Other Matters", with one exception: Phoenix Development Company, Inc., which holds real property for future use, will remain a wholly-owned subsidiary of the Company. CH Energy Group, Inc., following the share exchange, may also establish other subsidiaries over time.

Impact of Amended Settlement Agreement on Accounting Policies

The Agreement created certain changes to the Company's accounting policies. The Company's accounting policies conform to generally accepted accounting principles, which, for regulated public utilities, include SFAS 71. Under SFAS 71, regulated companies apply AFDC to the cost of construction projects. Because the Company's fossil-fueled generating plants are no longer subject to SFAS 71, capitalized interest will be applied instead of AFDC. Under SFAS 71, regulated companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be allowed in the rate-making process in a period different from when they otherwise would have been reflected in income. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in rates. If some of an enterprise's operations are regulated and meet the appropriate criteria, SFAS 71 is applied only to the regulated portion of the enterprise's operations.

During 1997, the FASB Emerging Issues Task Force ("EITF") concluded that an entity should discontinue application of SFAS 71, to any portion of its business when a deregulation transition plan is in place and the terms are known. However, the EITF further qualified, in its Issue No. 97-4, that regulatory assets and liabilities should be evaluated based on where the cash flows are to be derived in the determination of the applicability of SFAS 71. When the cash flows are from rates to be charged to customers of the regulated business for recovery and settlement, respectively, of regulatory assets and liabilities, they should not be eliminated until: a) they are recovered or settled through the regulated cash flows, or b) they are individually impaired or the regulator eliminates the individual obligation or c) the portion of the business providing the regulated cash flows no longer meets the criteria of SFAS 71. None of these conditions has occurred as it applies to the Company's fossil-fueled generation regulatory assets and liabilities even though the Agreement put into place a deregulation transition plan with the ultimate goal of divesting the Company's fossil-fueled generating plant assets. Therefore, these balances continue to be reflected in the total for regulatory assets and liabilities in the Company's consolidated balance sheet. At December 31, 1998, and 1997, net regulatory assets associated with the fossil-fueled generating assets totalled $6.5 million and $7.6 million, respectively.

Summary of Regulatory Assets and Liabilities

The following table sets forth the Company's regulatory assets and liabilities:

At December 31,	1998	1997
Regulatory Assets (Debits):	(In Thousands)	
Deferred finance charges -		
Nine Mile 2 Plant.	$ 67,326	$ 68,470
Income taxes recoverable		
through future rates	35,221	49,220
Deferred Newburgh Gas Site (Note 9)	22,679	2,195
Other	24,035	19,351
Total Regulatory Assets	$ 149,261	$ 139,236
Regulatory Liabilities (Credits):		
Deferred finance charges -		
Nine Mile 2 Plant	$ 10,431	$ 16,431
Income taxes refundable	17,574	28,516
Deferred Nine Mile 2 Plant costs.	15,790	11,296
Deferred pension costs overcollection (Note 8)	11,693	8,306
Deferred OPEB costs overcollection (Note 8)	9,796	6,824
Customer benefits account.	5,447	-
Other	10,334	9,898
Total Regulatory Liabilities	81,065	81,271
Net Regulatory Assets.	$ 68,196	$ 57,965

Some of the significant regulatory assets and liabilities include:

Deferred Finance Charges - Nine Mile 2 Plant: During the construction of the Nine Mile 2 Plant, the PSC authorized the inclusion in rate base of increasing amounts of the Company's investment in that Plant. The Company did not accrue AFDC on any of the Nine Mile 2 Plant construction work in progress ("CWIP") which was included in rate base and for which a cash return was being allowed; however, the PSC ordered, effective January 1, 1983, that amounts be accumulated in deferred debit and credit accounts equal to the amount of AFDC which was not being accrued on the CWIP included in rate base ("Mirror CWIP"). The balance in the deferred credit account is available to reduce future revenue requirements by amortizing portions of the deferred credit to other income or by the elimination through writing off other deferred balances as directed by the PSC. The Company expects such application of the deferred credit will occur over a period substantially shorter than the life of the Nine Mile 2 Plant. When amounts of such deferred credit are applied in order to reduce revenue requirements, amortization is started for a corresponding amount of the deferred debit, which amortization continues on a level basis over the remaining life of the Nine Mile 2 Plant resulting in recovery of such corresponding amount through rates. Mirror CWIP is expected to be exhausted by the end of the useful life of the Nine Mile 2 Plant either through the amortization or write-off procedures described above or through the write-off of the remaining debit and credit as directed by the PSC. The net effect of this procedure is that at the end of the amortization period for the deferred credit, the accounting and rate-making treatment will be the same as if the Nine Mile 2 Plant CWIP had not been included in rate base during the construction period.

Pursuant to a PSC Order issued and effective February 11, 1994, in an electric rate proceeding, the Company was authorized to amortize $6 million annually of the deferred credit beginning in December 1993.

The $6 million amortization of the deferred credit will be continued unless changed by a future PSC rate order or until it is exhausted. Under provisions of the Agreement, this amortization will be replaced with other deferred credits to the extent necessary to provide for full replacement of the expiring Mirror CWIP credits. The current level of the deferred debit amortization of $1.1 million is based on the level of deferred credits that have been utilized through the most recent rate year. Credit amounts utilized subsequently are included in the deferred debit amortization level at the time of the next PSC rate order for the new rate year based on the then remaining life of the Nine Mile 2 Plant.

Income Taxes Recoverable/Refundable: The adoption of SFAS 109 in 1993 increased the Company's net deferred tax obligation. As it is probable that the increase will be recovered from customers, the Company established a net regulatory asset for the recoverable future taxes.

Deferred Nine Mile 2 Plant Costs: The existing rate-making for the Nine Mile 2 Plant, as directed by the PSC in its Order on Nine Mile 2 Operating and Capital Forecast for 1996 ("Supplement No. 5"), provides for the deferral of the difference between actual and authorized operating and maintenance expense. Supplement No. 5 continues in effect until changed by a subsequent rate order. For 1998 and 1997, the Nine Mile 2 Plant incurred less actual expense than authorized, and the Company's share has been recorded as a regulatory liability in accordance with Supplement No. 5.

Customer Benefits Account: The Agreement requires that the Company set aside $10.0 million per calendar year in a Customer Benefits Account to fund rate reductions and retail access options. Funding sources include $3.0 million from shareholder sources, $3.5 million from fuel cost savings generated by the installation of the Company's coal dock unloading facility at its Danskammer Plant and $3.5 million from deferred credits related to the reconciliation of pension and OPEB costs. The Agreement also stipulates that unused funding accumulated to the end of the Agreement term is to be used for offsetting strandable costs or providing other ratepayer benefits.

Auction of Fossil Generation Plants

Under the Agreement, the Company is required to sell its fossil generation plants and transfer title by June 30, 2001. The Company has provided for the necessary internal and external resources to carry out the auction that is called for in the Agreement. An auction plan is being developed for approval by the PSC. The plan is intended to maximize the value received for the assets and provide for an orderly process and objective bid evaluation. Approval of the auction plan is expected during 1999 and selection of the winning bidder(s) is anticipated in 2000.

Independent System Operator

The Company is a member of the New York Power Pool ("NYPP") whose members, major investor-owned State electric utility companies, Long Island Lighting Company ("LILCO"), as a subsidiary of the Long Island Power Authority ("LIPA"), and the Power Authority of the State of New York ("PASNY"), by agreement, provide for coordinated operation of their bulk power electric systems. In a filing with the FERC, dated January 31, 1997, the member systems of the NYPP proposed a new market structure that would include as a key element the establishment of an Independent System Operator ("ISO") and certain other entities to supersede the NYPP. The ISO's principal mission would be to maintain the reliability of the New York State bulk power systems and to provide transmission service on a comparable and non-discriminatory basis. By Order, dated June 24, 1998, the FERC conditionally authorized the establishment of an ISO by the member systems of the NYPP. Said Order made an interim finding that the member systems' conditional proposal to restructure the New York electric wholesale market satisfied the principles set forth in FERC Order 888. The FERC deferred action on other aspects of such proposal including the rates, terms and conditions of the ISO's open access tariff. By Order dated June 30, 1998, FERC conditionally authorized the establishment of the ISO and by order dated January 27, 1999, FERC conditionally accepted, with modifications, the proposed ISO tariff and the proposed market rules of the ISO and granted the request for market-based rates. The January 27, 1999, order called for public hearings on certain aspects of the proposed rates and provided for settlement judge proceedings. Future filings with FERC will be required to obtain FERC approval of the transfer of control of all necessary facilities to the ISO; any such transfer would not involve the transfer of ownership of such assets.

Significant changes to pricing procedures now in effect within NYPP are expected, but it is unclear what effect these changes may have once other regulatory changes in New York State are implemented. At the present time, the Company cannot predict what effects regulations ultimately adopted by FERC will have, if any, on future operations or the financial condition of the Company.

NOTE 3 - NINE MILE 2 PLANT

General

The Nine Mile 2 Plant is located in Oswego County, New York, and is operated by Niagara Mohawk Power Corporation ("Niagara Mohawk"). The Nine Mile 2 Plant is owned as tenants-in-common by the Company (9% interest), Niagara Mohawk (41% interest), New York State Electric & Gas Corporation ("NYSE&G") (18% interest), LILCO, as a subsidiary of LIPA (18% interest), and Rochester Gas and Electric Corporation ("Rochester") (14% interest). The output of the Nine Mile 2 Plant, which has a rated net capability of 1,143 MW, is shared and the operating expenses of the Plant are allocated to the cotenants in the same proportions as the cotenants' respective ownership interests. The Company's share of direct operating expense for the Nine Mile 2 Plant is included in the appropriate expense classifications in the accompanying Consolidated Statement of Income.

Under the Operating Agreement entered into by the cotenants, Niagara Mohawk acts as operator of the Nine Mile 2 Plant, and all five cotenants share certain policy, budget and managerial oversight functions. The Operating Agreement remains in effect subject to termination on six months' notice.

Radioactive Waste

Niagara Mohawk has contracted with the U.S. Department of Energy ("DOE") for disposal of high-level radioactive waste ("spent fuel") from the Nine Mile 2 Plant. Despite a court order reaffirming the DOE's obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. The Company has been advised by Niagara Mohawk that the Nine Mile 2 Plant spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If DOE schedule slippage should occur, facilities that extend the on-site storage capability for spent fuel at the Nine Mile 2 Plant beyond 2012 would need to be acquired.

Nuclear Plant Decommissioning Costs

The Company's 9% share of costs to decommission the Nine Mile 2 Plant is estimated to be approximately $209.6 million ($80.4 million in 1998 dollars) and assumes that decommissioning will begin shortly after the operating license expires in the year 2026. This estimate is based upon a site-specific study completed in December 1995.

In order to assist the Company in meeting this obligation, the Company makes annual contributions of $868,000 to a qualified external decommissioning trust fund. The total annual amount allowed in rates is $999,000, but the maximum annual tax deduction allowed is $868,000. Currently, the difference between the rate allowance ($999,000) and the amount contributed to the external qualified fund ($868,000) is recorded as an internal reserve ($131,000), and the funds are held by the Company.

The qualified external decommissioning trust fund at December 31, 1998 and 1997, amounted to $13.9 million and $11 million, respectively, including net reinvested earnings to date of $6.4 million. The qualified external decommissioning trust fund is reflected in the Company's Consolidated Balance Sheet in "Investments and Other Assets-Other." At December 31, 1998, the external decommissioning trust fund investments carrying value approximated fair market value. The amount of accumulated decommissioning costs recovered through rates and the net earnings of the external decommissioning trust fund are reflected in accumulated depreciation in the Company's Consolidated Balance Sheet and amount to $15.6 million and $12.6 million at December 31, 1998 and 1997, respectively.

Reference is made to the subcaption "New Accounting Standards and Other FASB Projects - Plant Decommissioning" in Note 1 - "Summary of Significant Accounting Policies" for details of the proposed changes in accounting for nuclear decommissioning costs.

The Company believes that if decommissioning costs are greater than currently estimated, such revised costs would be recovered in rates. However, future developments in the utility industry, including the effects of deregulation and increasing competition, could change this conclusion.

NOTE 4 - FEDERAL INCOME TAX

Components of Federal Income Tax

The following is a summary of the components of federal income tax as reported in the Consolidated Statement of Income:

	1998	1997	1996
		(In Thousands)	
Charged to operating expense:			
Federal income tax	$28,408	$19,004	$18,936
Deferred income tax	1,367	10,186	13,764
Income tax charged to operating expense	29,775	29,190	32,700
Charged (credited) to other income and deductions:			
Federal income tax	335	(6,844)	(5,716)
Deferred income tax	(1,483)	3,891	4,084
Income tax (credited) to other income and deductions	(1,148)	(2,953)	(1,632)
Total federal income tax	$28,627	$26,237	$31,068

Reconciliation: The following is a reconciliation between the amount of federal income tax computed on income before taxes at the statutory rate and the amount reported in the Consolidated Statement of Income:

	1998	1997	1996
		(In Thousands)	
Net income	$52,544	$55,086	$56,082
Federal income tax	28,743	12,160	13,220
Deferred income tax	(116)	14,077	17,848
Income before taxes	$81,171	$81,323	$87,150
Computed tax @ 35% statutory rate	$28,410	$28,463	$30,503
Increase (decrease) to computed tax due to:			
Pension expense	(4,486)	(2,855)	(2,424)
Deferred finance charges -			
Nine Mile 2 Plant	(1,700)	(1,699)	(1,699)
Alternative minimum tax	(1,048)	(7,350)	(2,262)
Tax depreciation	4,248	(4,225)	(10,499)
Customer Benefits Account	1,906	-	-
Nine Mile 2 settlement costs	1,282	1,567	1,043
Deferred gas costs	375	1,216	(1,703)
Deferred storm costs	-	(2,257)	-
Other	(244)	(700)	261
Federal income tax	28,743	12,160	13,220
Deferred income tax	(116)	14,077	17,848
Total federal income tax	$28,627	$26,237	$31,068
Effective tax rate	35.3%	32.3%	35.6%

The following is a summary of the components of deferred taxes at December 31, 1998 and 1997, as reported in the Consolidated Balance Sheet:

	1998	1997
	(In Thousands)	
Accumulated Deferred Income Tax Assets:		
Future tax benefits on investment tax credit basis difference	$ 14,033	$ 14,837
Unbilled revenues	5,261	5,675
Alternative minimum tax	-	1,048
Other	32,938	29,047
Accumulated Deferred Income Tax Assets	$ 52,232	$ 50,607
Accumulated Deferred Income Tax Liabilities:		
Tax depreciation	$180,339	$181,314
Accumulated deferred investment tax credit	26,062	27,555
Future revenues - recovery of plant basis differences	11,319	17,475
Other	37,186	29,656
Accumulated Deferred Income Tax Liabilities	254,906	256,000
Net Accumulated Deferred Income Tax Liability	$202,674	$205,393

NOTE 5 - SHORT-TERM BORROWING ARRANGEMENTS

The Company has in effect a revolving credit agreement with four commercial banks which allows it to borrow up to $50 million through October 23, 2001, ("Borrowing Agreement"). The Borrowing Agreement gives the Company the option of borrowing at either the higher of the prime rate or the sum of the federal funds rate plus * of 1%, or three other money market rates, if such rates are lower. Compensating balances are not required under the Borrowing Agreement. In addition, the Company maintains confirmed lines of credit totaling $1.5 million with regional banks. There were no outstanding loans under the Borrowing Agreement or the line of credit at December 31, 1998 or 1997. In order to diversify its sources of short-term financing, the Company has entered into short-term credit facilities agreements with several commercial banks. At December 31, 1998, the Company had outstanding short-term debt of $18 million under such facilities with a weighted average interest rate of 5.5%. The Company had no short-term debt outstanding at December 31, 1997.

Authorization from the PSC limits the amount the Company may have outstanding, at any time, under all of its short-term borrowing arrangements to $52 million in the aggregate.

As part of its establishing a holding company structure, CH Energy Group, Inc., the proposed holding company, has established a $50 million revolving credit agreement with three commercial banks through December 4, 2001. No borrowings are permitted under such agreement until the share exchange establishing CH Energy Group, Inc. as a holding company is effected.

NOTE 6 - CAPITALIZATION - CAPITAL STOCK

Common Stock, $5 par value; 30,000,000 shares authorized:

	Common Stock Shares Outstanding	Common Stock Amount ($000)	Paid-In Capital ($000)	Reacquired Capital Stock ($000)
January 1, 1996	17,496,051	$87,480	$282,942	$ -
Issued under dividend reinvestment plan("DRP") (a)	49,023	245	1,278	-
Issued under customer stock purchase plan ("CSPP") (a)	9,913	50	245	-
December 31, 1996	17,554,987	87,775	284,465	-
Repurchased under common stock repurchase plan	(275,200)	-	-	(9,398)
December 31, 1997	17,279,787	87,775	284,465	(9,398)
Repurchased under common stock repurchase plan	(417,700)	-	-	(17,745)
December 31, 1998	16,862,087	$87,775	$284,465	$(27,143)

(a) In May 1996, the Company converted its DRP and its CSPP from original issue to open market purchase of common shares.

Cumulative Preferred Stock, $100 par value; 1,200,000 shares authorized:

	Series	Final Redemption Date	Redemption Price 12/31/98	Shares Outstanding December 31, 1998	Shares Outstanding December 31, 1997
Not Subject to Mandatory Redemption:					
	4 1/2%		$107.00	70,300	70,300
	4.75%		106.75	20,000	20,000
	4.35%		102.00	60,000	60,000
	4.96%		101.00	60,000	60,000
				210,300	210,300
Subject to Mandatory Redemption:					
	6.20%	10/1/08 (a)		200,000	200,000
	6.80%	10/1/27 (a)		150,000	150,000
				350,000	350,000
		Total		560,300	560,300

(a) Cannot be redeemed prior to October 1, 2003.

The Company had no cumulative preferred stock redemptions or issuances during 1998 and 1997; however, on January 1, 1996, the Company optionally redeemed its 7.72% Series Cumulative Preferred Stock (par value $100 per share) at a redemption price of $101.00 per share. The $13.1 million redemption price paid and associated costs were funded through internal sources.

Expenses incurred on issuance of capital stock are accumulated and reported as a reduction in common stock equity. These expenses are not being amortized, except that, as directed by the PSC, certain issuance and redemption costs and unamortized expenses associated with certain issues of preferred stock that were redeemed have been deferred and are being amortized over the remaining lives of the issues subject to mandatory redemptions.

By Order, issued and effective December 4, 1996, the PSC authorized the issuance and sale of certain debt and equity securities of the Company.

That Order authorizes the Company, through December 31, 1999, to: 1) issue and sell up to $40 million of new securities comprised of common stock and/or medium term notes, 2) acquire not more than 2.5 million shares of its issued and outstanding common stock, of which the Company repurchased 692,900 shares through December 31, 1998, and 3) effective January 1, 1997, combine its existing DRP, its CSPP and its Employee Stock Purchase Plan into a single plan called the Stock Purchase Plan. The Stock Purchase Plan became effective January 1, 1997, superseded such other plans and operates as an original issue or open market purchase plan.

NOTE 7 - CAPITALIZATION - LONG-TERM DEBT

Details of long-term debt are as follows:

Series				Maturity Date	December 31, 1998 (In Thousands)	December 31, 1997 (In Thousands)
First Mortgage Bonds:						
6.10%	(a)			April 28, 2000	$ 10,000	$ 10,000
7.70%	(a)			June 12, 2000	25,000	25,000
7.97%	(a)			June 11, 2003	8,000	8,000
7.97%	(a)			June 13, 2003	8,000	8,000
6.46%	(a)			August 11, 2003	10,000	10,000
6 1/4%	(b)			June 1, 2007	4,325	4,415
9 1/4%				May 1, 2021	70,000	70,000
8.12%	(a)			August 29, 2022	10,000	10,000
8.14%	(a)			August 29, 2022	10,000	10,000
8.375%	(b)(d)			December 1, 2028	16,700	16,700
					172,025	172,115
Promissory Notes:						
1984	Series A	(7 3/8%)	(c)	Oct. 1, 2014	16,700	16,700
1984	Series B	(7 3/8%)	(c)	Oct. 1, 2014	16,700	16,700
1985	Series A	(Var. rate)	(c)	Nov. 1, 2020	36,250	36,250
1985	Series B	(Var. rate)	(c)	Nov. 1, 2020	36,000	36,000
1987	Series A	(Var. rate)	(c)	June 1, 2027	33,700	33,700
1987	Series B	(Var. rate)	(c)	June 1, 2027	9,900	9,900
1998	Series A	(4.20%)	(c)	Dec. 1, 2028	16,700	-
5.38%	(a)			Jan. 15,1999	20,000	20,000
5.93%	(a)			Sept.10,2001	15,000	-
7.85%	(a)			July 2, 2004	15,000	15,000
					215,950	184,250
Secured Notes Payable of Subsidiary					9,023	7,379
Unamortized Discount on Debt					(573)	(598)
Total long-term debt					$396,425	$363,146
Less Current Portion					(39,507)	(1,317)
					$356,918	$361,829

(a) Issued under the Company's Medium Term Note Program. (b) First Mortgage Bonds issued in connection with the sale by the New York State Energy Research and Development Authority ("NYSERDA") of tax-exempt pollution control revenue bonds. (c) Promissory Notes issued in connection with the sale by NYSERDA of tax-exempt pollution control revenue bonds. (d) To be redeemed March 1, 1999.

Long-Term Debt Maturities

The aggregate principal amounts of long-term debt maturing for the next five years and thereafter are as follows: \$39.5 million in 1999, \$36.4 million in 2000, \$16.4 million in 2001, \$1.1 million in 2002, \$26.7 million in 2003 and \$276.3 million thereafter.

First Mortgage Bonds

The Company, on December 2, 1998, refinanced the 8.375% series of pollution control bonds, issued on its behalf by NYSERDA in 1988 in the aggregate principal amount of \$16.7 million, which bonds are supported by the Company's First Mortgage Bonds of like principal amount. Such bonds were refinanced with lower cost NYSERDA pollution control bonds, which bonds are supported by the Company's Promissory Note of like principal amount at a fixed rate of 4.20% for their initial term of five years and thereafter are subject to repricing. The 8.375% series will be redeemed on March 1, 1999, in order to coordinate with the Article XXI Mortgage Indenture requirements noted below under the subcaption "Mortgage Indenture Covenant." Accordingly, these bonds have been included in the "Current Maturities of Long-Term Debt" on the Company's Balance Sheet. The Company did not issue or redeem any First Mortgage Bonds during 1997; however, on May 1, 1996, the Company redeemed \$30 million of its 8 3/4% Series due 2001 at a redemption price of 102.07% of their principal amount.

Medium Term Notes

On September 8, 1998, the Company issued and sold a \$15 million tranche of its unsecured Medium-Term Notes, Series B, under its medium-term note program. Such notes bear a fixed annual interest rate of 5.93%, mature on September 10, 2001, and are not redeemable at the option of the Company prior to maturity. The net proceeds to the Company from the sale of such notes were \$14,947,500 or 99.65% (before deducting expenses).

On January 15, 1999, the Company issued and sold a \$20 million tranche of its unsecured Medium-Term Notes, Series C, under its medium-term note program. Such notes bear a fixed annual interest rate of 6.00%, mature on January 15, 2009, and are not redeemable at the option of the Company prior to maturity. The net proceeds to the Company from the sale of such notes were \$19,875,000 or 99.875% (before deducting expenses). Such proceeds were applied to the payment at maturity on January 15, 1999, of a \$20,000,000 tranche of the Company's unsecured Medium-Term Notes, Series A, that bore interest at a fixed annual interest rate of 5.38%.

Amended Settlement Agreement

Under the terms of the Agreement described in Note 2 - "Regulatory Matters," the Company may transfer up to \$100 million from its regulated utility business to its unregulated businesses prior to completing the holding company restructuring. As of December 31, 1998, approximately \$25.5 million has been transferred. The Company may, pursuant to this authorization, issue up to \$100 million of new securities prior to June 30, 2001. The Company expects to issue medium term notes; however, the amount and timing of any such issuance is not determinable at this time.

NYSERDA

The NYSERDA Pollution Control Revenue Bonds issued in 1985 (Series A and B) and 1987 (Series A and B) (collectively, the "1985 and 1987 NYSERDA Bonds") are variable rate obligations subject to weekly repricing and investor tender. The Company has the right, exercisable independently with respect to each series of the 1985 and 1987 NYSERDA Bonds, to convert those Bonds of each such series to a fixed rate for the remainder of their term. In its rate orders, the PSC has authorized deferred accounting for the interest costs on the Company's 1985 and 1987 Series A and B Promissory Notes which were issued in connection with the sale of the 1985 and 1987 NYSERDA Bonds. The authorization provides for full recovery of the variance between that portion of the actual interest costs supporting utility operations and the interest costs allowed in rates. The percent of interest costs supporting utility operations represents approximately 95% of the total costs. The deferred balances under such accounting were \$4.9 million and \$3.8 million at December 31, 1998 and 1997, respectively, and were included in "Regulatory Assets" in the Company's Consolidated Balance Sheet. Such deferred balances are to be addressed in future rate cases. By Order, issued and effective December 4, 1996, the PSC authorized the Company to issue up to \$132.55 million of tax-exempt NYSERDA Pollution Control Revenue Bonds for refunding purposes or for the purpose of refinancing, if economical, a like amount of such bonds presently outstanding.

Letters of Credit

The Company has in place irrevocable letters of credit which support certain payments required to be made on the 1985 and 1987 NYSERDA Bonds. Such letters of credit, which expire in 1999 and 2000, will be renewed prior to expiration. The Company anticipates being able to extend such letters of credit if the interest rate on the related series of such Bonds is not converted to a fixed interest rate. If the Company were unable to extend the letter of credit that is related to a particular series of such Bonds, that series would have to be redeemed unless a fixed rate of interest became effective. Payments made under the letters of credit in connection with purchases of tendered 1985 and 1987 NYSERDA Bonds are repaid with the proceeds from the remarketing of such Bonds. To the extent the proceeds are not sufficient, the Company would be required to reimburse the bank that issued the letter of credit for the amount of any resulting draw under that letter prior to its expiration date.

Debt Expense

Expenses incurred on debt issues and any discount or premium on debt are deferred and amortized over the lives of the related issues. Expenses incurred on debt redemptions prior to maturity have been deferred and are generally being amortized over the shorter of the remaining lives of the related extinguished issues or the new issues as directed by the PSC.

Debt Covenants

Certain debt agreements require the maintenance by the Company of certain financial ratios and contain other restrictive covenants.

Mortgage Indenture Covenant

Article XXI of the Company's Indenture of Mortgage, pursuant to which the Company's first mortgage bonds are outstanding (the "Mortgage"), requires generally that, to the extent that the cost of property additions (as defined in the Mortgage) acquired by the Company during a calendar year is less than the allowance for depreciation on property subject to the Mortgage (calculated pursuant to the Mortgage) for such calendar year, the Company must deposit cash with the Mortgage Trustee in the amount of such deficiency, less certain credits available to the Company under the Mortgage (the "Article XXI Deficiency").

Any cash deposited with the Mortgage Trustee as a result of an Article XXI Deficiency may be withdrawn by the Company in an amount equal to the cost of property additions acquired by the Company subsequent to such calendar year, or may be applied by the Mortgage Trustee, at the request of the Company, to redeem or purchase outstanding mortgage bonds in accordance with the provisions of the Mortgage. If any such cash left on deposit with the Mortgage Trustee for 12 consecutive months or more is in excess of $350,000, the amount of such cash in excess of $250,000 must be applied by the Mortgage Trustee to redeem or purchase mortgage bonds, subject to certain exceptions set forth in the Mortgage. Article XXI of the Mortgage will remain in effect so long as any of the Company's mortgage bonds of any series created prior to 1994 are outstanding under the Mortgage.

For calendar year 1997, the Company experienced an Article XXI Deficiency in the amount of $722,226, in satisfaction of which, on March 24, 1998, it deposited with the Mortgage Trustee cash in that amount. For calendar year 1998, the Company experienced an Article XXI Deficiency in the approximate amount of $16.3 million, in satisfaction of which it deposited with the Mortgage Trustee cash in that amount received by the Company from the proceeds of the 1998 NYSERDA Bonds. Such cash deposited will be applied by the Mortgage Trustee, at the request of the Company, to the redemption, on March 1, 1999, of the Company's First Mortgage Bonds, 8.375% Series due 2028.

NOTE 8 - POSTEMPLOYMENT BENEFITS

Pension Benefits

The Company has a non-contributory retirement income plan ("Retirement Plan") covering substantially all of its employees. The Retirement Plan provides pension benefits that are based on the employee's compensation and years of service. It has been the Company's practice to provide periodic updates to the benefit formula stated in the Retirement Plan.

The Company's funding policy is to make annual contributions equal to the amount of net periodic pension cost, but not in excess of the maximum allowable tax-deductible contribution under the federal income tax law nor less than the minimum requirement under the Employee Retirement Income Security Act of 1974.

The 1998 and 1997 accounting for pension benefits reflects adoption of PSC-prescribed provisions which, among other things, requires ten-year amortization of actuarial gains and losses and deferral of differences between actual pension expense and rate allowances.

In addition to the Retirement Plan, the Company sponsors a non-qualified plan for eligible officers (the "EDCP") and a non-qualified pension restoration plan.

Other Postretirement Benefits

The Company provides certain health care and life insurance benefits for retired employees through its postretirement benefit plan ("Benefit Plan"). Substantially all of the Company's employees may become eligible for these benefits if they reach retirement age while working for the Company. These and similar benefits for active employees are provided through insurance companies whose premiums are based on the benefits paid during the year. In order to reduce the total costs of these benefits, the Company requires employees who retired on or after October 1, 1994, to contribute toward the cost of such benefits.

The Company is fully recovering its net periodic postretirement costs in accordance with PSC guidelines. Under these guidelines, the difference between the amounts of postretirement benefits recoverable in rates and the amounts of post- retirement benefits determined by the actuary under SFAS 106, "Employers Accounting for Postretirement Benefits Other Than Pensions," are deferred as either a regulatory asset or liability, as appropriate.

Reconciliations of Pension and OPEB Plans' benefit obligation, plan assets and funded status, as well as the components of net periodic pension cost and the weighted average assumptions are as follows:

	Pension Benefits		Other Benefits	
	1998	1997	1998	1997
	In Thousands		In Thousands	
Change in Benefit Obligation:				
Benefit obligation at beginning of year	$225,038	$201,779	$78,953	$71,481
Service cost	5,205	4,578	2,076	1,745
Interest cost	16,234	15,504	5,610	5,264
Plan amendments	14,439	-	-	-
Benefits paid	(12,433)	(11,750)	(2,973)	(2,606)
Actuarial (gain) or loss	22,021	14,927	9,805	3,069
Benefit Obligation at End of Year	$270,504	$225,038	$93,471	78,953
Change in Plan Assets:				
Fair value of plan assets at beginning of year	$316,852	$268,615	$45,109	$31,402
Actual return on plan assets	6,040	60,842	10,607	10,004
Employer contributions	72	48	5,489	6,431
Benefits paid	(12,433)	(11,750)	(3,569)	(2,606)
Administrative Expenses	(1,494)	(903)	(456)	(122)
Fair Value of Plan Assets at End of Year	$309,037	$316,852	$ 57,180	$ 45,109
Reconciliation of Funded status:				
Funded status	$ 38,533	$ 91,814	$ (36,291)	$ (33,844)
Unrecognized actuarials (gain)	(18,985)	(73,949)	(9,800)	(14,716)
Unrecognized transition (asset) or obligation	(2,065)	(2,700)	43,579	46,693
Unamortized prior service cost	20,179	6,292	(129)	(139)
Accrued Benefit Cost	$ 37,662	$ 21,457	$ (2,641)	$ (2,006)
Components of Net Periodic Benefit Cost:				
Service cost	$ 5,205	$ 4,578	$ 2,076	$ 1,745
Interest cost	16,234	15,504	5,610	5,264
Expected return on plan assets	(27,325)	(24,373)	(2,867)	(1,886)
Amortization of prior service cost	552	355	(10)	(10)
Amortization of transitional (asset) or obligation	(635)	(635)	3,114	3,114
Recognized actuarial (gain) or loss	(10,162)	(7,846)	(1,789)	(1,504)
Net Periodic actuarial Benefit Cost	$ (16,131)	$ (12,417)	$ 6,134	$ 6,723
Weighted-average assumptions as of December 31:				
Discount rate	6.50%	7.25%	6.50%	7.25%
Expected long-term rate of return on plan assets	8.50%	9.25%	6.80%	6.80%
Rate of compensation increase	4.00%	4.50%	4.00%	4.50%

For measurement purposes, a 9.5% (9.9% for participants over age 65) annual rate of increase in the per capita cost of covered health benefits is assumed for 1999. The rate is assumed to decrease gradually to 5.5% for 2008 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage-Point Decrease	One-Percentage-Point Increase
Effect on total of service and interest cost components for 1998	$ 1,138,000	$ (987,000)
Effect on year-end 1998 postretirement benefit obligation	$12,245,000	$(10,826,000)

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Nuclear Liability Insurance

The Price-Anderson Act is a federal law which limits the public liability which can be imposed with respect to a nuclear incident at a licensed nuclear electric generating facility. Such Act also provides for assessment of owners of all licensed nuclear units in the United States for losses in excess of certain limits in the event of a nuclear incident at any such licensed unit. Under the provisions of the Price-Anderson Act, the Company's potential assessment (based on its 9% ownership interest in the Nine Mile 2 Plant and assuming that the other Nine Mile 2 Plant cotenants were to contribute their proportionate shares of the potential assessments) would be $7.6 million (subject to adjustment for inflation) and the Company could be assessed $378,000 (subject to adjustment for inflation) as an additional surcharge, but would be limited to a maximum assessment of $900,000 in any year with respect to any nuclear incident. The public liability insurance coverage of $200 million required under the Price-Anderson Act for the Nine Mile 2 Plant is provided through Niagara Mohawk.

The Company also carries insurance to cover the additional costs of replacement power (under a Business Interruption and/or Extra Expense Insurance Policy) incurred by the Company in the event of a prolonged accidental outage of the Nine Mile 2 Plant. This insurance arrangement provides for payments of up to $276,000 per week if the Nine Mile 2 Plant experiences a continuous accidental outage which extends beyond 21 weeks. Such payments will continue for 52 weeks after expiration of the 21-week deductible period, and thereafter the insurer shall pay 80% of the weekly indemnity for a second and third 52-week period. Subject to certain limitations, the Company may request prepayment, in a lump sum amount, of the insurance payments which would otherwise be paid to it with respect to said third 52-week period, calculated on a net present value basis.

The Company is insured as to its respective interest in the Nine Mile 2 Plant under property damage insurance provided through Niagara Mohawk. The insurance coverage provides $500 million of primary property damage coverage for both Units of the Nine Mile Point Nuclear Station and $2.25 billion of excess property damage coverage solely for Unit 2 of that station. Such insurance covers decontamination costs, debris removal and repair and/or replacement of property.

The Company intends to maintain, or cause to be maintained, insurance against such risks at the Nine Mile 2 Plant, provided such coverage can be obtained at an acceptable cost.

Environmental Matters

General: On an ongoing basis, the Company assesses environmental issues which could impact the Company and its customers.

Clean Water Act Compliance: In 1992 the Company filed renewal applications for the State Pollution Discharge Elimination System ("SPDES") permits for its Roseton and Danskammer Plants. Such permits are required to operate the Plants' cooling water systems and wastewater treatment systems. The Company is a party to an active proceeding before the New York State Department of Environmental Conservation ("NYSDEC") related to the processing of the application for the Roseton Plant. The utility participants in the proceeding agreed to prepare and submit a revised Draft Environmental Impact Statement ("DEIS") with a target date of December 31, 1999. NYSDEC has indicated that draft SPDES permits will be issued after the revised DEIS is filed. At this stage of the proceeding, the Company can make no determination as to the outcome of the proceeding or the impact, if any, on the Company's financial position.

Clean Air Act Amendments: The Clean Air Act Amendments of 1990 ("CAA Amendments") added several new programs which address attainment and maintenance of national ambient air quality standards. These include control of emissions from fossil-fueled electric generating plants that affect "acid rain" and ozone. At December 15, 1998, the Company believes it was in full compliance with regulations promulgated to date under the CAA Amendments. Ongoing federal and state clean air initiatives may require the Company to reduce its emissions in the future.

The Company's emissions of nitrogen oxides ("NOx") were subject to additional controls, effective May 31, 1995, under Title I of the CAA Amendments. The Company has installed appropriate controls in compliance with this requirement. The Northeast Ozone

Transport Commission ("OTC"), of which New York State is a member, has agreed that additional reductions of NOx emissions will be required in 1999 and, possibly, in the year 2003. The NYSDEC has proposed regulations intended to implement the 1999-2002 NOx emissions reduction contemplated by OTC. The Company is developing plans to comply with the NYSDEC proposal and believes that it can do so by fuels and operation management not requiring the use of additional back-end emissions controls.

In July 1997, the Environmental Protection Agency ("EPA") promulgated proposed revisions to the National Ambient Air Quality Standards for ozone and particulates. These regulations may result in the need for additional reductions of sulfur dioxide and NOx emissions, depending on the results of ongoing ambient air monitoring programs. Should monitoring determine that counties in the vicinity of the Company's electric generating stations exceed the new standards, emissions reductions could be required. However, ambient air monitoring for particulates will not be completed until 2002, at which time the EPA also intends to complete a reassessment of health risks associated with particulate emissions. Additional controls of NOx emissions that are associated with ozone formation are required in 2003 under rules promulgated by the EPA in September 1998. EPA has established limits on NOx emissions for each of 22 states in the midwest, southeast and northeast.

While it is not presently possible to determine the additional emissions reductions, if any, required at the Company's facilities under this EPA rule, the Company expects that they can be achieved by conventional control technologies, in combination with prudent operational management.

Beginning in 1997, the NYSDEC began an initiative seeking penalties from all New York electric utilities for past opacity variances and requiring various opacity reduction measures and stipulated penalties for future excursions after execution of a consent order. Each New York State electric utility, including the Company, is in the process of negotiating, or has negotiated, the various terms and conditions of a draft consent order with the NYSDEC. The Company's facilities, which are the subject of these negotiations, are in its Danskammer Plant and its Roseton Plant. The outcome of this matter is uncertain at this time; however, the Company believes that the amount of any civil penalty payment and implementation of an opacity reduction program, in the aggregate, will not be material.

Former Manufactured Gas Plant Facilities

In October 1995, the Company and the NYSDEC entered into an Order on Consent regarding the development and implementation of an investigation and remediation program for the Company's former coal gasification plant ("Central Hudson Site"), the City of Newburgh, New York's ("City") adjacent and nearby property and the adjoining areas of the Hudson River. Remedial investigations were completed in September 1997. A draft report on the investigations was provided to the NYSDEC for its review and comment on October 31, 1997. The investigations revealed the presence of contaminants in the soil in portions of the study area. In the majority of the study area contaminants were found deep within the ground and are not a threat to the public. Contaminated ground water is associated with the contaminated soil, but it is not used as a drinking water supply. Impacted sediments were also present within the Hudson River adjacent to the City's property, which is the location of its sewage treatment plant. There are several possible sources of the contaminants due to the long industrial history and current uses of the area.

The Company is conducting additional studies as part of the remedial investigation required by the Order on Consent with NYSDEC. The results of these studies will be provided as part of a revised final report on the remedial investigation to the NYSDEC in early 1999.

Following NYSDEC's approval of the report and its determination whether or not the contaminants found in the investigation may pose a significant threat to human health or the environment, a risk assessment will be completed by the Company, if required. Remedial alternatives addressing any unacceptable risks identified in the risk assessment will be evaluated. It is currently anticipated that the risk assessment and remedial alternatives report will be completed in 1999.

In May 1995, the City filed suit against the Company in the United States District Court for the Southern District of New York. The City alleges that the Company has released certain allegedly hazardous substances without a permit from the Central Hudson Site in Newburgh, New York into the ground at the Central Hudson Site and into adjacent and nearby property of the City, in violation of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the federal Resource Conservation and Recovery Act ("RCRA") and the federal Emergency Planning and Community Right to Know Act ("EPCRA"). The City also alleges a number of nuisance, trespass, damage and indemnification claims pursuant to New York State law.

The City seeks injunctive relief against such alleged disposal, storage or release of hazardous substances at the Central Hudson Site, remediation and abatement of the conditions alleged to lead to endangerment of the City's property, payment of restitution of clean-up costs and monetary damages of at least $70 million, assessment of certain civil penalties under RCRA, CERCLA and EPCRA, and recovery of the City's costs and attorneys' fees in such action.

The trial on this matter began November 30, 1998, and on December 18, 1998, the jury made its determination that the proper cost of environmental remediation on the City's property is $20 million and the Company's share is 80% (or $16 million). In addition, the jury awarded the City $435,000 of damages for increased costs of future operations of the City's sewage treatment plant due to the existence of contamination.

The Court reserved to itself decision on the City's allegations that the Company violated certain provisions of the federal RCRA and the EPCRA. The extent of exposure to the Company under these allegations cannot be estimated. In addition, the City's request for attorney's and consultant's fees (estimated to be approximately $5 million) also is yet to be determined by the Court.

The Court is expected to issue a decision on the matters referred to in the immediately preceding paragraph in the Spring of 1999. Upon issuance of such decision either party will have 30 days to appeal the jury's decision and/or the Court's decision.

The Company and the City have stipulated that the damages for clean-up costs awarded by the jury will be deposited by the City into an interest earning account ("Clean-up Fund") which, upon Court approval, shall be applied to the costs of the environmental clean-up of the City's properties pursuant to the said Order on Consent. Any excess funds in the Clean-up Fund shall be retained by the City. Within 45 days after any appeals become final in this matter, the City may apply to the NYSDEC to assume the responsibilities of the Company under said Order on Consent. If the City does not so apply to NYSDEC, or does apply and is not accepted for substitution by the NYSDEC, the Company shall continue to be responsible for the clean-up under said Order on Consent. In the event the amount in the Clean-up Fund is not sufficient to satisfy the clean-up responsibilities under said Order on Consent, the party responsible for the clean-up will be responsible for any excess required to comply with said Order on Consent.

In July 1998, the City and the Company entered into an agreement ("Newburgh Agreement") which allowed the City to recommence construction at its sewage treatment plant. The Newburgh Agreement provides for the City to construct a clarifier at the sewage treatment plant and to deal appropriately with any contaminants that may be encountered during the construction activities and for the Company to fund these construction and related activities. The Company estimates that the cost of such construction and other related activity is approximately $2.8 million. The Company's obligation to fund the costs of constructing the clarifier at the City's sewage treatment plant is in addition to the jury award, discussed above.

As of December 31, 1998, the Company recorded liabilities of $16.4 million and $2.4 million regarding this matter which are included in "Deferred Credit and Other Liabilities - Other" and "Current Liabilities - Other," respectively, in the Company's Consolidated Balance Sheet.

By letter dated June 3, 1997, the Company received authorization from the PSC to defer costs related to this matter, including legal defense costs, but excluding the Company's labor, related to environmental site investigation and remediation actions. The Company has deferred costs expended to date that it expects to be recovered in future rates. The cumulative deferred costs for 1998 amounted to $22.7 million and were included in "Deferred Charges-Regulatory Assets" in the Company's Consolidated Balance Sheet.

The Company can make no prediction as to the full financial effect this matter will have on it, including the extent, if any, of insurance reimbursement and including implementation of environmental clean-up under said Order on Consent.

Asbestos Litigation

Since 1987, the Company, along with many other parties, has been joined as a defendant or third-party defendant in 1,576 asbestos lawsuits commenced in New York State and federal courts. The plaintiffs in these lawsuits have each sought millions of dollars in compensatory and punitive damages from all defendants. The cases were brought by or on behalf of individuals who have allegedly suffered injury from exposure to asbestos, including exposure which allegedly occurred at Company facilities.

To date, of the 1,576 cases that had been brought against the Company, 642 remained pending against the Company. The 934 cases that were no longer pending against the Company, as of December 31, 1998, were resolved as follows: (i) the Company negotiated voluntary dismissals in 685 cases and won summary judgement dismissals in 10 cases; (ii) 113 third-party claims were extinguished with respect to the Company when the third party plaintiff, Owens Corning Fiberglas settled the cases with the plaintiffs; and (iii) the Company settled 126 cases. The Company is presently unable to assess the validity of the remaining asbestos lawsuits; accordingly, it cannot determine the ultimate liability relating to these cases. Based on information known to the Company at this time, including its experience in settling asbestos cases and in obtaining dismissals of asbestos cases, the Company believes that the cost to be incurred in connection with the remaining lawsuits will not have a material adverse effect on the Company's financial position or results of operations.

The Company is insured under successive comprehensive general liability policies issued by a number of insurers, has put such insurers on notice of the asbestos lawsuits and has demanded reimbursement for its defense costs and liability.

Purchased Power Commitments

Under federal and New York State laws and regulations, the Company is required to purchase the electrical output of unregulated cogeneration facilities ("IPPs") which meet certain criteria for Qualifying Facilities, as such term is defined in the appropriate legislation. Purchases are made under long-term contracts which require payment at rates higher than what can be purchased on the wholesale market. These costs are currently fully recoverable through the Company's electric fuel adjustment clause, with one exception, for which the impaired portion of the contract has been recognized as a reduction to income. IPPs with which the Company has contracts represent 6% of the Company's energy purchases in 1998.

Other Matters

The Company is involved in various other legal and administrative proceedings incidental to its business which are in various stages. While these matters collectively involve substantial amounts, it is the opinion of management that their ultimate resolution will not have a material adverse effect on the Company's financial position or results of operations.

Included in such proceedings are lawsuits against the Company arising from a November 1992 explosion in a dwelling in Catskill, New York. One lawsuit in this matter alleging personal injuries, the death of an occupant, and property damage and recovery of an unspecified amount of compensatory and punitive damages was settled in January 1999 in an amount that is not material to the Company; and one lawsuit remains, alleging personal injuries and property damage and compensatory and punitive damages in the sum of $4 million.

In addition to the above, on February 12, 1994, a fire and an explosion destroyed a residence in the Village of Wappingers Falls, New York, in the Company's service territory. A short time later, a second explosion and fire destroyed a nearby commercial facility. Lawsuits commenced against the Company arising out of the Wappingers Falls incident include one alleging property damage and seeking recovery of $250,000 in compensatory damages and one alleging personal injuries and property damage and seeking an unspecified amount of damages against the Company. All such lawsuits have been consolidated; however, no trial date has been set.

The Company is investigating the above claims and presently has insufficient information on which to predict their outcome. The Company believes that it has adequate insurance to cover any compensatory damages that might be awarded. The Company's insurance, however, does not extend to punitive damages which, if awarded, could have a material adverse effect on the Company's financial position.

NOTE 10 - SEGMENTS AND RELATED INFORMATION

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," during the fourth quarter of 1998. SFAS No. 131 established standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also established standards for related disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision-making group includes the senior executive officers.

The Company's reportable operating segments are its electric and gas operations. The Company's "Other Segment" consist primarily of Central Hudson Enterprises Corporation and CH Resources, Inc., both of which are non-regulated energy businesses. All of the segments currently operate in the northeast region of the United States.

Certain additional information regarding these segments is set forth in the following table. General corporate expenses, property common to both segments and depreciation of such common property have been allocated to the segments in accordance with practice established for regulatory purposes.

Central Hudson Gas & Electric Segment Disclosure - FAS 132 Year Ended December 31,

	Electric	Gas	Other	Total
		1998		
Net revenues from external customers	$418,426	$ 84,898	$ -	$ 503,324
Intersegment net revenues	80	65	-	145
Total net revenues	418,506	84,963	-	503,469
Depreciation and amortization	40,996	4,564	-	45,560
Interest expense	23,803	3,875	-	27,678
Interest income	695	87	-	782
Income tax (credit) expense	24,646	3,981	-	28,627
Earnings per share	2.51	0.35	0.04	2.90
Segment assets	1,093,455	169,587	52,996	1,316,038
Construction Expenditures	39,183	6,478	-	45,661
		1997		
Net revenues from external customers	$ 416,346	$103,835	$ -	$520,181
Intersegment net revenues	83	13	-	96
Total net revenues	416,429	103,848	-	520,277
Depreciation and amortization	39,480	4,384	-	43,864
Interest expense	23,186	3,464	-	26,650
Interest income	1,970	290	-	2,260
Income tax (credit) expense	21,405	4,835	-	26,237
Earnings per share	2.58	0.37	0.02	2.97
Segment assets	1,067,042	163,021	22,027	1,252,090
Construction Expenditures	36,685	7,183	-	43,868
		1996		
Net revenues from external customers	$418,673	$ 95,228	$ -	$ 513,901
Intersegment net revenues	88	(18)	-	70
Total net revenues	418,761	95,210	-	513,971
Depreciation and amortization	38,401	4,179	-	42,580
Interest expense	23,649	3,534	-	27,183
Interest income	263,426	36,748	-	300,174
Income tax (credit) expense	27,103	3,965	-	31,068
Earnings per share	2.67	0.27	0.05	2.99
Segment assets	1,066,185	160,764	22,157	1,249,106
Construction Expenditures	43,359	6,501	-	49,860

NOTE 11 - FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Temporary Cash Investments: The carrying amount approximates fair value because of the short maturity of those instruments.

Cumulative Preferred Stock Subject to Mandatory Redemption: The fair value is estimated based on the quoted market price of similar instruments.

Long-Term Debt: The fair value is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities and quality.

Notes Payable: The carrying amount approximates fair value because of the short maturity of those instruments.

The estimated fair values of the Company's financial instruments are as follows:

	Carrying Amount	Fair Value
	December 31, 1998	
	(In Thousands)	
Cumulative preferred stock subject to mandatory redemption	$ (35,000)	$ (37,083)
Long-term debt (including current maturities)	(396,425)	(413,905)
	December 31, 1997	
Cumulative preferred stock subject to mandatory redemption	$ (35,000)	$ (39,100)
Long-term debt (including current maturities)	(363,146)	(382,837)

Selected Quarterly Financial Data (Unaudited)

Selected financial data for each quarterly period within 1998 and 1997 are presented below:

Quarter Ended:	Operating Revenues	Operating Income (In Thousands)	Income Available for Common Stock	Earnings Per Average Share of Common Stock Outstanding (Dollars)
1998				
March 31	**$143,882**	**$24,003**	**$18,360**	**$1.06**
June 30	**112,106**	**14,404**	**9,234**	**.54**
September 30	**125,723**	**18,350**	**13,003**	**.77**
December 31	**121,758**	**14,543**	**8,717**	**.53**
1997				
March 31	$151,875	$25,802	$20,678	$1.18
June 30	118,604	14,842	9,657	.55
September 30	123,507	17,911	12,561	.72
December 31	126,291	11,501	8,963	.52

Schedule II - Reserves

Description	Balance at Beginning of Period	Additions: Charged to Cost and Expenses	Additions: Charged to Other Accounts	Payments Charged to Reserves	Balance at End of Period
YEAR ENDED DECEMBER 31, 1998					
Operating Reserves	$6,581,614	$7,474,979	$ 103,700	$8,165,693	$5,994,600
Reserve for Uncollectible Accounts	$2,800,000	$2,638,719	$ -	$3,038,719	$2,400,000
YEAR ENDED DECEMBER 31, 1997					
Operating Reserve	$4,755,264	$2,142,391	$ 334,700	$ 650,741	$6,581,614
Reserve for Uncollectible Accounts	$3,200,000	$3,493,405	$ -	$3,893,405	$2,800,000
YEAR ENDED DECEMBER 31, 1996					
Operating Reserves	$6,024,101	$2,665,136	$ 195,608	$4,129,581	$4,755,264
Reserve for Uncollectible Accounts	$2,500,000	$4,335,676	$ -	$3,635,676	$3,200,000

ITEM 9

Changes In And Disagreements With Accountant On Accounting And Financial Disclosure

None.

Part III

ITEM 10

Directors And Executive Officers Of The Company

The information with respect to the Directors of the Company required hereunder is incorporated by reference to the caption "Election of Directors" in the Company's definitive proxy statement, to be dated March 1, 1999, and to be used in connection with its Annual Meeting of Shareholders to be held on April 27, 1999, which proxy statement will be submitted to the Securities and Exchange Commission pursuant to that Commission's Regulation S-T.

The information with respect to the executive officers of the Company required hereunder is incorporated by reference to Item 1 herein, under the caption "Executive Officers of the Company."

ITEM 11

Executive Compensation

The information required hereunder is incorporated by reference to the caption "Executive Compensation" in the Company's definitive proxy statement, to be dated March 1, 1999, and to be used in connection with its Annual Meeting of Shareholders to be held on April 27, 1999.

ITEM 12

Security Ownership Of Certain Beneficial Owners And Management

The information required hereunder is incorporated by reference to the caption "Security Ownership" in the Company's definitive proxy statement, to be dated March 1, 1999, and to be used in connection with its Annual Meeting of Shareholders to be held on April 27, 1999.

ITEM 13 - Certain Relationships And Related Transactions

There were no relationships or transactions of the type required to be described by this Item.

Part IV

ITEM 14

Exhibits, Financial Statement Schedule, And Reports On Form 8-K

(a) Documents filed as part of this Report

1. and 2. All Financial Statements and Financial Statement Schedules filed as part of this Report are included in Item 8 of this Form 10-K and reference is made thereto.

3. Exhibits

Incorporated herein by reference to the Exhibit Index for this Report. Such Exhibits include the following management contracts or compensatory plans or arrangements required to be filed as an Exhibit pursuant to Item 14(c) hereof:

Description in the Exhibit List and Exhibit Nos. for this Report

Directors' Deferred Compensation Plan, effective October 1, 1980. (Exhibit (10)(iii)1)

Executive Deferred Compensation Plan of the Company, effective March 1, 1992, together with Amendment thereto dated December 17, 1993 and December 1, 1998. (Exhibits (10)(iii)2, 5 and 17)

Retirement Benefit Restoration Plan of the Company, effective May 1, 1993, together with Amendments thereto effective July 23, 1993 and December 1, 1998. (Exhibits (10)(iii)3, 4 and 18)

Agreement, made March 14, 1994, by and between Registrant and Mellon Bank, N.A., amending and restating, effective April 1, 1994, Registrant's Savings Incentive Plan and related Trust Agreement with The Bank of New York, together with amendments dated July 22, 1994, and December 16, 1994. (Exhibits (10)(iii)7, 8 and 9)

Executive Incentive Compensation Plan of the Company, effective January 3, 1993, as amended and restated, effective April 4, 1995. (Exhibits (10)(iii) 6 and 10)

Stock Plan for Outside Directors of the Company, dated November 17, 1995. (Exhibit (10)(iii)11)

Management Incentive Program of the Company, effective April 1, 1994, together with Amendment thereto dated July 25, 1997. (Exhibits (10)(iii)12 and 13)

Change-of-Control Severance Policy, as approved by the Board of Directors October 23, 1998 and, effective December 1, 1998, for all management employees of the Company.

Form of Employment Agreement, dated October 23, 1998, effective December 1, 1998, for all officers of the Company.

Employment Agreement, dated October 23, 1998, effective December 1, 1998, for the President and Chief Executive Officer of the Company.

(b) Reports on Form 8-K

During the last quarter of the period covered by this Report and including the period to the date hereof, the following Reports on Form 8-K were filed by the Company:

1) Report dated October 9, 1998, relating to a special shareholders meeting held on September 25, 1998, at which more than the required two-thirds of outstanding shares of the Company were voted in favor of establishing a holding company, CH Energy Group, Inc., which holding company is more fully described under the caption "Competition/ Deregulation" in Item 7 of Part I of this Annual Report on Form 10-K and the Company's Registration Statement, on Form S-4, Registration No. 333-52797 filed with the SEC.

2) Report dated December 22, 1998, relating to the jury decision in the lawsuit filed by the City of Newburgh against the Company as reported under the caption "Former Manufactured Gas Plant Facilities" in Note 9 - "Commitments and Contingencies" to the Company's Consolidated Financial Statements made a part of this Annual Report on Form 10-K.

3) Report dated January 15, 1999, relating to the Company's sale of a tranche of Medium-Term Notes in the aggregate principal amount of $20 million, such sale being authorized under the Company's shelf registration statement on Form S-3 (Registration No. 333-65597) as filed with the SEC.

(c) Exhibits Required by Item 601 of Regulation S-K

Incorporated herein by reference to subpart (a)-3 of Item 14, above.

Note to Shareholders: The copy of this Annual Report to the SEC, on Form 10-K for the fiscal year ended December 31, 1998, does not contain the list of exhibits contained in the copy of the Report as filed with the SEC. Shareholders who wish to obtain a copy of the list of exhibits may obtain it without charge by contacting: Steven V. Lant, Chief Financial Officer, Treasurer and Corporate Secretary, Central Hudson Gas & Electric Corporation, 284 South Avenue, Poughkeepsie, NY 12601-4879, telephone (914) 486-5254; E-mail: http://www.cenhud.com. Copies of the exhibits can be purchased from the Company for a specified fee.

(d) Financial Statement Schedule required by Regulation S-X which is excluded from the Company's Annual Report to Shareholders for the fiscal year ended December 31, 1998

Not applicable, see Item 8 hereof.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CENTRAL HUDSON GAS & ELECTRIC CORPORATION

By John E. Mack III

(John E. Mack III, Chairman of the Board)

Dated: March 1, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following person on behalf of the Company and in the capacities and on the date indicated:

Signature	Title	Date
(a) Principal Executive Officer or Officers:		
(John E. Mack III)	Chairman of the Board	March 1, 1999
(Paul J. Ganci)	President and Chief Executive Officer	March 1, 1999
(b) Principal Accounting Officer:		
(Donna S. Doyle)	Controller	March 1, 1999
(c) Chief Financial Officer:		
(Steven V. Lant)	Chief Financial Officer, Treasurer and Corporate Secretary	March 1, 1999

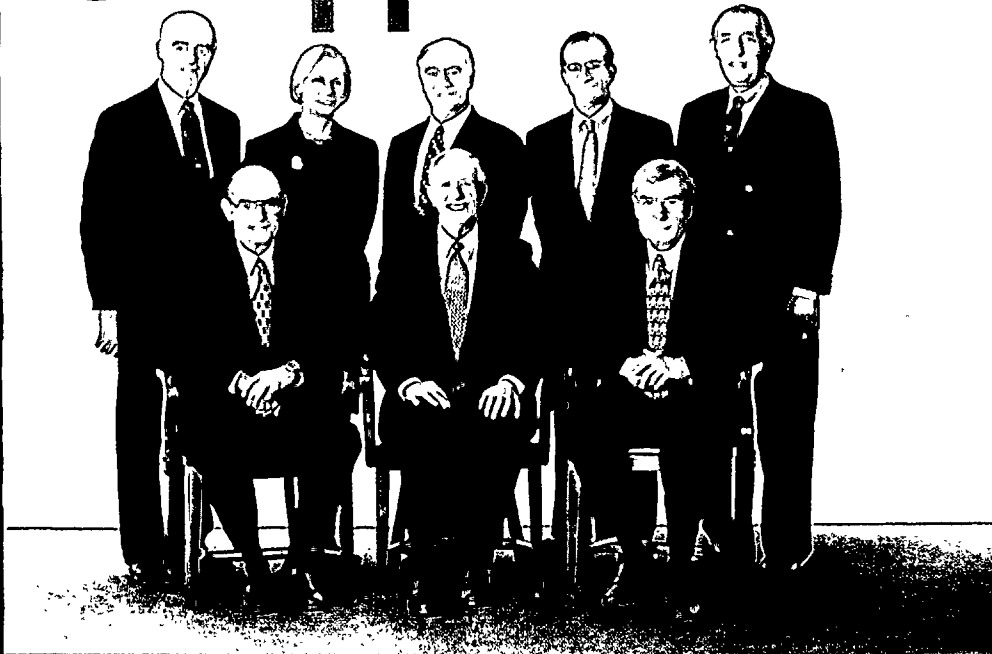
(d) A majority of Directors:

Jack Effron*, Frances D. Fergusson*, Heinz K. Fridrich*, Edward F.X.Gallagher*, Paul J. Ganci*, Charles LaForge* and John E. Mack III*, Directors

By (John E. Mack III) March 1, 1999

* *John E. Mack, III, by signing his name hereto, does thereby sign this document for himself and on behalf of the persons named above after whose printed name an asterisk appears, pursuant to powers of attorney duly executed by such persons and filed with the Securities and Exchange Commission as Exhibit 24 hereof.*

Central Hudson



Seated: Jack Effron, John E. Mack III & Heinz K. Fridrich. Standing: Edward F.X. Gallagher, Frances D. Fergusson, Paul J. Ganci, Edward P. Swyer & Charles LaForge.

Board of Directors

Jack Effron
Poughkeepsie, NY *1987
President, EFCO Products, Inc.; Chairman of the Committee on Compensation & Succession and member of the Executive and Finance Committees

Frances D. Fergusson
Poughkeepsie, NY *1993
President, Vassar College; member of the Compensation & Succession and Audit Committees

Heinz K. Fridrich
Fernandina Beach, FL *1988
Courtesy Professor, University of Florida, Gainesville Florida; Former Vice President — Manufacturing, IBM Corp.; Chairman of the Committee on Audit; member of the Executive Committee

Edward F.X. Gallagher
Newburgh, NY *1984
Chairman and Owner, Gallagher Transportation Services; member of the Committee on Finance

Paul J. Ganci
Poughkeepsie, NY *1989
President and Chief Executive Officer (appointed effective August 1, 1998); member of the Executive and Finance Committees

Charles LaForge
Rhinebeck, NY *1987
President, Wayfarer Inns and Owner, Beekman Arms; member of the Retirement and Audit Committees

John E. Mack III
Poughkeepsie, NY *1981
Chairman of the Board; Chairman of the Executive, Finance and Retirement Committees

Edward P. Swyer
Albany, NY *1990
President, the Swyer Companies; member of the Compensation & Succession and the Retirement Committees

* Year Joined the Board

Officers of the Board

John E. Mack III
Chairman of the Board and the Executive, Finance and Retirement Committees

Jack Effron
Chairman of the Compensation & Succession Committee

Heinz K. Fridrich
Chairman of the Audit Committee

Officers

Paul J. Ganci
President & Chief Executive Officer

Carl E. Meyer
Executive Vice President
— Operations

Allan R. Page
Executive Vice President
— Energy Resources & Development

Steven V. Lant
Treasurer, Corporate Secretary & Chief Financial Officer

Arthur R. Upright
Senior Vice President
— Regulatory Affairs, Fin. Planning & Accounting

Donna S. Doyle
Controller

Ronald P. Brand
Senior Vice President
— Engineering, Env. Affairs & Special Projects

Joseph J. DeVirgilio, Jr.
Senior Vice President
— Corporate Services & Administration

James P. Lovette
Vice President
— Generation

John C. Checklick
Assistant Vice President
— Customer Services

Gladys L. Cooper
Assistant Vice President
— Governmental Relations

William P. Reilly
Assistant Secretary & Assistant Treasurer


Central Hudson

Long Island Power Authority and Subsidiaries

Consolidated Financial Statements and Other Financial Information December 31, 1998 and March 31, 1998

Long Island Power Authority and Subsidiaries

Index

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
401 Broad Hollow Road
Melville NY 11747
Telephone (516) 753 2700
Facsimile (516) 753 2800

Report of Independent Accountants

March 5, 1999

To the Board of Trustees
of Long Island Power Authority and Subsidiaries

In our opinion, the accompanying consolidated statements of financial position and of capitalization and the related consolidated statements of revenues, expenses and changes in accumulated deficit and of cash flows present fairly, in all material respects, the financial position of Long Island Power Authority and its subsidiaries (collectively, the "Company") at December 31, 1998 and March 31, 1998, and the results of their operations and their cash flows for the nine and twelve months then ended, respectively, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

The year 2000 supplementary information on page 36 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures required by professional standards because the disclosure criteria specified by TB 98-1, as amended, are not sufficiently specific and, therefore, preclude the prescribed procedures from providing meaningful results. In addition, we do not provide assurance that the Company is or will become year 2000 compliant, that the Company's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Company does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 5, 1999, on our consideration of the Company's compliance and internal control over financial reporting.

PricewaterhouseCoopers LLP

Long Island Power Authority and Subsidiaries
Consolidated Statements of Financial Position
(Thousands of Dollars)

	December 31, 1998	March 31, 1998
Assets		
Utility Plant, net	$ 2,071,482	$ -
Property and Equipment, net	822	106
Current Assets		
Cash and cash equivalents (including $184 of restricted cash at March 31, 1998)	517,264	5,910
Customer accounts receivable (less allowance for doubtful accounts of $20,211)	119,161	-
Other accounts receivable	10,096	-
Accrued unbilled revenues	78,414	-
Promissory note receivable	398,000	-
Prepayments and other current assets	28,790	122
Total Current Assets	1,151,725	6,032
Promissory Note Receivable	646,902	-
Designated Funds	194,972	-
Nonutility Property and Other Investments	19,410	-
Deferred Charges	78,507	2,310
Acquisition Adjustment (net of accumulated amortization of $68,766 at December 31, 1998 and zero at March 31, 1998)	4,026,956	11,671
Total Assets	$ 8,190,776	$ 20,119
Capitalization		
Long-term debt	$ 7,487,018	$ -
Accumulated deficit	(100,055)	(23,926)
Total Capitalization	7,386,963	(23,926)
Current Liabilities		
Current maturities of long-term debt	468,880	-
Due to KeySpan	75,040	-
New York Power Authority advance	-	9,000
State of New York appropriations/advances	-	26,160
Accounts payable and accrued expenses	42,623	8,885
Accrued taxes	79,021	-
Accrued interest	63,387	-
Customer deposits	23,205	-
Total Current Liabilities	752,156	44,045
Deferred Credits	34,059	-
Claims and Damages	17,598	-
Commitments and Contingencies		
Total Capitalization and Liabilities	$ 8,190,776	$ 20,119

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

Long Island Power Authority and Subsidiaries
Consolidated Statements of Revenues, Expenses and Changes in Accumulated Deficit
(Thousands of Dollars)

	Nine Months Ended December 31, 1998	Twelve Months Ended March 31, 1998
Revenue		
Electric	$ 1,377,605	$ -
Contractual	-	40,976
Total revenues	1,377,605	40,976
Expenses		
Operations - fuel and purchased power	408,192	-
Operations and maintenance	387,643	-
General and administrative	10,497	1,098
Depreciation and amortization	122,022	13
Payments in lieu of taxes	157,561	40,892
Customer rebates	168,806	-
Total Operating Expenses	1,254,721	42,003
Excess of operating revenues/(expenses) over expenses/(revenues)	122,884	(1,027)
Other income and (deductions), net		
Investment income	33,720	268
Other	(249)	30
Total other income, net	33,471	298
Excess of revenues/(expenses) over expenses/(revenues) before interest charges and (credits)	156,355	(729)
Interest charges and (credits)		
Interest on long-term debt, net	223,852	-
Other interest	9,933	-
Allowance for borrowed funds used during construction	(1,301)	-
Total interest charges	232,484	-
Excess of expenses over revenues	(76,129)	(729)
Accumulated deficit		
Beginning	(23,926)	(23,197)
Ending	$ (100,055)	$ (23,926)

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

Long Island Power Authority and Subsidiaries
Consolidated Statements of Cash Flows
(Thousands of Dollars)

	December 31, 1998	March 31, 1998
Operating Activities		
Excess of expenses over revenues	(76,129)	(729)
Adjustments to reconcile excess of expenses over revenues to net cash provided by (used in) operating activities		
Depreciation and amortization	122,022	13
Amortization of cost of issuing and redeeming securities	1,705	-
Other	1,973	-
Changes in operating assets and liabilities		
Accounts receivable, net and accrued unbilled revenue	34,568	-
Accounts payable and accrued expenses	33,738	(900)
Net change in Due to KeySpan	(136,757)	(84)
Accrued taxes	56,358	-
Accrued interest	63,386	(89)
Other	45,573	(2)
Net cash provided by (used in) operating activities	146,437	(1,791)
Investing Activities		
Capital and nuclear fuel expenditures	(71,800)	(75)
Merger costs, net of cash transferred	(49,827)	(5,467)
Acquisition of common stock, net of $75,000 cash transferred	(2,422,500)	-
Proceeds of investment securities, net of purchases - unrestricted	-	2,413
Proceeds of investment securities, net of purchases - restricted	-	256
Net cash used in investing activities	(2,544,127)	(2,873)
Cash Flows from Non-Capital related Financing Activities		
(Repayment) Proceeds of State of New York advances	(26,160)	1,400
(Repayment) Proceeds of New York Power Authority advance	(9,000)	9,000
Net cash (used in) provided by non-capital related financing activities	(35,160)	10,400
Cash Flows from Capital and related Financing Activities		
Proceeds from notes receivable	3,000	-
Proceeds from the issuance of bonds	6,779,823	-
Redemption of long-term debt	(3,338,659)	-
Redemption of preferred stock	(221,600)	-
Bond issuance costs	(79,397)	-
Other	(3,991)	-
Net cash provided by capital and related financing activities	3,139,176	-
Net Increase in cash and cash equivalents	706,326	5,736
Cash and cash equivalents at beginning of period	5,910	174
Cash and cash equivalents at end of period	$ 712,236 *	$ 5,910
Interest paid	$ 305,993	$ -

*Includes designated funds.

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

Long Island Power Authority and Subsidiaries
Consolidated Statements of Capitalization
(Thousands of Dollars)

	Maturity	Interest Rate	Series	December 31, 1998	March 31, 1998
Electric System General Revenue Bonds					
Serial Bonds	December 1, 1999 to 2016	4.10% to 6.00% a	1998A	$ 1,279,965	$ -
Taxable Term Bonds	December 1, 1999	5.94% a	1998A	25,000	-
Term Bonds	December 1, 2018 to 2029	5.00% to 5.75% a	1998A	1,998,770	-
Capital Appreciation Bonds	December 1, 2003 to 2028	4.40% to 5.30% a	1998A	150,095	-
Serial Bonds	April 1, 2000 to 2016	4.25% to 5.13% a	1998B	1,256,655	-
Term Bonds	April 1, 2018	4.75% a	1998B	57,145	-
Electric System Subordinated Revenue Bonds					
	May 1, 2033	4.15% b	Series 1	250,000	-
	May 1, 2033	3.80% b	Series 2	250,000	-
	May 1, 2033	3.00% b	Series 3	250,000	-
	May 1, 2033	3.00% b	Series 4	250,000	-
	May 1, 2033	5.10% b	Series 5	250,000	-
	May 1, 2033	4.85% b	Series 6	250,000	-
	April 1, 2025	5.10% b	Series 7	250,000	-
	April 1, 2001 to 2008	4.00% to 5.00% a	Series 8	218,300	-
Total General and Subordinated Revenue Bonds				6,735,930	-
Debentures					
	July 15, 1999	7.30% a		397,000	-
	January 15, 2000	7.30% a		278	-
	July 15, 2001	6.25% a		8,460	-
	March 15, 2003	7.05% a		5,890	-
	March 1, 2004	7.00% a		2,999	-
	June 1, 2005	7.13% a		14,307	-
	November 1, 2022	9.00% a		26,877	-
	March 15, 2023	8.20% a		270,000	-
Total Debentures				725,811	-
NYSERDA Financing Notes					
Pollution Control Revenue Bonds					
	December 1, 2006	7.50% a	1976 A	26,375	-
	December 1, 2009	7.80% a	1979 B	19,100	-
	March 1, 2016	3.58% a	1985 A,B	138,120	-
Electric Facilities Revenue Bonds					
	September 1, 2019	7.15% a	1989 A,B	35,030	-
	June 1, 2020	7.15% a	1990 A	73,900	-
	December 1, 2020	7.15% a	1991 A	26,560	-
	February 1, 2022	7.15% a	1992 A,B	13,455	-
	August 1, 2022	6.90% a	1992 C,D	28,060	-
	November 1, 2023	3.70% b	1993 B	50,000	-
	October 1, 2024	3.70% b	1994 A	50,000	-
	August 1, 2025	3.70% b	1995 A	50,000	-
Total NYSERDA Financing Notes				510,600	-
Unamortized premium and deferred amortization				(16,443)	-
Total Long-Term Debt				7,955,898	-
Less Current Maturities				468,880	-
Long-Term Debt				7,487,018	-
Accumulated Deficit				(100,055)	(23,926)
Total Capitalization				$ 7,386,963	$ (23,926)

a Fixed rate
b Variable rate (rate presented is as at December 31, 1998)

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

Note 1. Basis of Presentation

The Long Island Power Authority was established as a corporate municipal instrumentality of the State of New York, constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the "Act"). As such, it is a component unit of the State and is included in the State's annual financial statements.

As used herein, the term "LILCO" refers to the Long Island Lighting Company, the publicly owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger, as described in Note 2, and the term "LIPA" refers to that company as it exists after the LIPA/LILCO Merger, as a wholly-owned electric utility subsidiary company of the Long Island Power Authority (the "Authority"), doing business as LIPA. LIPA has 1 share of $1 par value common stock authorized, issued and outstanding, which is held by the Authority and eliminates in consolidation.

In October 1994, a not-for-profit subsidiary corporation, LIPA Resources, Inc. was formed under Section 402 of the Not-For-Profit Corporation Law. The subsidiary was formed for the purpose of marketing the Authority owned assets and providing consulting services by using the expertise developed by the Authority in decommissioning a fully licensed commercial nuclear plant. LIPA Resources, Inc. was inactive during the nine months ended December 31, 1998 and the fiscal year ended March 31, 1998 and has no assets or liabilities as of December 31, 1998 and March 31, 1998.

Subsequent to the LIPA/LILCO Merger, the Authority and its subsidiaries, LIPA and LIPA Resources, Inc., (collectively, the "Company") adopted a calendar year-end.

Note 2. Merger/Change in Control/Nature of Operations

Merger/Change in Control
On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO (the "Merger") pursuant to an Agreement and Plan of Merger dated as of June 26, 1997, by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy, "KeySpan"), the Authority and LIPA Acquisition Corp., (the "Merger Agreement").

Pursuant to the Merger Agreement, immediately prior to the Merger, all of the assets and liabilities of LILCO related to the conduct of its gas distribution business and its non-nuclear electric generation business, and all common assets used by LILCO in the operation and management of its electric transmission and distribution business and its gas distribution business and/or its non-nuclear electric generation business (the "Transferred Assets") were sold to KeySpan. The consideration received by LILCO for the Transferred Assets consisted of: (i) 3,440,625 shares of the common stock of KeySpan; (ii) 553,000 shares of the Series B Preferred Stock of KeySpan; and (iii) 197,000 shares of the Series C Preferred Stock of KeySpan.

The value of the consideration was determined by KeySpan and LILCO to be equal to the net fair market value of the Transferred Assets. The transfer of assets and liabilities was effected by a Bill of Sale, dated as of May 28, 1998, made and executed by LILCO and acknowledged by KeySpan.

As a result of the Merger, the Authority became the holder of 1 share of LILCO's common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately $1.048 billion. The interest rate and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed by the LIPA in the Merger. KeySpan is required to make principal and interest payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA then transfers those amounts to debtholders in accordance with the original debt repayment schedule.

The former holders of LILCO's common stock, primarily individual public shareowners, became entitled to receive a pro-rata share of: (i) cash consideration of $2.497 billion; and (ii) 3,440,625 shares of the common stock of KeySpan, which were received by LILCO in exchange for the Transferred Assets. Pursuant to the Merger Agreement, the former holders of LILCO's common stock (other than holders of dissenting shares) were deemed to have subscribed for additional shares of the common stock of KeySpan, with an aggregate purchase price equal to the cash consideration. In order to effect the Merger, it was necessary to: (i) retire all shares of LILCO's preferred stock, whether by conversion, redemption or cancellation; and (ii) redeem certain of LILCO's bonds, at a cost to LIPA of approximately $1.557 billion. The cash consideration required for the Merger was obtained by the Authority from the proceeds of the issuance and sale of its Electric System General Revenue Bonds, Series 1998A and Electric System Subordinated Revenue Bonds, Series 1 through Series 6. The proceeds from the sale of the bonds were then transferred by the Authority to LIPA in exchange for a promissory note of approximately $4.949 billion. As a result of the Merger, there was a change in control of LILCO which effectively resulted in the creation of a new reporting entity, LIPA.

The remaining assets and liabilities of LILCO acquired by LIPA consist of: (i) LILCO's electric transmission and distribution system; (ii) its net investment in Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2"); (iii) certain regulatory assets and liabilities associated with its electric business, (iv) allocated accounts receivable and other assets and liabilities; and (v) substantially all of its long-term debt.

Because of the manner in which LIPA's rates and charges will be established by the Authority's Board of Trustees, the original net book value of the transmission and distribution and nuclear generation assets acquired in the Merger is considered to be their fair value. The excess of the acquisition costs over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35 year period, the weighted average useful life of the net assets acquired. The acquisition adjustment principally arose through the elimination of LILCO's regulatory assets and liabilities, totaling $6.3 billion, and net deferred federal income tax liability of approximately $2.4 billion.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services for LIPA's transmission and distribution system through a management services agreement. Therefore, LIPA pays KeySpan directly for their services and KeySpan, in turn, pays the salaries of their employees. LIPA has no employees, however LIPA is charged a management fee by the Authority to oversee LIPA's operations of which the salaries of the Authority's employees is a significant component. LIPA contracts for capacity from the fossil fired generating plants of KeySpan through a power supply agreement ("PSA").

Energy and fuel are purchased by KeySpan on LIPA's behalf through an energy management agreement (collectively; the "Operating Agreements").

The electric transmission and distribution system is located in the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways ("Service Area"). The Service Area covers an area of approximately 1,230 square miles and the population of the service area is approximately 2.75 million persons, including approximately 98,500 persons who reside in Queens County within the City of New York. LIPA receives approximately 49% of its revenues from residential sales, 48% from sales to commercial and industrial customers, and the balance from sales to other utilities and public authorities.

Nature of operations

Post-Merger
LIPA, as owner of the transmission and distribution system and as party to the Operating Agreements, conducts the electric business in the Service Area. The Authority is responsible, however, for administering, monitoring and managing the performance by all parties to the Operating Agreements.

The Authority and LIPA are also parties to an Administrative Services Agreement which describes the terms and conditions under which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area.

As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above.

Pre-Merger
In 1989, LILCO and the State of New York entered into a Settlement Agreement ("Settlement Agreement") to resolve the controversy over the Shoreham Nuclear Power Station ("Shoreham") and power supply issues affecting LILCO and its customers. The Settlement Agreement contemplated, among other things, the transfer of Shoreham from LILCO to the Authority for $1.00, the payment by LILCO of all costs attributable to the Authority's ownership, possession, maintenance, decommissioning or dismantling of Shoreham, including any of the Authority's administrative and general costs directly related to Shoreham, and the determination by the New York State Public Service Commission ("PSC") of just and reasonable rates for LILCO. On February 29, 1992, the United States Nuclear Regulatory Commission ("NRC") approved the transfer of Shoreham and the NRC license for the Shoreham plant from LILCO to the Authority. Title to Shoreham and the NRC license for Shoreham was transferred from LILCO to the Authority on that date for $1.00.

In December 1990, the Authority submitted to the NRC its plan to decommission Shoreham, which was approved by the NRC on June 11, 1992. The decommissioning of Shoreham was completed in October 1994, and the NRC officially terminated the license for the Shoreham plant on May 2, 1995.

On April 14, 1989, LILCO and the Authority entered into the Amended and Restated Asset Transfer Agreement ("Asset Transfer Agreement") under which LILCO reiterated its agreement never to operate Shoreham and to transfer the plant to the Authority. The Settlement Agreement and the Asset Transfer

Agreement became effective on June 28, 1989, when LILCO's shareholders voted to approve both agreements.

In conjunction with the Asset Transfer Agreement, the Authority and LILCO also entered into a Site Cooperation and Reimbursement Agreement ("Site Agreement") on January 24, 1990. Among other things, the Site Agreement established the specific mechanism for LILCO to provide payment for all Costs Attributable To Shoreham ("CATS", as defined in the Site Agreement), including such costs incurred prior to January 24, 1990.

The Authority also entered into a Management Services Agreement with the New York Power Authority ("NYPA"), dated January 24, 1990, which specifies the management and technical services NYPA would provide to the Authority in connection with the license transfer, maintenance and decommissioning of Shoreham. Both the Site Agreement and the Management Services Agreement are in effect, although the Management Services Agreement is inactive.

The Authority and LILCO also entered into a Memorandum of Understanding ("MOU"), which became effective January 1, 1996, for long-term custodial care of the Shoreham plant. Under the MOU, LILCO was responsible for maintaining the Shoreham plant under the direction of the Authority, at no cost to the Authority. As a result of the Merger, the Authority is responsible for any remaining costs related to the Shoreham plant.

Note 3. Summary of Significant Accounting Policies

General

The Company complies with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," the Company also complies with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Authority and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting for the Effects of Rate Regulation

Under current New York law, the Authority is empowered to set rates for electric service in LIPA's service area without being required by law to obtain the approval of the PSC or any other State regulatory body.

The Company is subject to the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Company records these future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

Regulatory assets represent probable future revenues associated with previously incurred costs that are expected to be recovered from customers. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be refunded to customers through the ratemaking process.

Utility Plant and Property and Equipment

Utility plant was stated at fair value at the date of the Merger. Additions to and replacements of utility plant are capitalized at original cost, which includes material, labor, indirect costs associated with an addition or replacement, plus an allowance for funds used during construction. The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, is charged to accumulated depreciation. The cost of repairs and minor renewals is charged to maintenance expense. Mass properties (such as poles, wire and meters) are accounted for on an average unit cost basis by year of installation.

Property and equipment represents leasehold improvements, office equipment and furniture and fixtures of the Authority.

Depreciation

The provisions for depreciation for utility plant, result from the application of straight-line rates to fair values at the date of the Merger, by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The average depreciation rate as a percentage of respective average depreciable plant costs was as 2.9%.

Leasehold improvements are being amortized over the lesser of, the life of the assets or the term of the lease using the straight-line method. All other property and equipment are being depreciated over their estimated useful lives (5 years) using the straight-line method.

Allowance for Borrowed Funds Used During Construction

The allowance for funds used during construction ("AFC") is the net cost of borrowed funds used for construction purposes. AFC is not an item of current cash income. AFC is computed monthly on a portion of construction work in progress. The average AFC rate for the period from the Merger date through December 31, 1998, was 4.71%.

Cash and Cash Equivalents and Designated Funds

Funds are held in an investment pool that is administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. Certain cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific purposes, including debt service and capital expenditures.

Statement No. 3 of the Governmental Accounting Standards Board, "Investments, including Repurchase Agreements" ("GASB 3"), requires state and local governments to classify their investments in three defined categories of credit risk. Category one includes investments that are insured or registered; or securities that are held by the Company or its agent in the Company's name. Category two includes investments that are collateralized with securities which are held by the pledging financial institution's

trust department or agent in the Company's name. Category three includes uncollateralized investments for which the securities are held by the broker's or dealer's trust department or agent in the Company's name. The investments held by the Company are classified as Category one at December 31, 1998 and March 31, 1998.

Restricted - As required by the agreement to decommission Shoreham, the Authority established two reimbursement accounts, one for CATS, incurred or to be incurred by the Authority and one for CATS incurred or to be incurred by the Authority's contractor, the New York Power Authority ("NYPA") and the Authority third-party suppliers. At December 31, 1998, these accounts were inactive since CATS are no longer being incurred and as a result the cash is no longer restricted.

Fair Values of Financial Instruments

The Company's financial instruments approximate their fair market value at December 31, 1998 and March 31, 1998. The fair values for the Company's long-term debt is based on quoted market prices, where available. The fair values for all other long-term debt were estimated using discounted cash flow analyses based upon the Company's current incremental borrowing rate for similar types of securities.

Revenues

Revenues are comprised of cycle billings rendered to customers and the accrual of electric revenues for services rendered to customers not billed at month-end.

Fuel and Purchased Power Cost Adjustment ("FPPCA")

LIPA's rates include the FPPCA mechanism whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA is designed to ensure that LIPA will recover from or return to customers any fuel costs that fall outside an established base fuel and purchased power tolerance band. The tolerance band is equal to 1% above and 1% below LIPA's base cost of fuel and purchased power costs for 1999. The tolerance band increases to two percent in 2000 and will continue to increase in one percent increments annually thereafter. Expenses for fuel and purchased power costs in excess of or below this level will be recovered from or returned to customers beginning the following year. Should fuel and purchased power costs increase in excess of five percent cumulatively over the original base cost, the FPPCA will recover, from that year forward, all costs in excess of the original base.

Under LIPA's current tariffs, the measurement of the under or over recovery of fuel costs was scheduled to begin January 1, 1999. However, as a result of decreasing fuel costs, LIPA recovered from customers approximately $22 million more for fuel than was incurred, through December 31, 1998. In order to preserve this benefit for customers, LIPA recorded a liability for the full amount of the over recovery. This amount is included in deferred credits.

Income Taxes

The Authority is a political subdivision of the State of New York and, therefore, the Authority and its subsidiaries are exempt from Federal, state and local income taxes.

Payments in lieu of taxes

The Company is required to make payments in lieu of taxes ("PILOTS"), for all operating taxes previously paid by LILCO, including gross income, gross earnings, property, Metropolitan Transportation

Authority and certain taxes related to fuels used in utility operations. PILOTS include payments to municipalities and school districts in which Shoreham is located. Shoreham related PILOTS paid in the first year following the Authority's acquisition of Shoreham, which occurred on February 29, 1992, were equal to the taxes and assessments which would have been received had Shoreham not been transferred to the Authority. In each succeeding year, Shoreham related PILOTS have been reduced by ten percent per year and will continue to be reduced by ten percent per year until such payments equal taxes and assessments which would have been levied on Shoreham in a non-operative state.

On September 11, 1996, February 25, 1995 and June 1, 1992, the Authority reached three separate interim agreements with certain taxing jurisdictions. Pursuant to these interim agreements the Authority paid approximately $388 million and $372 million through December 31, 1998 and March 31, 1998, respectively. These payments were made under protest and without prejudice to the Authority's or the taxing jurisdiction's positions in contemplated litigation regarding the parties' rights and obligations under the Act. For a further discussion on Shoreham related PILOTS and the Shoreham tax litigation, see Note 11.

Reserves for Claims and Damages

Losses arising from claims against LIPA, including workers' compensation claims, property damage, extraordinary storm costs and general liability claims, are partially self-insured. Reserves for these claims and damages are based on, among other things, experience and risk of loss. Extraordinary storm losses incurred by LIPA are partially insured by various commercial insurance carriers. These insurance carriers provide partial insurance coverage for individual storm losses to the transmission and distribution system between $15 million and $35 million. Storm losses which are outside of this range are self-insured by LIPA.

Use of Estimates

The accompanying financial statements were prepared in conformity with generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified in the financial statements to conform with the current period presentation.

Recent Accounting Pronouncements

Derivative Instruments

In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement established accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The Company will adopt SFAS No. 133 in the first quarter of fiscal year 2000. The Company does not expect any material earnings effect from adoption of this statement.

Plant Decommissioning

In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear plant decommissioning. Over the past two years, this exposure draft has been the source of continual debate. The FASB has committed to completing the project and is proceeding toward issuance of another exposure draft (expected in the second quarter of 1999). If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project, including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. The Company can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition or results of operations of the Company.

Investments

GASB Statements No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," was implemented during the period ending December 31, 1998. The statement generally requires that investments should be reported in the balance sheet at fair value and that realized and unrealized gains and losses on investments flow through the statement of operations. The adoption of this statement did not have a material impact on the financial position, results of operations or cash flows of the Company.

Note 4. LIPA Rate Matters

Under current New York law, the Authority is empowered to set rates for electric service in the Service Area without being required by law to obtain the approval of the PSC or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the Merger by the New York State Public Authorities Control Board (the "PACB"), that it will not impose any permanent increase, nor extend or re-establish any portion of a temporary rate increase, in average customer rates over a 12 month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. Another of the PACB conditions requires that the Authority reduce average rates within LIPA's service area by no less than 14% over a ten year period commencing on the date when LIPA began providing electric service, when measured against LILCO's base rates in effect on July 16, 1997 (excluding the impact of the proposed Shoreham tax settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events.)

The Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Company; PILOTS; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

LIPA's rates include the FPPCA to adjust rates to reflect significant changes in the cost of fuel, purchased power and related costs. For further discussion regarding the FPPCA, see Note 3.

LIPA's rates are largely based on LILCO's pre-Merger rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, LIPA's rates include the FPPCA, a PILOTS recovery rider, a rider providing for the Shoreham settlement and a rider providing for the RICO Credits (credits to the bills of customers as a result of the settlement by LILCO of a RICO action in connection with the construction and completion of nuclear generating facilities).

The Act requires LIPA to make PILOTS for certain New York State and local revenue taxes which would otherwise have been imposed on LILCO. The PILOTS recovery rider allows for LIPA's rate adjustments to accommodate the PILOTS.

For a further discussion on the Shoreham tax matters see Note 11.

Note 5. Utility Plant and Property and Equipment

Utility Plant consists of:

	(in thousands)	
	December 31, 1998	**March 31, 1998**
Generation - nuclear	$ 662,893	$ -
Transmission and distribution	1,385,099	-
Common	3,827	-
Construciton work in progress	52,897	-
Nuclear fuel in process and in reactor	17,053	-
	2,121,769	-
Less - Accumulated depreciation and amortization	50,287	-
Total Net Utility Plant	$ 2,071,482	$ -

Property and equipment consists of:

	(in thousands) December 31, 1998	March 31, 1998
Office equipment	$ 422	112
Leasehold improvements	276	-
Office furniture	252	68
	950	180
Less - Accumulated depreciation and amortization	128	74
Total Net Property and Equipment	$ 822	$ 106

Note 6. Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2")

As a result of the Merger, LIPA acquired an undivided 18% interest in NMP2, located in Scriba, New York which is operated by Niagara Mohawk Power Corporation ("NMPC"). The owners of NMP2 and their respective percentage ownership are as follows: LIPA (18%), NMPC (41%), New York State Electric & Gas Corporation ("NYSEG") (18%), Rochester Gas Electric Corporation ("RG&E") (14%) and Central Hudson Gas & Electric Corporation (9%). LIPA's share of the rated capability is approximately 205 MW. LIPA's net utility plant investment, excluding nuclear fuel, was approximately $650 million at December 31, 1998. The accumulated provision for depreciation, excluding decommissioning costs, was approximately $13 million at December 31, 1998. Generation from NMP2 and operating expenses incurred by NMP2 are shared in the same proportions as the cotenant's respective ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

NMPC has contracted with the United States Department of Energy for the disposal of spent nuclear fuel. LIPA reimburses NMPC for its 18% share of the cost under the contract at a rate of $1.00 per megawatt hour of net generation less a factor to account for transmission line losses.

Nuclear Plant Decommissioning

NMPC expects to commence the decommissioning of NMP2 in 2026, shortly after the cessation of plant operations, using a method which provides for the removal of all equipment and structures and the release of the property for unrestricted use. LIPA's share of decommissioning costs, based upon a "Site-Specific" 1995 study (1995 study), is estimated to be $407 million in 2026 dollars ($161 million in 1998 dollars using a 3.5% escalation factor). LIPA's share of the estimated decommissioning costs is currently being provided for in electric rates and is being charged to operations as depreciation expense over the service life of NMP2. The amount of decommissioning costs recorded as depreciation expense for the period ended December 31, 1998 totaled $3.9 million.

LIPA has acquired external trust funds established for the decommissioning of the contaminated portion of the NMP2 plant. It is currently estimated that the cost to decommission the contaminated portion of the plant will be approximately 76% of the total decommissioning costs. These funds comply with regulations issued by the NRC and the FERC governing the funding of nuclear plant decommissioning costs. LIPA's policy is to fund these trusts at least annually. As of December 31, 1998, the balance in these funds, including reinvested net earnings, was approximately $19 million. These amounts are included in Nonutility Property and Other Investments. The trust fund investments consist of U.S. Treasury debt securities and cash equivalents. The carrying amounts of these investments approximate fair market value.

Reference is made to Note 3 under the subcaption "Recent Accounting Pronouncements" for details of the proposed changes in accounting for nuclear decommissioning costs.

In 1996, NMPC and RG&E announced plans to establish a joint nuclear operating company to be known as New York Nuclear Operating Company ("NYNOC"). NYNOC was envisioned to assume full responsibility for operation of all nuclear plants in New York. In 1997, NYPA, Con Edison, Niagara Mohawk and Rochester Gas and Electric Corporation, the four utilities operating nuclear generating facilities in New York State, executed a joint announcement which expressed their desire to move forward with plans to form NYNOC, and stated that the four utilities will initiate the steps to assure that NYNOC will have the necessary leadership, personnel and structure to operate the six nuclear units now operated independently by such utilities. The joint announcement also stated that during the transition phase, while necessary governmental approvals are sought, the utilities would continue with and add to the cooperative initiatives the companies have already begun. NYNOC, a limited liability company, would operate the six nuclear plants currently operated by the four entities to achieve economies of scale and increase cost effectiveness. The plants would continue to be owned, and the output of the plants marketed, by the respective owners of the plants. It is contemplated that NYNOC would become the operator under the plants' NRC operating licenses, while other aspects of the NRC licenses would remain with the owners of the plants. It is uncertain what effect Niagara Mohawk's participation in such an arrangement will have on LIPA; nor can LIPA predict the effect on such an arrangement of the auction proposal in the staff report.

On or about June 15, 1998, NYSEG, one of the owners of the Nine Mile 2 Plant, commenced an action against NMPC (which is the operator of the Nine Mile 2 Plant) in Supreme Court of the State of New York, Tompkins County, demanding, among other things, judgment to: (i) enjoin NMPC from transferring operating responsibility of the Nine Mile 2 Plant to NYNOC; and (ii) declare that NMPC may not transfer its operational responsibility for the Nine Mile 2 Plant to NYNOC without NYSEG's consent. LIPA can make no prediction as to the outcome of this litigation.

NMPC and NYSEG have announced that they plan to pursue the sale of their nuclear assets including its interest in NMP2. LIPA is reviewing its rights and remedies under the agreements governing its 18% interest in NMP2. LIPA has not received an offer to purchase its 18% interest in NMP2 and is not pursuing a sale at this time.

On August 27, 1997, the PSC Staff ("Staff") issued a "Notice Soliciting Comments on Nuclear Generation" requesting comments and alternative approaches by interested parties on a "Staff Report on

Nuclear Generation" ("Nuclear Report"). The Nuclear Report concludes that nuclear generation along with non-nuclear generation facilities, should be subject to the discipline of market-based pricing.

On March 20, 1998, the PSC initiated a proceeding to examine a number of issues raised by the Nuclear Report and the comments received in response to it. In reviewing the Nuclear Report and parties' comments, the PSC: (a) adopted as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, with parties challenging that premise having to bear a substantial burden of persuasion; (b) characterized the proposals in the Staff paper as by and large consistent in concept with the PSC's goal of a competitive, market-based electricity industry; (c) questioned PSC Staff's position that would leave funding and other decommissioning responsibilities with the sellers of nuclear power interests; and, (d) indicated interest in the potential for the NYNOC to benefit customers through efficiency gains and directed pursuit of that matter in this nuclear generating proceeding or separately upon the filing of a formal NYNOC proposal. The proceeding is expected to be completed in 1999.

The NRC issued a policy statement on the Restructuring and Economic Deregulation of the Electric Utility Industry ("Policy Statement") in 1997. The Policy Statement addresses NRC's concerns about the adequacy of decommissioning funds and about the potential impact on operational safety and reserves to the NRC the right, in highly unusual situations where adequate protection of public health and safety would be compromised, to consider imposing joint and several liability on minority co-owners when one or more co-owners have defaulted on their contractual obligations. On December 28, 1998, the NRC announced commencement of a rulemaking proceeding initiated by a group of utilities which are non-operating joint owners of nuclear plants. These utilities request that the enforcement provisions of the NRC regulations be amended to clarify NRC policy regarding the potential liability of joint owners if other joint owners become financially incapable of bearing their share of the burden for safe operation or decommissioning of a nuclear power plant. Current NRC regulations allow a utility to set aside decommissioning funds annually over the estimated life of a plant. On March 22, 1997, the Authority filed comments in support of the rulemaking proceedings. In addition to the above Policy Statement, the NRC is proposing to amend its regulations on decommissioning funding to reflect conditions expected from deregulation of the electric power industry. LIPA is unable to predict how such increased stringency may affect the results of operations or financial condition of the Nine Mile 2 Plant.

On July 5, 1998, the Nine Mile 2 Plant completed its sixth refueling outage, which commenced on May 2, 1998. It is scheduled to commence its seventh refueling outage in March 2000.

Radioactive Waste

NMPC has contracted with the U.S. Department of Energy ("DOE") for disposal of high-level radioactive waste ("spent fuel") from the Nine Mile 2 Plant. Despite a court order reaffirming the DOE's obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. LIPA has been advised by NMPC that the Nine Mile 2 Plant spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required.

Nuclear Plant Insurance
NMPC procures public liability and property insurance for NMP2, and LIPA reimburses NMPC for its 18% share of those costs.

The Price-Anderson Amendments Act mandates that nuclear power secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $200 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 108 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $88.1 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of $15.9 million, per incident, through assessments of up to $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor. These assessments are subject to periodic inflation indexing and to a 5% surcharge if funds prove insufficient to pay claims.

NMPC has also procured $500 million primary nuclear property insurance with the Nuclear Insurance Pools and approximately $2.3 billion of additional protection (including decontamination costs) in excess of the primary layer through Nuclear Electric Insurance Limited (NEIL). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $1.6 million per loss. This level of insurance is in excess of the NRC required minimum of $1.06 billion of coverage.

LIPA has obtained insurance coverage from NEIL for the extra expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, should losses exceed the accumulated reserves of NEIL, each member, including LIPA, would be liable for its share of deficiency. LIPA's maximum liability per incident under the replacement power coverage, in the event of a deficiency, is approximately $700,000.

The NRC has notified all utilities operating nuclear power plants that they are required to inform the NRC of steps they are taking to see that computer systems will function properly by the year 2000. In connection therewith, each such utility was required to submit a written indication of, among other things, whether or not they are pursuing and continuing to pursue a plan to solve their Year 2000 issue, such as, or similar to, that outlined in the publication Nuclear Utility Year 2000 Readiness published by the Nuclear Energy Institute and the Nuclear Utilities Software Management Group (the "NEI/NUSM Plan"). In addition, not later than July 1, 1999, each such utility must submit a written response confirming that its plant is Year 2000 ready, or if not ready, the utility must provide a status report of work remaining to be done. Niagara Mohawk submitted its required response indicating that it has pursued and is continuing a Year 2000 readiness program similar to that recommended in the NEI/NUSM Plan.

Note 7. Cash and Cash Equivalents and Designated Funds

Cash and cash equivalents and designated funds consist of:

	December 31, 1998	March 31, 1998
Unrestricted:		
Commercial paper	$ 653,152	$ -
Money market funds	38,465	-
Certificates of deposit	20,000	5,269
Demand deposits	619	457
	712,236	5,726
Restricted:		
Certificate of Deposit	-	134
U.S. Treasury bill	-	50
	-	184
Total	$ 712,236	$ 5,910

Commercial paper, money market funds and certificates of deposit with maturities of three months or less when purchased and are valued at amortized cost, which approximates market value at December 31, 1998 and March 31, 1998. Commercial paper is rated A-1 at December 31, 1998 by Standard & Poor's Corporation and P-1 by Moody's Commercial Paper Record. Money market funds are rated AAA at December 31, 1998 by Standard and Poor's Corporation. The certificates of deposit are either insured by the FDIC or collateralized by securities held by the Authority's custodian bank in the Authority's name.

Note 8. Debt

The Authority

The Authority financed the cost of the Merger and the refinancing of certain of the LILCO's outstanding debt by the issuance of approximately $6.73 billion aggregate principal amount of Electric System General Revenue Bonds and Electric System Subordinated Revenue Bonds (collectively the "Bonds"). In accordance with the issuance of the Bonds, LIPA and the Authority entered into a Financing Agreement, whereby LIPA transferred to the Authority all of its right, title and interest in and to the revenues generated from the operation of the transmission and distribution system, including the right to collect and receive the same. In exchange for the transfer of these rights to the Authority, LIPA received the proceeds of the Bonds evidenced by a Promissory Note.

The Bonds are secured by a Trust Estate as pledged under the Authority's Bond Resolution (the "Resolution"). The Trust Estate consists principally of the revenues generated by the operation of LIPA's transmission and distribution system and have been pledged by LIPA to the Authority.

Electric System General Revenue Bonds

1998 Series A
This Series is comprised of Current Interest and Capital Appreciation Bonds. The Current Interest Bonds include: (i) tax exempt Serial Bonds with maturities beginning in December 1999 and continuing each year through December 2016; (ii) tax exempt Term Bonds with maturities beginning in December 2018 and with a final maturity.in December 2029; and (iii) Taxable Term Bonds which mature on December 1, 1999. The Capital Appreciation Bonds are tax exempt bonds with maturities beginning in December 2003 continue each year through December 2028.

Optional Redemption
The 5.0% Serial Bonds due on December 1, 2014 ($39,385) and the Serial and Term Bonds maturing on and after December 1, 2015 (except the Term Bonds maturing on December 1, 2029), which total $207,040 and $1,411,545, respectively, are subject to redemption prior to maturity, at the option of the Authority, at a price of 101% of the principal amounts on any date beginning on June 1, 2008 through May 31, 2009, or at 100.5% beginning on June 1, 2009 through May 31, 2010 or at 100% beginning June 1, 2010 through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

The Term Bonds maturing on December 1, 2029 ($587,225) are subject to redemption prior to maturity, at the option of LIPA, on any date on and after June 1, 2003, in whole, or in part from time to time, at a redemption price of 101% of the principal amounts, together with the interest accrued on such principal amount to the redemption date.

The Serial and Term Bonds maturing on December 1, 1999 through December 1, 2013 ($976,875 and $25,000, respectively) and the 5.25% Serial Bonds due on December 1, 2014, ($56,665) are not subject to redemption prior to maturity. In addition, the Capital Appreciation Bonds and the Taxable Term Bonds are not subject to redemption prior to maturity.

Sinking Fund
Certain Term Bonds are subject to redemption, in part, beginning on December 1, 2017 through December 1, 2029 at 100% of the principal amounts, plus accrued interest at the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

1998 Series B
This Series is comprised of Serial Bonds with maturities beginning in April 2000 and continuing each year through April 2016 and Term Bonds maturing in April 2018.

Optional Redemption
Securities maturing on and after April 1, 2009 ($483,505) are subject to redemption prior to maturity, at the option of the Authority, at a redemption price of 101% of the principal amounts on any date beginning

on April 1, 2008 through May 31, 2009, or at 100.5% beginning on April 1, 2009 through May 31, 2010 or at 100% beginning April 1, 2010 through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

Sinking Fund

The Term bond that matures on April 1, 2018 is subject to redemption as follows $27,895 on April 1, 2017, and $29,250 on April 1, 2018.

Electric System Subordinated Revenue Bonds

Series 1 through 6

These Series are variable rate bonds payable from and secured by the Trust Estate subject to and subordinated to the Authority's Electric System General Revenue Bonds. These bonds are classified into various modes that determine the frequency that the interest rate is re-determined, the interest rate applied and the optional redemption features. Series 1 and 2 are Weekly Mode bonds, therefore, the applicable interest rate is re-determined on a weekly basis. Series 3 and 4 are Commercial Paper Mode bonds, and as such, interest rates can be re-determined as often as daily, but not less frequently than 270 days, and Series 5 and 6 are Daily Mode bonds, and as such the interest rate is re-determined daily.

Provisions of the indenture allow for a change of interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period i.e., from daily to monthly, semi-annually or annually) or a Fixed mode.

Series 1 through 6 Bonds are supported by letters of credit which expire on May 25, 2001.

Series 7

This Series is comprised of variable rate bonds issued in the Daily Mode. Principal and interest on these bonds are secured by a financial guaranty insurance policy.

The Authority has executed a Standby Bond Purchase Agreement, to provide funds for the purchase of Series 7 Bonds tendered but not remarketed. The standby agreement expires in November 2008.

Provisions of the indenture allow for a change of interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period i.e., from daily to monthly, semi-annually or annually) or a Fixed mode.

Optional and Mandatory Redemption

Series 1 through 6 and Series 7 Bonds are redeemable on their respective interest rate re-determination dates at the option of the Authority. These bonds are redeemable at face value when they are in the Weekly, Daily or Commercial Paper mode. Term or Fixed rate mode bonds are redeemable at rates varying between 100% and 101% when the life of the mode is greater than four years. Term or Fixed Rate mode bonds are not redeemable if the life of the mode is less than four years.

Series 1 through 6 and Series 7 Bonds are also subject to mandatory redemptions from sinking funds such that they will be redeemed by their respective maturity dates. Sinking funds for Series 1 through 6 and Series 7 begin on April 1, 2019 and December 1, 2030, respectively.

Interest Rate Swap Agreements
The Authority has entered into interest rate swap agreements to reduce the impact of changes in interest rates on the Series 7 Bonds. At December 31, 1998, the Authority had two interest rate swap agreements outstanding having a total notional amount of $150 million and $100 million, respectively. These agreements effectively change the Authority's interest rate exposure on the Series 7 Bonds to a fixed rate of 4.208%. The interest rate swap agreements are co-terminus with the Series 7 Bond, with optional earlier termination at the Authority's discretion. The Authority is exposed to credit loss in the event of nonperformance by the parties to the interest rate swap agreements. However, the Authority does not anticipate nonperformance by the counterparties.

Series 8 (Subseries A-H)
This Series is comprised of Current Interest Bonds issued as follows:

This Series is Comprised of Subseries	Mandatory Purchase Date (April 1)	Maturity (April 1)	Principal Outstanding $(000)	Interest Rate to Mandatory Purchase Date
8A	2001	2009	$ 27,300	4.00%
8B	2002	2009	27,300	4.00%
8C	2003	2010	27,300	4.00%
8D	2004	2010	27,300	4.50%
8E	2005	2011	27,300	4.50%
8F	2006	2011	27,300	5.00%
8G	2007	2012	27,300	5.00%
8H	2008	2012	27,300	5.00%

Each bond is due on its mandatory purchase date, however, the Authority can remarket the securities on that date, and the remarketed securities would then become due at the maturity date or such earlier date as determined by the remarketing. Additionally, the original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing if the Authority determines to remarket. Principal, interest and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy.

Each Subseries of Series 8 is not subject to optional redemption nor mandatory sinking fund redemption prior to its mandatory purchase date.

LIPA
The LILCO debt assumed by LIPA as part of the Merger, consisted of $1.186 billion of General and Refunding Bonds, ("G&R Bonds"), which were defeased by LIPA immediately upon the closing of the

Merger, debentures totaling $2.2 billion, and tax exempt debt of $916 million. As part of the Merger, KeySpan and LIPA executed Promissory Notes whereby KeySpan is obligated to LIPA for approximately $1.048 billion of the assumed debt (the "Promissory Notes"). KeySpan is also required to pay LIPA principal and interest on the Promissory Notes 30 days in advance of the date amounts are due to bond holders. At December 31, 1998, the balance of the Promissory Notes between KeySpan and LIPA totaled $1.045 billion of which $398 million is due to be collected in 1999.

The tax exempt debt assumed by LIPA were notes issued by LILCO to the New York State Research and Development Authority ("NYSERDA") to secure tax-exempt Industrial Development Revenue Bonds, Pollution Control Revenue Bonds ("PCRBs"), and Electric Facilities Revenue Bonds ("EFRBs") issued by NYSERDA.

Letters of Credit
The 1995, 1994, and 1993 EFRBs and the 1985 PCRBs were supported by letters of credit. Pursuant to which a letter of credit bank agreed to pay principal, interest and premium, if applicable, in the aggregate up to $326 million in the event of default. Subsequent to December 31, 1998, the EFRBs and the PCRBs were converted to fixed rate securities and LIPA canceled the letters of credit.

Bond Defeasance/Refundings
A portion of the proceeds of the Authority's Electric System General Revenue Bonds and Subordinated Bonds (which includes fixed and variable rate debt) were used to refund all the G&R Bonds, certain Debentures and certain NYSERDA notes issued by LILCO that were assumed by LIPA as a result of the Merger. The purpose of these refundings was to achieve debt service savings.

General and Refunding Bonds
On May 29, 1998, LIPA refunded all the G&R Bonds totaling $1.186 billion by depositing $1.190 billion in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on these obligations were sufficient to pay the principal and interest on the G&R Bonds, which were redeemed on June 29, 1998.

The Authority will realize gross debt service savings from this refunding of approximately $588 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $576 million.

Debentures
In October 1998, LIPA commenced a tender offer for its 7.30% Debentures Due 2000, 6.25% Debentures Due 2001, 7.05% Debentures Due 2003, 7.00% Debentures Due 2004, 7.125% Debentures Due 2005 and 9.00% Debentures Due 2022 (collectively, the "Debentures"). The tender offers for the Debentures expired in November, and LIPA purchased an aggregate principal amount of Debentures including accrued interest in the amount of $1.13 billion pursuant to the tender offers. Payment for Debentures purchased pursuant to the tender offers was made from the sale of $1.31 billion Electric System General Revenue Bonds, Series 1998B (the "Refinancing Bonds") of the Authority which closed in November. Under the terms of the financing agreement dated as of May 1, 1998, between LIPA and the Authority, a portion of the proceeds from the sale of the Refinancing Bonds were advanced to LIPA to fund payment for the tendered Debentures.

In October 1998, LIPA sent a notice of redemption to the holders of its 7.50% Debentures Due 2007 calling for redemption in November of all such debentures at a redemption price equal to 103.54% of the $142 million aggregate principal amount outstanding. In addition, LIPA sent a notice of redemption to the holders of its 8.90% Debentures Due 2019 calling for redemption in November of all such debentures at a redemption price equal to 105.94% of the $420 million aggregate principal amount outstanding.

As a result of the refundings described above, the Authority will realize gross debt service savings of approximately $547 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $376 million.

NYSERDAs
The Authority deposited $379 million in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing Principal of and interest on such securities will be sufficient to pay the principal, interest and applicable call premium on the following issues of NYSERDA Notes: $11.9 million Series 1985A, $50 million Series 1989A, $15 million Series 1989B, $26 million Series 1990A, $73 million Series 1991A, $50 million Series 1992A, $36.5 million Series 1992B, $50 million Series 1992C and $22 million Series 1992D, (collectively, the "Refunded NYSERDA Notes").

As a result of the refunding and the deposit with the Escrow Agent, the Refunded NYSERDA Notes are deemed to have been paid, and they cease to be a liability of LIPA. Accordingly, the Refunded NYSERDA Notes (and the related deposit with the Escrow Agent) are excluded from the Balance Sheet. The Authority will realize gross debt service savings from this refunding of approximately $287 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $66 million.

In November 1998, LIPA sent a notice of redemption to the holders of its 1982 NYSERDA Notes calling for redemption in December of all such NYSERDA Notes at a redemption price equal to the $17.2 million aggregate principal amount outstanding.

The Authority will realize gross debt service savings from the refunding of approximately $14.9 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $6.5 million.

Deferred Amortization
A debt refinancing charge of $61.9 million resulted from the transactions described above primarily because of the difference between the amounts paid for refundings, including amounts deposited with the Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, the $61.9 million has been deferred and is shown in the Statement of Financial Position as Deferred Amortization within long term debt and is being amortized over the life of the new debt or the old debt, whichever is shorter.

The Company

Debt Maturity Schedule

The total long-term debt maturing in each of the next five years ending December 31 is as follows: 1999, $468.9 million; 2000, $129.2 million; 2001, $156.6 million; 2002, $143.6 million; and 2003, $153.8 million.

Fair Values of Long - Term Debt

The carrying amounts and fair values of the Company's long-term debt at December 31, 1998 and March 31, 1998 were as follows:

(in thousands of dollars)

Fair Value	December 31, 1998	March 31, 1998
Electric System General Revenue Bonds, Series 1998 A	$ 3,565,699	$ -
Electric System General Revenue Bonds, Series 1998 B	1,351,923	
Electric System Subordinated Revenue Bonds, Series 1 through 6	1,500,000	
Electric System Subordinated Revenue Bonds, Series 7	250,000	
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	224,050	-
Debentures	745,822	-
NYSERDA Notes	536,401	-
Total	$ 8,173,895	$ -

(in thousands of dollars)

Carrying Amount	December 31, 1998	March 31, 1998
Electric System General Revenue Bonds, Series 1998 A	$ 3,453,830	$ -
Electric System General Revenue Bonds, Series 1998 B	1,313,800	-
Electric System Subordinated Revenue Bonds, Series 1 through 6	1,500,000	-
Electric System Subordinated Revenue Bonds, Series 7	250,000	-
Electric System Subordinated Revenue Bonds, Series 8 (Subseries A-H)	218,300	-
Debentures	725,811	-
NYSERDA Notes	510,600	-
Total	$ 7,972,341	$ -

Note 9. Advances Payable

State of New York appropriations/advances
As of March 31, 1998, the State advanced $26.1 million to the Authority. The entire amount of advances received from the State were repaid by the Authority in December 1998.

New York Power Authority advance
In July 1997, NYPA advanced the Authority $9 million for the Authority's costs associated with its efforts to reduce electric rates on Long Island. These funds were repaid, without interest, to NYPA in June 1998.

Note 10. Retirement Plans

The Authority participates in the New York State Employees' Retirement System, which is a cost-sharing, multi-employer, public employee retirement system. The plan benefits are provided under the provisions of the New York State Retirement and Social Security Law which are guaranteed by the State Constitution and may be amended only by the State Legislation. The Authority's election to participate in the plan is irrevocable. The New York State Employees' Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement Systems, A.E. Smith State Office Building, Albany, New York 12244. The Employees' Retirement System is subdivided into the following four classes:

Tier I	-	members who last joined prior to July 1, 1973.
Tier II	-	members who last joined on or after July 1, 1973 and prior to July 27, 1976.
Tier III	-	members who last joined on or after July 27, 1976 and prior to September 1, 1983.
Tier IV	-	members who joined on or after September 1, 1983.

Tier I members are eligible for retirement at age 55. If members retire with 20 or more years of total service, the service retirement benefit is 2% of the final average salary for each year of service. If members retire with less than 20 years of total service, the service retirement benefit is 1.66% of the final average salary for each year of service. Under this plan, the pension portion of your retirement allowance cannot exceed 75% of the member's final average salary, unless the member's date of membership is prior to April 1, 1970, than an alternative calculation is used.

Tier II members are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service, and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Retirement benefits are equivalent to Tier I members. Under this plan, the pension portion of the retirement allowance cannot exceed 75% of the member's final average salary.

Tier III members with 10 or more years of credited service after July 27, 1976 are eligible to retire with full benefits between the ages of 55 and 62 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are integrated with Social Security beginning at age 62. If members retire at age 62 and have 25 or more years of credited service, the service retirement benefit will be 2% of final average salary for each year of service (not to exceed 30

years), plus 1.5% of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 25 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year service.

Tier IV members with 5 or more years of credited service are eligible to retire with full benefits at age 62 or between the ages of 55 and 62 with 30 years or more of credited service. Tier IV members with less than 30 years of credited service will receive reduced benefits if they retire prior to age 62. Benefits are equivalent to Tier III members.

Retirement benefits vest after 5 years of credited service and are payable at various rates at age 55 or greater. The Employees' Retirement System also provides death and disability benefits.

Tier III and IV members are required by law to contribute 3% of their annual salary to the Employees' Retirement System and eligible Tier I and II members may make contributions under certain conditions. The Authority is required by the same statute to contribute the remaining amounts necessary to pay benefits when due.

The State of New York and the various local governmental units and agencies which participate in the Retirement System are jointly represented, and it is not possible to determine the actuarial computed value of benefits for the Authority on a separate basis.

The Authority's contributions to the retirement plan were approximately $27,000 and $12,000 for the periods ended December 31, 1998 and March 31, 1998, respectively.

Note 11. Commitments and Contingencies

Operating Lease

In December 1996, the Authority entered into a noncancelable office lease agreement for the period January 1, 1997 through January 31, 2003. In November 1997 and April 1998, the lease was amended to include additional premises. As a result of the amendments, the lease expiration date was changed to September 30, 2003. The future minimum payments under the lease are as follows:

Year Ended December 31,	*(In thousands)*
1999	$ 500
2000	518
2001	537
2002	557
2003	417
	$ 2,529

Legal Proceedings

Shoreham Tax Matters

Through November 1992, Suffolk County and the following Suffolk County political subdivisions (collectively, the "Suffolk Taxing Jurisdictions"), the Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and the Shoreham-Wading River Library District (which was succeeded by the North Shore Library District), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments, claiming the Shoreham plant was overassessed. To date, the Authority has made such payments, in whole or in part, pursuant to interim PILOT agreements and collected the costs thereof pursuant to the PILOTs rider which is part of LIPA's rates.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding $868 million, including interest as of the date of the judgement. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain Suffolk Taxing Jurisdictions sought to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

The Authority had proposed a settlement agreement with the Suffolk Taxing Jurisdictions and Nassau County. The proposed settlement agreement would, among other things, cause the Authority: (i) not to enforce the judgment in favor of LILCO; and (ii) not to make any claim for a refund of what the Authority believes is an overpayment of PILOT's, in exchange for the payment by the Suffolk Taxing Jurisdictions to the Authority of $625 million.

On February 1, 1999, a lawsuit was filed in the Supreme Court of the State of New York, Nassau County, by the Association for a Better Long Island against the Authority and LIPA. This lawsuit seeks: (i) to require the Authority to collect the full amount of the judgment obtained by the Authority in the Shoreham Property Tax Litigation as well as certain overpaid PILOTs; and (ii) to declare that the offer of the Authority to settle the Shoreham Property Tax Litigation is void and legally unenforceable. No assurance can be given as to the method, amount (if any) or timing of any recovery by the Authority related to the Shoreham Property Tax Litigation.

The proposed settlement agreement with the Suffolk Taxing Jurisdictions was not accepted and on March 1, 1999, the Authority withdrew its offer to settle the Shoreham Property Tax Litigation including claims related to the Authority's overpayment of PILOTs on the Shoreham plant for $625 million and indicated that any settlement would have to be at a higher amount. On that date, the Authority also demanded that

the Suffolk Taxing Jurisdictions pay refunds of real estate taxes in the amount of approximately $784 million consisting of: (i) refunds and interest due as of the entry of the judgment on March 26, 1997, for the period from and after January 15, 1987, (the effective date of the Act), of approximately $675 million; and (ii) accrued post-judgment interest in the amount of approximately $109 million. Post-judgment interest will continue to accrue until the judgment is satisfied.

On September 15, 1998, Suffolk County filed an action against the Authority in the Supreme Court of the State of New York, Suffolk County seeking to enjoin the Authority from recovering tax refunds based upon the over-assessment of the Shoreham nuclear plant. The action claims that the Authority does not have the right to recover property taxes previously assessed against LILCO for tax years 1984-1985 through 1991-1992. On April 14, 1999, a judgment was entered ordering that the Authority shall discontinue and abandon all proceedings which seek the repayment of all or part of the taxes assessed against the Shoreham plant, and enjoining the Authority from enforcing any judgment for refund of taxes paid on the Shoreham plant. The Authority has appealed this decision to the Appellate Division, Second Department. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's or LIPA's financial condition. Further, the court stated that under a ruling of the State Court of Appeals, the Authority is not prohibited from seeking refunds of PILOTs paid on over-assessments of the Shoreham plant.

The New York State Court of Appeals in a separate case has ruled that the Act does not prohibit the Authority from recovering overpayments of PILOTs plus interest based upon inflated assessed valuations of Shoreham. The Authority has made PILOT payments of approximately $345 million which it believes were based on such inflated assessed valuations. On February 24, 1999, the Authority filed an action against the Suffolk Taxing Jurisdictions in the Supreme Court of the State of New York, Nassau County seeking a judgment in an amount equal to the total amount of PILOTs overpaid by the Authority, plus interest.

On March 23, 1999, the Shoreham Wading River Central School District filed an action against the Authority in the Supreme Court of the State of New York, County of Nassau seeking an order directing the Authority to pay approximately $6.4 million of PILOTs which the plaintiff alleges are due and owing and approximately $24.6 million of PILOTs which the plaintiff alleges is the cumulative deficiency as of June 1, 1998. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's of LIPA's financial condition.

Merger Matters

LIPA has been named as a nominal defendant in a derivative suit pending in the United States District Court for the Eastern District of New York entitled Sylvester v. Catacosinos, et al. A motion to dismiss on behalf of LIPA was filed on September 23, 1998 and argued on January 28, 1999. In addition, LIPA has been named as a defendant in an action brought by the County of Suffolk that is pending in New York State Supreme Court, Suffolk County, entitled County of Suffolk v. KeySpan et al. The response date has been postponed until such time as it is determined whether the action will be consolidated with a class action pending in New York State Supreme Court, Nassau County, entitled In re KeySpan Corporation Shareholder Litigation. Former officers and directors of LILCO also have been named as defendants in each of these actions.

The complaints in the foregoing actions allege in substance that certain former officers of LILCO received excessive compensation which totaled approximately $67 million in connection with the closing of the Brooklyn Union merger with LILCO and with the Authority's acquisition of all common stock of LILCO. The Sylvester lawsuit seeks damages of an unspecified amount. The complaint brought by the County of Suffolk seeks to make the defendants pay restitution, or damages, of $67 million.

Because the cases are in an early state, at which no discovery has yet taken place, LIPA cannot express an opinion as to the likelihood of any liability. LIPA has notified KeySpan of its entitlement to indemnification pursuant to an indemnification agreement dated June 26, 1997 for any losses LIPA suffers as a result of these lawsuits. LIPA expects that KeySpan will honor the request for indemnification.

On September 28, 1998, Suffolk County and the Towns of Huntington and Babylon (collectively, the "Plaintiffs") brought a class action on behalf of themselves and all electric utility ratepayers in Suffolk County (the "Ratepayers") against the Authority, LIPA, KeySpan and others in the United States District Court for the Eastern District of New York entitled County of Suffolk et al. v. Long Island Power Authority, et al. (the "Huntington Lawsuit"). The Huntington Lawsuit alleges that (i) LIPA and the Authority failed to refund alleged capital gains directly to Ratepayers as a result of the Merger, unlawfully depriving Ratepayers of their property under federal and state constitutional provisions and (ii) LIPA failed to refund to Ratepayers certain deferred tax reserves carried on LILCO's books at the time of the Merger, unjustly enriching KeySpan.

Based on these allegations, Plaintiffs are seeking judgments, among other things: (i) awarding damages against KeySpan and LIPA for impairment of contract, breach of contract and conversion; and (ii) declaring that KeySpan holds the proceeds of the Merger attributable to the capital gains and the deferred tax reserve in trust for the benefit of the Ratepayers and ordering KeySpan to make a full accounting of such proceeds. LIPA believes that, although the recovery sought by Plaintiffs could be material in amount, any such recovery would not have a material financial impact on LIPA or its customers.
In an action commenced on May 26, 1998 (*Schulz et al. V. New York State Public Authorities Control Board et al.*, United States District Court, Northern District of New York), the plaintiff's complaint, in several claims for relief, sought a judgment declaring, *inter alia*, the resolution of the PACB authorizing the Authority to issue bonds to be null and void on State and federal constitutional grounds and sought a temporary restraining order or preliminary injunction prohibiting and enjoining the issuance of bonds. On May 27, 1998, the District Court denied the plaintiff's request for a temporary restraining order or preliminary injunction and dismissed the plaintiff's action on the ground that the plaintiffs lack standing to assert the claims pleaded in the complaint. On February 8, 1999, the United States Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the plaintiff's action.

On May 27, 1998, the Initiative for Competitive Energy (the "ICE") filed an action in the Supreme Court of the State of New York, County of Suffolk, against the Authority seeking, inter alia, an injunction enjoining the Authority from selling bonds "whose purpose is to finance the proposed Shoreham Property Tax Settlement, the Shoreham Rebates, Credits and Suffolk Surcharge." The action further requested a judgment declaring invalid and directing the rescission of the sale of such bonds. By decision dated October 7, 1998, the Supreme Court dismissed the complaint and rules in favor of the Authority on all issues. On October 28, 1998, the ICE filed a notice of appeal.

Notes to Consolidated Financial Statements

In May 1995, eight participants of LILCO's Retirement Income Plan ("RIP") filed a lawsuit against LILCO, the RIP and Robert X. Kelleher, the Plan Administrator, in the United States District Court for the Eastern District of New York. In January 1996, the Court ordered that this action be maintained as a class action. This proceeding arose in connection with the plaintiff's withdrawal, approximately 25 years ago, of contributions made to the RIP, thereby resulting in a reduction of their pension benefits. On January 7, 1999, a settlement agreement was filed with the Court providing for the payment of $7.75 million to the plaintiffs. The Authority would be responsible for approximately $5.4 million. The settlement is subject to judicial review. Amended settlement papers were filed on February 22, 1999 and a hearing date is scheduled for July 27, 1999.

In December 1997, Suffolk County brought a suit against the Authority and others in the Supreme Court of the State of New York seeking a judgment, among other things: (i) annulling and vacating the acceptance by the Authority of certain conditions contained in the July 1997 PACB resolution approving the Authority's acquisition of LILCO and related transactions; (ii) declaring that all or any actions taken by the Authority to implement or carry out the PACB conditions are null and void; and (iii) directing that the Authority take no further action to acquire the stock or assets of LILCO unless and until such acquisition has been approved by the PACB in the manner approved by law. A decision was rendered in March 1998 which held for the Authority on all substantive issues. Suffolk County filed a notice of appeal and its brief with the Appellate Division of the State of New York. The Authority filed its brief to the Appellate Division and Suffolk County filed its reply brief. Oral argument has yet to be calendared.

The Company may from time to time become a party to various legal proceedings arising in the ordinary course of its business. In the judgment of the Company, these matters will not individually or in the aggregate, have a material effect on the financial position, results of operations or cash flows of the Company.

Environmental Matters
In connection with the Merger, KeySpan and LIPA entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and LIPA on the basis of whether they relate to assets transferred to KeySpan or retained by LIPA as part of the Merger. In addition, to clarify and supplement these agreements, KeySpan and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan after the Merger (the "Transferred Business").

KeySpan is responsible for all liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those currently or formerly operated by KeySpan or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, KeySpan is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business may be recoverable by KeySpan as part of the capacity charge under the PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities that exist as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan.

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection ("DEP") and the DEC separately have issued Administrative Consent Orders ("ACOs") in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound. The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA is working cooperatively with the Suffolk County Department of Health, the DEC and Novartis to conduct studies and monitoring activities in connection with the presence of this herbicide. The liability, if any, resulting from the use of this herbicide cannot yet be determined. However, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

Superfund Sites. Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA", also commonly referred to as the "Superfund Legislation"), parties who generated or arranged for disposal of hazardous substances are liable for costs incurred by the EPA in responding to a release or threat of release of the hazardous substances.

Metal Bank. In December 1997, the EPA issued its Record of Decision ("ROD"), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is $17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 potentially responsible parties ("PRPs"), including LIPA, for the remedial design and for remedial action at the site. LIPA can not predict with reasonable certainty the actual cost of the selected remedy, who will implement the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability of $1.6 million representing its estimated share of the additional cost to remediate this site.

PCB Treatment Inc. LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing PCBs. According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and have developed a work plan for investigating environmental conditions at the site. The EPA provided LILCO with documents indicating that LILCO was responsible for less than 1% of the materials that were shipped to this site. LIPA is currently unable to determine its share of the cost to remediate these sites.

Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA

Asharoken. In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (*Incorporated Village of Asharoken, New York, et al.* v. *Long Island Lighting Company*). The Village is seeking monetary damages and injunctive relief based upon theories of negligence, gross negligence and nuisance in connection with the LILCO design and construction of the Northport Power Plant which the Village alleges upset the littoral drift, thereby causing beach erosion. In November 1996, the court decided LILCO's motion to dismiss the lawsuit, dismissing two of the three causes of action. The court limited monetary damages on the surviving continuous nuisance claim to three years prior to the commencement of the action. The liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility

Other Superfund Sites. In connection with a lawsuit filed against LILCO and nine other PRPs by the Town of Oyster Bay for indemnification for remediation and investigation costs for a federal Superfund site in Syosset, New York, a settlement agreement has been reached and is subject to court approval. If approved, the settlement would not have a material adverse effect on LIPA's financial position, cash flows or results of operations. In addition, LILCO was notified by the Attorney General of the State of New York that it may be responsible for the disposal of wastes and/or for the generation of hazardous substances that may have been disposed of at the Blydenburgh Superfund site. LILCO conducted a search of its corporate records and did not locate any documents concerning waste disposal practices associated with this landfill.

DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The DEC investigation is in its preliminary stages, and LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site.

Class Settlement. The Class Settlement, which became effective in June 1989, resolved a civil lawsuit against LILCO brought under the federal Racketeer Influenced and Corrupt Organizations Act. The lawsuit, which the Class Settlement resolved, had alleged that LILCO made inadequate disclosures before the PSC concerning the construction and completion of nuclear generating facilities.

The Class Settlement continues to provide the electric rate payers with rate reductions which will total $390 million over a ten-year period which began on June 1, 1990. As of December 31, 1998, the remaining rate reductions, which are being reflected as adjustments to customer's bills, total approximately $85 million and consists of approximately $25 million for the five-month period beginning January 1, 1999 and $60 million for the 12-month period beginning June 1, 1999. Such reductions to LIPA's customer's are reimbursed by KeySpan, in accordance with the Merger Agreement.

Other Matters

As a result of the Merger, LIPA has assumed contracts with numerous Independent Power Producers ("IPPs") and the New York Power Authority ("NYPA") for electric generating capacity. Under the terms of the agreement with NYPA, which will expire in May 2014, LIPA may purchase up to 100% of the

electric energy produced at the NYPA facility located within LIPA's service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed non-energy payments associated with operating and maintaining the plant.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs it they fail to deliver energy. For purposes of the table below, LIPA has assumed full performance by the IPPs, as no event has occurred to suggest anything less than full performance by these parties.

LIPA has also assumed a contract with NYPA for firm transmission ("wheeling") capacity in connection with a transmission cable which was constructed, in part, for the benefit of LIPA. In accordance with the provisions of this agreement, which expires in 2020, LIPA is required to reimburse NYPA for debt service payments and the cost of operating and maintaining the cables. The cost of such contracts is included in electric fuel expense and is recoverable through rates.

The following table represents LIPA's commitments under purchased power contracts:

(In millions)

	NYPA Holtsville					
	Debt Service	Other Fixed Charges	Energy*	Firm Transmission	IPPs*	Total Business*
For the years ended						
1999	$ 21.7	$ 14.0	$ 8.7	$ 26.3	$ 126.6	$ 197.3
2000	21.8	14.4	8.7	26.0	132.5	203.4
2001	21.9	14.8	8.6	28.3	135.5	209.1
2002	22.0	15.2	8.8	28.4	139.3	213.7
2003	22.0	15.5	9.1	28.5	142.6	217.7
Subsequent thereto	215.9	185.2	105.3	514.0	991.1	2,011.5
Total	325.3	259.1	149.2	651.5	1,667.6	3,052.7
Less: Imputed Interest	142.9	121.8	69.5	368.9	683.5	1,386.6
	$ 182.4	$ 137.3	$ 79.7	$ 282.6	$ 984.1	$ 1,666.1

* Assumes full performance by the IPPs and NYPA.

Note 11. Subsequent Events

On January 4, 1999, LIPA redeemed $102.6 million of the NYSERDA Electric Facilities Revenue Bonds Series 1982, 1993A, 1993B and 1995A, which were called for redemption prior to December 31, 1998.

On March 1, 1999, the variable rate bonds listed below were converted to fixed interest rates of 5.15% on the PCRBs and 5.3% on the EFRBs.

	Maturity	Former Interest Rate	(In thousands) Balance at December 31, 1998
PCRBs			
1985 Series A	March 1, 2016	Variable	$ 58,020
1985 Series B	March 1, 2016	Variable	$ 50,000
EFRBs			
1993 Series B	November 1, 2023	Variable	$ 29,600
1994 Series A	October 1, 2024	Variable	$ 2,600
1995 Series A	August 1, 2025	Variable	$ 15,200

Also, on March 1, 1999, LIPA redeemed $30.1 million of the NYSERDA Pollution Control Revenue Bonds, 1985 Series A.

Supplementary Information
Impact of Year 2000

General:
A portion of the computer hardware and software and embedded technology (such as microcontrollers and microprocessors contained in equipment and machinery) used by the Authority and LIPA, as well as KeySpan and the subsidiaries of KeySpan that are parties to the MSA, EMA and PSA and others with whom the foregoing have business arrangements, was not designed to recognize calendar years after 1999 (the "Year 2000 Issue").

The Authority recently purchased new computer software to support certain activities of LIPA and believes that these systems are Year 2000 ready. Management also believes that, based on available information, it will be able to manage its Year 2000 transition for systems and infrastructure, without any material adverse effect on its business operations or financial prospects. However, there can be no assurance that failure to resolve any issue relating to such transition would not have a material adverse effect on LIPA. LIPA has had continuing discussions with KeySpan, their largest vendor, who is responsible for the management and operation of LIPA's transmission and distribution system, and KeySpan indicates that they have evaluated the extent to which modifications to computer software, hardware and databases will be necessary to accommodate the year 2000.

KeySpan's computer applications are generally based on two digits and do require additional programming to recognize the new millennium. A corporate-wide program has been established by KeySpan and its subsidiaries. The program includes both information technology ("IT") and non-IT systems. The critical non-IT systems are generally in the areas of electric production, distribution, transmission, gas distribution and communications. The readiness of suppliers and vendor systems is also under review. The project is under the direction of KeySpan's Year 2000 Program Office, chaired by the Vice President, Technology Operations and Corporate Y2K Officer. Each of KeySpan's critical business processes is being reviewed to: identify and inventory sub-components; assess for Year 2000 compliance; establish repair plans as necessary; and test in a Year 2000 environment. The inventory phase for the IT systems and non-IT systems is 100% complete. The assessment phase is 100% complete for the IT systems, and over 90% complete for non-IT systems. The assessment phase is expected to be complete by July 1, 1999.

KeySpan's hardware, software and embedded systems are being tested and certified to be Year 2000 compliant. Repair and testing to sustain operability is now 73% complete for the IT systems and approximately 75% for the non-IT systems. Components needed to support the critical business process and associated business contingency plans are expected to be ready for the year 2000 by July 1, 1999.

KeySpan's vendors and business partners needed to support the critical business processes of KeySpan are also being reviewed for their year 2000 compliance. At this time, none of these vendors have indicated to KeySpan that they will be materially affected by the year 2000 problem.

KeySpan has analyzed each of the critical business processes to identify possible Year 2000 risks. Each of KeySpan's critical businesses will be certified by the responsible KeySpan officer as being Year 2000 ready. However, the most reasonable likely worst case scenarios are also being identified. Business operating procedures at KeySpan will be reviewed to ensure that risks are minimized when entering the

Year 2000 and other high risk dates. KeySpan is developing contingency plans to address possible failure points in each critical business process.

While KeySpan must plan for the following worst case scenarios, management believes that these events are improbable.

Loss of generating flexibility:
KeySpan's generation subsidiary receives gas delivery from multiple national and international pipelines and, therefore the effects of a loss in any one pipeline can be mitigated through the use of other pipelines. Complete loss of all the supply lines is not considered a reasonable scenario. Nevertheless, the impact of the loss of any one pipeline is dependent on temperature and vaporization rate. The partial loss of gas supply will not affect KeySpan's ability to supply electricity since many of the plants have the ability to operate on oil.

Loss of electric grid inter-connections/KeySpan operated electric distribution facilities:
Electric utilities are physically connected on a regional basis to manage electric load. This is often referred to as the regional grid. Presently, KeySpan is working with other regional utilities to develop a coordinated operating plan. Should there be an instability in the grid, KeySpan has the ability to remove LIPA's operations from the grid, and operate independently.

Certain electric system components such as individual generating units, transmission and distribution system facilities, and the electric energy management system have the potential to malfunction due to Year 2000 problems. KeySpan has inventoried electric system components and developed a plan to certify mission critical processes as Year 2000 compliant. Contingency plans are being developed, where appropriate, for loss of critical system elements. KeySpan presently estimates that contingency plans regarding its electric facilities should be completed by July 1999.

Loss of telecommunications:
KeySpan has a substantial dependency on many telecommunication systems and services for both internal and external communications. External communications with the public and the ability of customers to contact KeySpan in cases of emergency response is essential. KeySpan intends to coordinate its emergency response efforts with the offices of emergency management of the various local governments within its service territory. Internally, there are a number of critical processes in both the gas and electric operating areas that rely on external communication providers. Contingency plans will address methods for manually monitoring these functions. These contingency plans, KeySpan presently estimates, should be finalized by July 1999.

In addition to the above, KeySpan is also planning for the following scenarios: short-term reduction in system power generating capability; limitation of fuel oil operation; reduction in quality of power output; loss of automated meter reading; loss of ability to read, bill and collect; and loss of the purchasing/ materials management system.

KeySpan believes that, with modifications to existing software and conversions to new hardware and software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed on time, and contingency plans fail, the Year 2000 issue could have a material adverse impact on the operations of LIPA.

The Company's Contingency Plans:
In order to insure that the Year 2000 will have a minimal impact on the operations of the Company, the Company is closely monitoring the initiatives and progress of KeySpan's Year 2000 Program Office. In addition, the Company is working with various other governmental agencies to insure communication between the Company and such other governmental entities is uninterrupted.

Other Financial Information

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Report of Independent Accountants on Other Financial Information

March 5, 1999

To the Board of Trustees
of Long Island Power Authority and Subsidiaries

Our report on the audit of the consolidated financial statements of Long Island Power Authority and its subsidiaries, (collectively, the "Company") as of December 31, 1998, and for the nine months then ended appears on page 1. This audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary consolidating information accompanying the consolidated financial statements is not necessary for fair presentation of the consolidated financial position, results of operations, and cash flows of the Comany in conformity with generally accepted accounting principles. The supplementary information is presented only for purposes of additional analysis and is not a required part of the consolidated financial statements. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

PricewaterhouseCoopers LLP

Long Island Power Authority and Subsidiaries
Consolidating Statement of Financial Position
December 31, 1998
(Thousands of Dollars)

	LIPA	Authority	Eliminations	Consolidated
Assets				
Utility Plant, net	$ 2,071,482	$ -	$ -	$ 2,071,482
Property and Equipment, net	-	822	-	822
Current Assets				
Cash and cash equivalents	-	517,264	-	517,264
Customer accounts receivable (less allowance for doubtful accounts of $20,211)	119,161	-	-	119,161
Other accounts receivable	10,096	-	-	10,096
Accrued unbilled revenues	78,414	-	-	78,414
Promissory note receivable - KeySpan	398,000	-	-	398,000
Due from LIPA	-	70,880	(70,880)	-
Prepayments and other current assets	28,583	207	-	28,790
Total Current Assets	634,254	588,351	(70,880)	1,151,725
Promissory Note Receivable - KeySpan	646,902	-	-	646,902
Note Receivable - LIPA	-	5,355,085	(5,355,085)	-
Designated Funds	194,972	-	-	194,972
Nonutility Property and Other Investments	19,410	-	-	19,410
Deferred Charges	78,507	-	-	78,507
Due from LIPA	-	855,684	(855,684)	-
Investment in Subsidiary	-	(79,981)	79,981	-
Acquisition Adjustment (net of accumulated amortization of $68,766)	4,026,956	-	-	4,026,956
Total Assets	$ 7,672,483	$ 6,719,961	$ (6,201,668)	$ 8,190,776
Capitalization				
Long-term debt	$ 778,075	$ 6,708,943	$ -	$ 7,487,018
Note Payable - the Authority	5,355,085	-	(5,355,085)	-
Due to the Authority	855,684	-	(855,684)	-
	6,988,844	6,708,943	(6,210,769)	7,487,018
Accumulated deficit	(79,981)	(100,055)	79,981	(100,055)
Total Capitalization	6,908,863	6,608,888	(6,130,788)	7,386,963
Current Liabilities				
Current maturities of long-term debt	398,000	70,880	-	468,880
Due to the Authority	70,880	-	(70,880)	-
Due to KeySpan	75,085	(45)	-	75,040
Accounts payable and accrued expenses	35,921	6,702	-	42,623
Accrued taxes	79,021	-	-	79,021
Accrued interest	29,851	33,536	-	63,387
Customer deposits	23,205	-	-	23,205
Total Current Liabilities	711,963	111,073	(70,880)	752,156
Deferred Credits	34,059	-	-	34,059
Claims and Damages	17,598	-	-	17,598
Commitments and Contingencies				
Total Capitalization and Liabilities	$ 7,672,483	$ 6,719,961	$ (6,201,668)	$ 8,190,776

Long Island Power Authority and Subsidiaries
Consolidating Statement of Revenues, Expenses, and Changes in Accumulated Deficit
For the nine months ended December 31, 1998
(Thousands of Dollars)

	LIPA	Authority	Eliminations	Consolidated
Revenue - Electric	$ 1,377,605	$ -	$ -	$ 1,377,605
Expenses				
Operations - fuel and purchased power	408,192	-	-	408,192
Operations and maintenance	398,193	-	(10,550)	387,643
General and administrative	-	10,497	-	10,497
Depreciation and amortization	121,969	53	-	122,022
Payment in lieu of taxes	157,561	-	-	157,561
Customer rebates	168,806	-	-	168,806
Total Operating Expenses	1,254,721	10,550	(10,550)	1,254,721
Excess of operating revenues/(expenses) over expenses/(revenues)	122,884	(10,550)	10,550	122,884
Other income and (deductions), net				
Loss on investment in subsidiary	-	(79,981)	79,981	-
Investment income	25,290	151,312	(142,882)	33,720
Management fee	-	10,550	(10,550)	-
Other	(249)	-	-	(249)
Total other income and (deductions), net	25,041	81,881	(73,451)	33,471
Excess of revenues/(expenses) over expenses/(revenues) before interest charges	147,925	71,331	(62,901)	156,355
Interest charges and (credits)				
Interest on long-term debt, net	76,392	147,460	-	223,852
Interest on note payable to the Authority	142,882	-	(142,882)	-
Other interest	9,933	-	-	9,933
Allowance for borrowed funds used during construction	(1,301)	-	-	(1,301)
Total interest charges	227,906	147,460	(142,882)	232,484
Excess of revenues/(expenses) over expenses/(revenues)	(79,981)	(76,129)	79,981	(76,129)
Accumulated Deficit				
Beginning	-	(23,926)	-	(23,926)
Ending	$ (79,981)	$ (100,055)	$ 79,981	$ (100,055)

Long Island Power Authority and Subsidiaries
Consolidating Statement of Cash Flows
December 31, 1998
(Thousands of Dollars)

	LIPA	Authority	Eliminations	Consolidated
Operating Activities				
Net Excess of (expenses)/revenues over (revenues)/expenses	$ (79,981)	$ (76,129)	$ 79,981	$ (76,129)
Adjustments to reconcile excess of (expenses)/revenues over (revenues)/expenses to net cash provided by operating activities				
Depreciation and amortization	121,969	53	-	122,022
Amortization of cost of issuing and redeeming securities	1,705	-	-	1,705
Other	1,973	-	-	1,973
Loss on investment in subsidiary	-	79,981	(79,981)	-
Changes in operating assets and liabilities				
Accounts receivable, net and accrued unbilled revenue	34,568	-	-	34,568
Accounts payable and accrued expenses	35,921	(2,183)	-	33,738
Net change in Due to KeySpan	(136,712)	(45)	-	(136,757)
Accrued taxes	56,358	-	-	56,358
Accrued interest	29,850	33,536	-	63,386
Other	45,657	(84)	-	45,573
Net cash provided by operating activities	111,308	35,129	-	146,437
Investing Activities				
Capital and nuclear fuel expenditures	(71,030)	(770)	-	(71,800)
Merger costs, net of cash transferred	(61,498)	11,671	-	(49,827)
Acquisition of common stock, net of $75,000 cash transferred	(2,422,500)	-	-	(2,422,500)
Net cash (used in) provided by investing activities	(2,555,028)	10,901	-	(2,544,127)
Cash Flows from Non-Capital related Financing Activities				
Repayment of State of New York advances	-	(26,160)	-	(26,160)
Repayment of New York Power Authority advance	-	(9,000)	-	(9,000)
Proceeds (Repayment) of note payable-Authority	2,640,000	(2,640,000)	-	-
Net cash (used) provided by non-capital related financing activities	2,640,000	(2,675,160)	-	(35,160)
Cash Flows from Capital and related Financing Activities				
Proceeds from notes receivable	3,000	-	-	3,000
Proceeds from the issuance of bonds	-	6,779,823	-	6,779,823
Net proceeds (issuance) of Authority loan	926,564	(926,564)	-	-
Proceeds (issuance) of note payable - Authority	4,137,992	(4,137,992)	-	-
(Issuance) proceeds of note payable - Authority	(1,422,908)	1,422,908	-	-
Redemption of long-term debt	(3,338,659)	-	-	(3,338,659)
Redemption of preferred stock	(221,600)	-	-	(221,600)
Bond issuance costs	(81,706)	2,309	-	(79,397)
Other	(3,991)	-	-	(3,991)
Net cash provided by (used in) capital and related financing activities	(1,308)	3,140,484	-	3,139,176
Net Increase in cash and cash equivalents	194,972	511,354	-	706,326
Cash and cash equivalents at beginning of period	-	5,910	-	5,910
Cash and cash equivalents at end of period	$ 194,972	$ 517,264	$ -	$ 712,236 *
Interest paid	$ 178,564	$ 127,429	$ -	$ 305,993

*Includes designated funds.

Long Island Power Authority and Subsidiaries
Consolidating Statement of Capitalization
December 31, 1998
(Thousands of Dollars)

	Maturity	Interest Rate	Series	LIPA	Authority	Eliminations	Consolidated
Electric System							
General Revenue Bonds							
Serial Bonds	December 1, 1999 to 2016	4.10% to 6.00% a	1998A	$ -	$ 1,279,965	$ -	$ 1,279,965
Taxable Term Bonds	December 1, 1999	5.94% a	1998A	-	25,000	-	25,000
Term Bonds	December 1, 2018 to 2029	5.00% to 5.75% a	1998A	-	1,998,770	-	1,998,770
Capital Appreciation Bonds	December 1, 2003 to 2028	4.40% to 5.30% a	1998A	-	150,095	-	150,095
Serial Bonds	April 1, 2000 to 2016	4.25% to 5.13% a	1998B	-	1,256,655	-	1,256,655
Term Bonds	April 1, 2018	4.75% a	1998B	-	57,145		57,145
Electric System							
Subordinated Revenue Bonds	May 1, 2033	4.15% b	Series 1	-	250,000	-	250,000
	May 1, 2033	3.80% b	Series 2	-	250,000	-	250,000
	May 1, 2033	3.00% b	Series 3	-	250,000	-	250,000
	May 1, 2033	3.00% b	Series 4	-	250,000	-	250,000
	May 1, 2033	5.10% b	Series 5	-	250,000	-	250,000
	May 1, 2033	4.85% b	Series 6	-	250,000	-	250,000
	April 1, 2025	5.10% b	Series 7	-	250,000	-	250,000
	April 1, 2001 to 2008	4.00% to 5.00% a	Series 8	-	218,300	-	218,300
Total General and Subordinated Revenue Bonds				-	6,735,930	-	6,735,930
Debentures							
	July 15, 1999	7.30% a		397,000	-	-	397,000
	January 15, 2000	7.30% a		278	-	-	278
	July 15, 2001	6.25% a		8,460	-	-	8,460
	March 15, 2003	7.05% a		5,890	-	-	5,890
	March 1, 2004	7.00% a		2,999	-	-	2,999
	June 1, 2005	7.13% a		14,307	-	-	14,307
	November 1, 2022	9.00% a		26,877	-	-	26,877
	March 15, 2023	8.20% a		270,000	-	-	270,000
Total Debentures				725,811	-	-	725,811
NYSERDA Financing Notes							
Industrial Development Revenue Bonds							
	December 1, 2006	7.50% a	1976 A	26,375	-	-	26,375
	December 1, 2009	7.80% a	1979 B	19,100	-	-	19,100
	March 1, 2016	3.58% a	1985 A,B	138,120	-	-	138,120
Electric Facilities Revenue Bonds							
	September 1, 2019	7.15% a	1989 A,B	35,030	-	-	35,030
	June 1, 2020	7.15% a	1990 A	73,900	-	-	73,900
	December 1, 2020	7.15% a	1991 A	26,560	-	-	26,560
	February 1, 2022	7.15% a	1992 A,B	13,455	-	-	13,455
	August 1, 2022	6.90% a	1992 C,D	28,060	-	-	28,060
	November 1, 2023	3.70% b	1993 B	50,000	-	-	50,000
	October 1, 2024	3.70% b	1994 A	50,000	-	-	50,000
	August 1, 2025	3.70% b	1995 A	50,000	-	-	50,000
Total NYSERDA Financing Notes				510,600	-	-	510,600
Unamortized premium and deferred amortization				(60,336)	43,893	-	(16,443)
Subtotal				1,176,075	6,779,823	-	7,955,898
Note Payable - the Authority				5,355,085	-	(5,355,085)	-
Due to the Authority				926,564	-	(926,564)	-
Total				7,457,724	6,779,823	(6,281,649)	7,955,898
Less Current Maturities				468,880	70,880	(70,880)	468,880
Total Long-Term Debt				6,988,844	6,708,943	(6,210,769)	7,487,018
Accumulated Deficit				(79,981)	(100,055)	79,981	(100,055)
Total Capitalization				$ 6,908,863	$ 6,608,888	$ (6,130,788)	$ 7,386,963

a - [illegible] rate
b - Variable rate (rate presented is as at December 31, 1998)

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Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

March 5, 1999

To the Board of Trustees
of Long Island Power Authority and Subsidiaries

We have audited the financial statements of Long Island Power Authority and its subsidiaries (collectively, the "Company") as of December 31, 1998 and March 31, 1998, and have issued our report thereon dated March 5, 1999. We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. For purposes of this report, we have categorized the provisions of laws, regulations, contracts, and grants we tested as part of obtaining such reasonable assurance into the following categories:

- Cash and cash equivalents and designated funds
- Revenues and receivables
- Purchasing and payables
- Officers and Employee Costs
- New York State Appropriations
- Payments in Lieu of Taxes

However, providing an opinion on compliance with those provisions was not an objective of our audits and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting
In planning and performing our audits, we considered the Company's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a

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timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the design of internal control over financial reporting or its operation that we consider to be material weaknesses.

This report is intended for the information of the Company. However, this report is a matter of public record, and its distribution is not limited.

PricewaterhouseCoopers LLP

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549-1004

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended ____________

OR

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

For the transition period from April 1, 1998 to December 31, 1998

Commission File Number 1-3571

Long Island Lighting Company d/b/a LIPA

(Exact Name of Registrant as Specified in its Charter)

New York (State or Other Jurisdiction of Incorporation or Organization)	11-1019782 (I.R.S. Employer Identification No.)
333 Earle Ovington Boulevard, Suite 403, Uniondale, New York (Address of Principal Executive Offices)	11553 (Zip Code)

Registrant's telephone number, including area code: (516) 222-7700

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
7.30% Debentures Due 2000	New York Stock Exchange
7.05% Debentures Due 2003	New York Stock Exchange
7.00% Debentures Due 2004	New York Stock Exchange
9.00% Debentures Due 2022	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The number of shares of the registrant's common stock outstanding on March 29, 1999 was 1.

LONG ISLAND LIGHTING COMPANY d/b/a LIPA
TRANSITION REPORT ON FORM 10-K
FOR THE TRANSITION PERIOD FROM APRIL 1, 1998 TO DECEMBER 31, 1998

PART I.

This Annual Report on Form 10-K contains statements which, to the extent they are not recitations of historical fact, constitute "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 ("Reform Act"). In this respect, the words "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. All such forward-looking statements are intended to be subject to the safe harbor protection provided by the Reform Act. A number of important factors affecting business and financial results of Long Island Lighting Company d/b/a LIPA ("LIPA") could cause actual results to differ materially from those stated in the forward-looking statements. Those factors include state and federal regulatory rate proceedings, competition and certain environmental matters each as discussed herein, or in other reports filed by LIPA with the Securities and Exchange Commission.

Item 1. *Business*

LIPA is a wholly-owned subsidiary of the Long Island Power Authority (the "Authority"), a corporate municipal instrumentality and a political subdivision of the State of New York. The Authority's and LIPA's principal offices are located at 333 Earle Ovington Blvd., Uniondale, New York 11553 and their telephone number is (516) 222-7700.

On May 28, 1998, the Authority became the sole stockholder of LILCO (as defined below) as a result of LIPA Acquisition Corp. (a wholly-owned transitory subsidiary formed by the Authority to facilitate the acquisition) merging into LILCO (the "Merger"). Prior to the Merger, LILCO transferred certain generation and other assets to a subsidiary company which merged with the former Brooklyn Union Gas Company to form what was then known as MarketSpan Corporation ("MarketSpan"). MarketSpan has since announced that it will henceforth conduct its business under the name of KeySpan Energy ("KeySpan"), and that it expects to formally change its name in 1999. At the time of the Merger, LILCO's principal assets included: (i) the electric transmission and distribution system and other items relating to the system that provides electric power and energy at retail in LIPA's Service Area (as defined herein) (the "T & D System"); (ii) an 18% undivided ownership interest in Unit 2 of the Nine Mile Point Nuclear Station ("NMP2"); and (iii) certain agreements and contracts for power supply and transmission. As used herein, the term "LILCO" means the Long Island Lighting Company, the publicly-owned gas and electric utility company as it existed prior to the Merger, and the term "LIPA" means that company as it exists after the Merger as a wholly-owned electric utility subsidiary company of the Authority, doing business as LIPA.

Service Area

The service area in which LIPA conducts its retail electric business includes two counties on Long Island, Nassau County and Suffolk County (except for the Nassau County villages of Freeport and Rockville Centre and the Suffolk County village of Greenport, each of which has its individually owned municipal electric system), and a small portion of the borough of Queens in New York City known as the Rockaways (the "Service Area").

As of December 31, 1998, LIPA had approximately 1.04 million customers in the Service Area. LIPA receives approximately 49% of its revenue from residential customers and approximately 48% from commercial and industrial customers with the balance derived from sales to other utilities and public authorities. Individual commercial and industrial customers are relatively small with approximately 45% of these customers having peak demands at less than 75kW. LIPA's largest customer in the Service Area accounted for less than two percent of total sales for the nine months ended December 31, 1998.

In addition to its retail customers, LIPA makes wholesale sales (sales for resale) to other electric utilities (through the EMA as defined below), including the three existing municipally-owned electric utilities on Long Island (the villages of Greenport, Freeport, and Rockville Centre). These villages rely primarily upon their own generation and purchases from the Power Authority of the State of New York ("NYPA") for their power supply.

LIPA also provides electric transmission service to NYPA for the delivery of NYPA capacity and energy to the three municipal utilities and other NYPA-power recipients on Long Island, including the Suffolk County Electrical Agency and the Nassau County Public Utility Agency.

System Operation

The operation of LIPA's system (including obtaining all necessary power supplies) is done through operating agreements with various subsidiaries of KeySpan. Day-to-day operations and maintenance are performed by the workforce of such subsidiaries. The operating agreements consist of a Management Services Agreement ("MSA"), a Power Supply Agreement ("PSA") and an Energy Management Agreement ("EMA").

The MSA provides for KeySpan Electric Services LLC ("KeySpan Electric") to perform the day-to-day operation and maintenance of the T&D System, including among other functions, transmission and distribution facility operation, customer service, billing and collection, meter reading, planning, engineering and construction, all in accordance with policies and procedures adopted by the Authority. Under the MSA, KeySpan Electric earns a management fee and can earn certain incentive payments or be subject to certain penalties based upon performance. The term of the MSA is eight years. The PSA provides for the sale to LIPA by KeySpan Generation LLC of all of the capacity and, to the extent LIPA requests, energy from the existing oil and gas-fired generation plants on Long Island formerly owned by LILCO (the "Generating Facilities"). The PSA provides for incentives and penalties for the maintenance of the output capability of the Generating Facilities. The term of the PSA is fifteen years. The EMA provides for KeySpan Energy Trading Services LLC ("KeySpan Energy Trading") to: (i) procure and manage fuel supplies for LIPA to fuel the Generating Facilities; (ii) perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs; and (iii) manage off-system sales of output from the Generating Facilities and other power supplies owned or under contract to LIPA. The EMA provides for incentives and penalties for performance related to fuel purchases and off-system power purchases. LIPA is entitled to two-thirds of the profit from any off-system energy sales arranged by KeySpan Energy Trading. The term for the services provided in (i) above is fifteen years and the term of the services provided in (ii) and (iii) above is eight years.

The Transmission and Distribution System

The T&D System is an integrated transmission and distribution system with electricity delivered to and from the Service Area over five transmission interconnections that are owned in part by or are under contract to LIPA. These interconnections connect the T&D System to utilities outside of the Service Area and enable delivery of: (i) energy produced by NMP2; (ii) additional energy resources needed to meet the peak demands of LIPA's electric customers; (iii) favorably-priced energy to supplement or displace generation from generating resources within the Service Area; and (iv) excess generation from generating facilities within the Service Area to purchasers outside of the Service Area when market conditions merit. The table below provides summary information on the transmission interconnections.

TABLE 1

SERVICE AREA TRANSMISSION INTERCONNECTIONS

Name	Off-System Terminal Location	Interconnecting Utility (1)(2)	Voltage Level (3)
Dunwoodie to Shore Road	Westchester County, NY	Con Edison	345kV
East Garden City to Sprainbrook	Westchester County, NY	NYPA	345kV
Northport to Norwalk Harbor	Norwalk, CT	CL&P	138kV
Jamaica to Lake Success	Queens, NY	Con Edison	138kV
Jamaica to Valley Stream	Queens, NY	Con Edison	138kV

(1) These utilities own the portion of the interconnections not owned by LIPA, except for the interconnection with NYPA, which is owned entirely by NYPA.

(2) CL&P = The Connecticut Light and Power Company.

(3) Kilovolt or "kV".

Two of the T&D System's transmission interconnections are tied to the Consolidated Edison Company of New York, Inc. ("Con Edison") transmission system in Queens County, New York. LIPA owns these facilities to the border of Nassau County and Queens County, at which point ownership transfers to Con Edison. The three remaining interconnections extend under water across the Long Island Sound to New York or Connecticut. One of these lines, the East Garden City to Sprainbrook line, is owned entirely by NYPA (the "NYPA Line") and is used by LIPA under the terms of the contract with NYPA. The other two interconnections are owned by LIPA from their termination points on Long Island to the middle of Long Island Sound, at which point ownership is held by the interconnecting utility.

The agreement for use of the NYPA Line provides that LIPA will reimburse NYPA for the costs it incurs in connection with the NYPA Line, including, but not limited to, debt service, reserves, and operation and maintenance expenses, in return for the use of the capacity of the line. LIPA is contractually obligated to pay such costs based on the full capacity of the NYPA Line; however, to the extent that NYPA allocates capacity to other parties, LIPA's payment obligations are reduced proportionately, with such other parties making payments pursuant to rates under NYPA's Open Access Tariff. In the past, NYPA has allocated capacity of the NYPA Line to certain loads served by NYPA in the Service Area when there has been insufficient capacity to serve such loads on another transmission line jointly owned by LIPA and Con Edison. This practice is expected to continue in the future.

LIPA's transmission system includes approximately 1,300 miles of overhead and underground lines with voltage levels ranging from 345kV to 23kV. There are 32 transmission substations to step down transmission voltage levels from 345kV or 138kV to 69kV, 33kV or 23kV. The distribution system has approximately 46,000 circuit miles of overhead lines and over 10,000 circuit miles of underground lines and approximately 149,000 line transformers.

Nine Mile Point Nuclear Power Station, Unit 2

LIPA owns an 18 percent interest in NMP2, which is part of a two-unit nuclear power station located at a 900-acre site on Lake Ontario in the Town of Scriba, New York. NMP2 is rated at 1,144 MW of capacity and is owned by five co-tenants under a Basic Agreement dated as of September 22, 1975, which provides for contractual rights, payments and other matters. Under an Operating Agreement among the co-tenants, dated December 29, 1992, Niagara Mohawk Power Corporation ("Niagara Mohawk") has the exclusive control of the operation and maintenance of NMP2 under the oversight of a Management Committee (comprised of the co-tenants) for policy making, planning, budgeting, and operational decisions of Niagara Mohawk related to NMP2. This Operating Agreement provides for a sharing of all costs relating to NMP2 by the co-tenants in proportion to their percentage interests in the unit.

NMP2 is scheduled for decommissioning in 2026. LIPA's share of the decommissioning costs, based on a site specific study conducted in 1995, is estimated to be $161 million in 1998 dollars ($407 million in 2026 dollars). LIPA retained title to LILCO's external trust fund established for the decommissioning of the contaminated portion of the NMP2 plant. The balance in the external trust fund as of December 31, 1998 was approximately $19 million. An annual contribution of approximately $3 million is required to fully fund the external trust fund to meet LIPA's 18 percent share of the costs of decommissioning the contaminated portion of NMP2 by the decommissioning date of 2026. Commencing in 1999, LIPA will also contribute approximately $1.2 million annually to fund its share of decommissioning the non-contaminated portion of NMP2.

NMP2 has generally exceeded average industry performance for the five years ended 1997 (the most recent period for which complete information is reported) with respect to annual capacity factor. Periodic outages for refueling are being extended to every 24 months rather than every 18 months to improve overall unit capacity factors. Notwithstanding a 1998 outage described below, planned and actual outage times have generally decreased due to improved outage management and fewer emergent problems. The principal factors that caused the extended outage in 1998 are not expected to recur in future outages.

NMP2's most recent refueling outage occurred from May 1, 1998 through July 5, 1998. This outage was scheduled to last 35 days, but was extended to 64 days due, in part, to additional inspections resulting from indications of stress corrosion cracking of the reactor shroud, a hollow cylinder inside the reactor vessel that serves to divert cooling water recirculation flow. Niagara Mohawk reported that the cracking indications were not of any safety significance, and NMP2 was allowed to resume operations with no particular restrictions. Niagara Mohawk installed appropriate equipment and procedures to manage the problem. Design problems with the control building heating, ventilating, and air conditioning system, and delays in reactor pressure vessel disassembly and core off load, among other factors, caused further delays in the refueling outage. In addition to the removal of spent fuel assemblies and the installation of new assemblies, Niagara Mohawk used this refueling outage to perform maintenance and repairs on NMP2. The next scheduled refueling outage for NMP2 is in 2000.

Niagara Mohawk has announced that it plans to pursue the sale of its nuclear assets including its interest in NMP2. LIPA is reviewing its rights and remedies under the agreements governing its 18% interest in NMP2. LIPA has not received an offer to purchase its 18% interest in NMP2 and is not pursuing a sale at this time.

Loads

The Service Area is characterized by customer usage patterns and weather conditions that result in peak usage during the summer and relatively low annual load factors. The peak usage in the summer of 1998 was approximately 4,208 MW. It is estimated that peak load growth will range between 0.4 percent and 1.3 percent annually on a weather-normalized basis, averaging 0.9 percent over the 1998-2008 period. It is estimated that energy growth will range between 1.0 percent and 1.8 percent annually, averaging 1.3 percent over the 1998-2008 period. This load forecast assumes moderate economic growth in the Service Area, consistent with the general economic conditions and low levels of unemployment on Long Island. Residential sales are projected to grow at approximately 1.2 percent per year between 1998 and 2008, while commercial and industrial sales are expected to grow 1.5 percent per year.

The load and energy forecasts mentioned above were prepared by KeySpan and reviewed by LIPA's consulting engineers and take into account a price elasticity effect resulting from rate reductions that LIPA has implemented. In addition, these forecasts include the effects of LIPA's conservation program and further reductions resulting from cogeneration or similar installations designed to serve customer loads directly.

Power Supply

LIPA currently expects to rely on existing power supply resources, additional purchases, and demand side management ("DSM") programs to meet its capacity and energy requirements during the 1998 through 2008 period. During 1998, LIPA's 18% interest in NMP2 and its rights to the capacity of the Generating Facilities provided approximately 4,224 MW of generating capacity, with on-island independent power producers providing an additional 350 MW of capacity under contract to LIPA. Purchases from NYPA, excluding NYPA's Power for Jobs Program, and on-island municipal utilities provided approximately 235 MW. Additional capacity was provided by purchases of 20 MW from NYPA under the Power for Jobs Program, other firm purchases of 159 MW, and DSM program load curtailment capability of 17 MW. In aggregate, these resources provided approximately 5,000 MW in 1998.

To satisfy the growing needs of its electric customers, LIPA is expected to enter into additional power purchase agreements beginning on or about June 1999. The estimated power supply plan also anticipates an additional reduction of approximately 150 MW in customer peak load requirements through DSM programs by 2008. As a result of these changes, total capacity available to LIPA to meet the needs of its customers is expected to be 5,529 MW by 2008.

Fuel Supply

Pursuant to the EMA, KeySpan procures and manages the fuel supplies used at the Generating Facilities. The particular fuel used for generation depends on generation plant fuel capability, fuel supply, transportation availability, fuel cost and environmental restrictions. Most of the KeySpan steam units can burn either natural gas or residual oil and certain units are required to burn lower sulfur residual oil or natural gas. Natural gas or distillate fuel is burned in the gas turbines.

KeySpan shares eight gas delivery interconnections between its distribution system and the New York gas market. KeySpan and Con Edison have entered into the New York Facilities Agreement that provides for use of their joint systems to allow the parties to receive gas from interstate pipelines connected to their systems.

Oil is stored on site or at locations accessible by each generation facility. LIPA believes that: (i) existing oil storage capacity plus an active oil management program has historically helped avoid a fuel oil supply disruption at the Generating Facilities; and (ii) conversion of certain generating units to burn natural gas has further reduced exposure to potential oil interruptions.

Regulation

LIPA is subject to regulation by various State and Federal agencies.

New York State. The Public Service Commission ("PSC") is the principal agency in the State regulating the generation, transmission, distribution and sale of electric power and energy. It has no statutory jurisdiction over rates for power generated, transmitted, distributed or sold by LIPA but does regulate the rates of New York State's investor-owned utilities and certain municipal systems to which LIPA sells power.

The PSC is empowered by the New York Public Service Law to issue Certificates of Environmental Compatibility and Public Need prior to the construction in New York of power transmission lines of certain capacities and lengths, including those of LIPA. In addition, the New York State Board on Electric Generation Siting and the Environment is empowered by the New York Public Service Law to issue Certificates of Environmental Compatibility and Public Need prior to the construction in New York of major electric generating facilities.

Under the Long Island Power Authority Act (the "LIPA Act"), the Authority is empowered to set rates on behalf of LIPA for electric service in the Service Area without obtaining the approval of the PSC or any other state regulatory body. See, however, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Rate Matters."

The Department of Environmental Conservation ("DEC") is the principal agency of the State of New York regulating air, water and land quality. Before any Federal license or permit can be issued for any activity involving a discharge into navigable waters, the DEC must certify that the discharge will comply with the State water quality standards (or waive certification). Certain aspects of the DEC's regulatory authority over pollutant discharge permits, air quality permits and hazardous waste regulation arise from delegation of such authority to the State by Federal legislation.

Federal. Under Part II of the Federal Power Act, the Federal Energy Regulatory Commission ("FERC") regulates the rates, terms and conditions of: (i) the sale for resale of electric power by "public utilities"; and (ii) the provision of transmission service in interstate commerce by public utilities. Neither the Authority nor LIPA is a "public utility" under the Federal Power Act ("FPA"). Although the rates, terms and conditions under which LIPA provides transmission service are not currently subject to general FERC jurisdiction, FERC may order LIPA to provide transmission services to individual customers meeting the requirements of Sections 211 and 212 of the Federal Power Act on rates, terms and conditions comparable to those of LIPA for LIPA's own use of its system.

The Environmental Protection Agency ("EPA") is the principal agency of the Federal government regulating air, water and land quality. LIPA and the Authority are subject to EPA rules requiring the securing of routine discharge permits for non-radiological emissions and effluents from all Authority and LIPA facilities. The Nuclear Regulatory Commission ("NRC") regulates the construction and operation of nuclear power plants. The NRC prescribes various operating standards and other rules for the operation of nuclear power plants.

Shoreham Tax Matters

Through November 1992, Suffolk County and the following Suffolk County political subdivisions (collectively, the "Suffolk Taxing Jurisdictions"), the Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and the Shoreham-Wading River Library District (which was succeeded by the North Shore Library District), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make Payments-In-Lieu-Of-Taxes ("PILOTs") on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates in an amount sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments, claiming the Shoreham plant was overassessed. To date, the Authority has made such payments, in whole or in part, pursuant to interim PILOT agreements and collected the costs thereof pursuant to the PILOTs rider which is part of LIPA's rates.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding $868 million, including interest as of the date of the judgment. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain of the Suffolk Taxing Jurisdictions sought to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

The Authority had proposed a settlement agreement with the Suffolk Taxing Jurisdictions and Nassau County. The proposed settlement agreement would, among other things, cause the Authority: (i) not to enforce the judgment in favor of LILCO; and (ii) not to make any claim for a refund of what the Authority believes is an overpayment of PILOTs, in exchange for the payment by the Suffolk Taxing Jurisdictions to the Authority of $625 million.

On February 1, 1999, a lawsuit was filed in the Supreme Court of the State of New York, Nassau County by the Association for a Better Long Island against the Authority and LIPA. This lawsuit seeks: (i) to require the Authority to collect the full amount of the judgment obtained by the Authority in the Shoreham Property Tax Litigation; and (ii) to declare that the offer of the Authority to settle the Shoreham Property Tax Litigation is void and legally unenforceable. No assurance can be given as to the method, amount (if any) or timing of any recovery by the Authority related to the Shoreham Property Tax Litigation.

The proposed settlement agreement with the Suffolk Taxing Jurisdictions was not accepted and on March 1, 1999, the Authority withdrew its offer to settle the Shoreham Property Tax Litigation including claims related to the Authority's overpayment of PILOTs on the Shoreham plant for $625 million and indicated that any settlement would have to be at a higher amount. On that date, the Authority also demanded that the Suffolk Taxing Jurisdictions pay refunds of real estate taxes in the amount of approximately $784 million consisting of (i) refunds and interest due as of the entry of the judgment on March 26, 1997 for the period from and after January 15, 1987 (the effective date of the LIPA Act) of approximately $675 million and (ii) accrued post-judgment interest in the amount of approximately $109 million. Post-judgment interest will continue to accrue until the judgment is satisfied.

On September 15, 1998, Suffolk County filed an action against the Authority in the Supreme Court of the State of New York, County of Suffolk seeking to enjoin the Authority from recovering tax refunds based upon the over-assessment of the Shoreham nuclear plant. The action claims that the Authority does not have the right to recover property taxes previously assessed against LILCO for tax years 1984-1985 through 1991-1992. On March 19, 1999, the court ruled that the Authority was not entitled to collect any refund of property taxes assessed against the Shoreham plant. In addition, the court stated that the Authority has a duty to discontinue and abandon all proceedings which seek the repayment of all or part of the taxes assessed against the Shoreham Plant. The Authority intends to appeal this decision. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's or LIPA's financial condition. Further, the court stated that under a ruling of the New York State Court of Appeals, the Authority is not prohibited from seeking refunds of PILOTs paid on over-assessments of the Shoreham plant.

The New York State Court of Appeals in a separate case has ruled that the LIPA Act does not prohibit the Authority from seeking refunds plus interest if it has overpaid PILOTs based on an over-assessment of Shoreham. The Authority has made PILOT payments of approximately $345 million which it believes were based on such an over-assessment. On February 24, 1999, the Authority filed an action against the Suffolk Taxing Jurisdictions in the Supreme Court of the State of New York, Nassau County, seeking a judgment in an amount equal to the total amount of PILOTs overpaid by the Authority, plus interest.

On March 23, 1999, the Shoreham Wading River Central School District filed an action against the Authority in the Supreme Court of the State of New York, County of Nassau seeking an order directing the Authority to pay approximately $6.4 million of PILOTs which the plaintiff alleges are due and owing and approximately $24.6 million of PILOTs which the plaintiff alleges is the cumulative deficiency as of June 1, 1998. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's or LIPA's financial condition.

Certain Factors Affecting the Electric Utility Industry

General

The electric utility industry has been, and in the future will be, affected by a number of factors which will have an impact on the business, affairs and financial condition of both public and private electric utilities, including the Authority and LIPA.

One of the most significant of these factors is the efforts on both the national and local levels to restructure the electric utility industry from a heavily regulated monopoly to an industry in which there is open competition for power supply service on both the wholesale and retail level.

Electric utilities are also subject to increasing Federal, state and local statutory and regulatory requirements with respect to the siting and licensing of facilities, safety and security, air and water quality, land use and other environmental factors. The industry is subject to claims asserting health effects from electric and magnetic fields associated with power lines, home appliances and other sources.

Energy Policy Act of 1992

The Energy Policy Act of 1992 (the "Energy Policy Act") made fundamental changes in the Federal regulation of the electric utility industry, particularly in the area of transmission access. The purpose of these changes, in part, was to bring about increased competition in the wholesale electric power supply market. In particular, the Energy Policy Act provides FERC with the authority, upon application by any person selling electricity, federal power marketing agency, or other power generator, to require a transmitting utility to provide transmission services to the applicant essentially on a cost-of-service basis. Municipally-owned electric utilities are "transmitting utilities" for purposes of these provisions of the Energy Policy Act. However, the Energy Policy Act specifically denied FERC the authority to mandate "retail wheeling," under which a retail customer of one utility could obtain transmission services for the purpose of obtaining power from another utility or non-utility power generator.

FERC Initiatives

On April 24, 1996, the FERC issued two final rules that contain significant policy initiatives designed to open the market for generation of electricity to competition. The final rules effect significant changes in the regulation of transmission services provided by "public utilities" (as defined in the FPA) that own, operate or control interstate transmission facilities used to transmit power in interstate commerce ("jurisdictional utilities"). Neither the Authority nor LIPA is a jurisdictional utility as so defined.

One of the final rules, Order No. 888, as modified on rehearing: (i) requires all public utilities to provide open access transmission services on a non-discriminatory basis by requiring all such public utilities to file tariffs that offer other entities seeking use of the interstate transmission system the same transmission services they provide themselves under comparable terms and conditions; and (ii) contains a reciprocity provision that requires non-jurisdictional utilities (including municipal and consumer-owned utilities such as

LIPA and the Authority) that purchase transmission services under FERC-filed open-access tariffs and that own or control transmission facilities to, in turn, provide open access service to the transmitting utility on rates, terms and conditions that are comparable to the service that the non-jurisdictional utility provides itself. Order No. 888 also includes provisions which, in effect, would permit jurisdictional utilities to recover so-called "stranded costs" for generating and other facilities from wholesale customers of a utility who opt to purchase from other power suppliers.

The rates that LIPA charges for transmission service under its Open Access Transmission Tariff ("OATT"), including the calculation of any stranded cost charge, are not subject to direct regulation by FERC under Part II of the FPA. FERC has reviewed the rates under LIPA's OATT and found that the OATT represents an acceptable reciprocity tariff subject to the condition that LIPA adopt a code of conduct and maintain an Open Access Same-time Information Service ("OASIS"). A prospective customer seeking service under the OATT may challenge the rate or stranded cost charge quoted by LIPA to the customer by filing an application to the FERC for an order requiring LIPA to provide transmission service under Sections 211 and 212 of the FPA. FERC has discretion to entertain such an application, but it has noted that when FERC has approved an OATT for comparability purposes for that nonjurisdictional utility the applicant requesting a Section 211 order has the burden to show why service to the applicant under the same terms as available under the OATT is not sufficient and why a Section 211 order should be granted.

The other final rule, Order No. 889, as supplemented by later orders, requires standards of conduct for utilities that offer open access transmission services to ensure that transmission owners and their affiliates do not have an unfair competitive advantage in using transmission to sell power. To this end, Order No. 889 (i) requires those utilities to establish an electronic OASIS to share transmission-related information (including information about available capacity) on a real-time basis, and also requires those utilities to obtain information about their transmission systems for their own wholesale power transactions, such as available capacity, in the same way that their competitors do via an OASIS; and (ii) promulgated standards of conduct to ensure that utilities functionally separate their transmission and wholesale power merchant functions to prevent self-dealing.

In the Spring of 1997, FERC issued its orders on rehearing of Order Nos. 888 and 889. In these supplemental orders FERC upheld the bulk of its rulings in Order Nos. 888 and 889, while making changes to certain aspects of those rules to implement its open-access policies. Public utilities were required to submit revised tariffs to FERC during the Summer of 1997 to reflect FERC's orders on rehearing. In November 1997 and again in 1998, FERC issued further orders on rehearing affirming, with certain clarifications, its previous orders. Both Order Nos. 888 and 889 have been appealed to the U.S. Court of Appeals.

Neither the Authority nor LIPA is directly subject to the new rules. However, the Authority and LIPA are subject to the reciprocity provision in Order No. 888, described above. Moreover, the Authority has voluntarily filed an OATT that substantially conforms to the provisions of Order No. 888, as modified on rehearing, which FERC had made a condition to FERC's approval of the transfer to the Authority of LILCO's transmission assets. On September 22, 1998, FERC approved LIPA's OATT finding that it is consistent with the compatibility requirements of Order No. 888 as modified on rehearing for an acceptable reciprocity transmission tariff on the condition that LIPA adopt a code of conduct and maintain an OASIS. LIPA's OASIS is in place. LIPA has filed its code of conduct with FERC.

Under Part II of the FPA, "public utilities" are subject to regulation by FERC. A "public utility" includes any person or entity that owns, controls, or operates facilities used for the transmission of electric energy in interstate commerce or for the sale of electric energy at wholesale in interstate commerce.

However, under Part II of the FPA a "public utility" does not include a state or any political subdivision of a state, or any agency, authority, or instrumentality of any one or more of the foregoing. As a corporate municipal instrumentality and political subdivision of the State of New York, the Authority, and, indirectly, LIPA, are largely exempt from FERC regulation as "public utilities" under Part II of the FPA. Notwithstanding this exemption, the Authority and LIPA are subject to the authority of FERC to order interconnection of its facilities pursuant to Section 210 of the FPA, and the authority of FERC to order "transmitting utilities" to provide transmission services in accordance with sections 211 and 212 of the FPA as amended by the Energy Policy Act.

Proposed Federal Deregulation Legislation

Many bills have been introduced into the United States House of Representatives and the United States Senate to deregulate the electric utility industry on the federal or state level, including bills supported by the Clinton Administration as discussed below. In general, many of the bills provide for open competition in the furnishing of electricity to all retail customers (i.e., retail wheeling). No prediction can be made as to whether these bills, or any future proposed federal bills to deregulate the electric industry, will become law, or, if they become law, what their final form or effect would be.

In March 1998, the Clinton Administration announced a Comprehensive Electricity Competition Plan. The components of the plan fall into five categories which include: (i) encouraging states to implement retail competition by permitting retail customers to purchase power from the supplier of their choice by January 1, 2003, although it would permit states or non-regulated utilities to opt out of competition under certain circumstances; (ii) protecting consumers by facilitating competitive markets; (iii) assuring access to and reliability of transmission systems by amending the Federal Power Act to provide FERC with the authority to require transmitting utilities to turn over the operational control of transmission facilities to an independent system operator; (iv) promoting and preserving public benefits by, among other things, requiring a minimum level of renewable generation facilities and requiring a trading system for nitrogen oxide pollutant reductions; and (v) amending federal statutes to provide FERC with authority to order transmission in certain circumstances, reinforcing FERC authority over certain matters and amending the laws with respect to tax-exempt bonds. The Clinton Administration Plan to amend the laws with respect to tax-exempt bonds would provide that the private use limitations are inapplicable to outstanding bonds for publicly-owned generation, transmission or distribution facilities if used in connection with retail competition or open access transmission. Tax-exempt financing would not be available for new generation or transmission facilities but would continue to be available for distribution facilities subject to current law private use limitations.

Bills were introduced into the Senate and the House in 1998 which reflected the Clinton Administration's proposal which bills expired upon the adjournment of the 1998 Congressional session. On February 1, 1999, the Clinton Administration released its revenue proposals, including proposals that are substantially the same as those announced in 1998, as described above, which would impose restrictions on the availability of tax-exempt financing for electric generation facilities. LIPA can not predict whether the Clinton Administration will introduce actual legislation to deregulate the electric utility industry in the current session of Congress and, if so, whether such legislation will be similar to that which was introduced in 1998. Moreover, LIPA cannot predict what effect such legislation, if adopted, would have on the Authority or LIPA.

New York State Electric Utility Industry Restructuring Matters

Public Service Commission Competitive Opportunities Proceeding. On March 19, 1993, the PSC commenced a proceeding to investigate issues related to a future regulatory regime for New York's electric industry in light of increasing competitive opportunities. The second phase of this proceeding, which commenced in August 1994, concerned issues related to potential restructuring of the industry from a regulated monopoly service to a more competitive framework.

The PSC issued an Opinion and Order on May 20, 1996 ("Order 96-12") in the competitive opportunities proceeding which required each of the New York investor-owned electric utilities (except Niagara Mohawk and LILCO) to submit a restructuring plan to the PSC. In Order 96-12, the PSC set goals for the introduction of competition in New York State's generation and energy services sectors. The PSC's preferred industry structure would ultimately allow all customers retail access after a period of transition. The PSC anticipates both lower electricity prices and economic development to result from competition.

One of the key issues that must be addressed before competition is established in New York concerns stranded costs. Stranded (or strandable) costs are defined by the PSC as those costs incurred by utilities that may become unrecoverable during the transition from regulation to a competitive market for electricity. The investor-owned utilities contend that all prudent costs incurred to provide electric service should be recovered. The PSC stated in Order 96-12 that the utilities and independent power producers must mitigate potential stranded costs.

While not under the regulatory control of the PSC, LIPA has a significant interest in the outcome of Con Edison, New York State Electric and Gas Corporation ("NYSEG") and other PSC restructuring proceedings. Any decision by the PSC relating to the future competitive structure of New York's electric industry could affect the manner in which LIPA operates.

Nuclear Plant Issues. In August 1997, the staff of the PSC issued a report in the context of the PSC's Competitive Opportunities Proceeding proposing, among other things, that, beyond a transition period, which is generally the period covered by the individual restructuring agreements before the PSC, nuclear generation should operate on a competitive basis. The report also proposed that the sale of nuclear plants to third parties be the preferred means of determining the fair market value of marketable generation plants, as it offers the greatest potential for mitigation of stranded costs and for the elimination of anti-competitive subsidies.

On March 20, 1998, the PSC initiated a proceeding to examine a number of issues raised by the staff report and the comments received in response thereto. In summary, the PSC: (i) adopted as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, with parties challenging that premise having to bear a substantial burden of persuasion; (ii) characterized the proposals in the staff report as by and large consistent in concept with the PSC's goal of a competitive, market-based electricity industry; (iii) questioned the staff's position that would leave funding and other decommissioning responsibilities with the sellers of nuclear power interests; and (iv) indicated interest in the potential for New York Nuclear Operating Company ("NYNOC") to benefit customers through efficiency gains and directed pursuit of that matter in this nuclear generation proceeding or separately upon the filing of a formal NYNOC proposal. The initiating order announced the intention to complete the proceeding by the second quarter of 1999.

During 1997, NYPA, Con Edison, Niagara Mohawk and Rochester Gas and Electric Corporation, the four utilities operating nuclear generating facilities in New York State, executed a joint announcement which expressed their desire to move forward with plans to form NYNOC, and stated that the four utilities will initiate the steps to assure that NYNOC will have the necessary leadership, personnel and structure to operate the six nuclear units now operated independently by such utilities. The joint announcement also stated that during the transition phase, while necessary governmental approvals are sought, the utilities would continue with and add to the cooperative initiatives the companies have already begun. NYNOC, a limited liability company, would operate the six nuclear plants currently operated by the four entities to achieve economies of scale and increase cost effectiveness. The plants would continue to be owned, and the output of the plants marketed, by the respective owners of the plants. It is contemplated that NYNOC would become the operator under the plants' NRC operating licenses, while other aspects of the NRC licenses would remain with the owners of the plants. It is uncertain what effect Niagara Mohawk's participation in such an arrangement will have on LIPA; nor can LIPA predict the effect on such an arrangement of the auction proposal in the staff report.

On or about June 15, 1998, NYSEG, one of the owners of NMP2 commenced an action against Niagara Mohawk in Supreme Court of the State of New York, Tompkins County, demanding, among other things, judgment to: (i) enjoin Niagara Mohawk from transferring operating responsibility of NMP2 to NYNOC; and (ii) declare that Niagara Mohawk may not transfer its operational responsibility for NMP2 to NYNOC without NYSEG's consent. LIPA can make no prediction as to the outcome of this litigation.

The NRC issued a policy statement on the Restructuring and Economic Deregulation of the Electric Utility Industry ("Policy Statement") in 1997. The Policy Statement addresses NRC's concerns about the adequacy of decommissioning funds and about the potential impact on operational safety, and reserves to the NRC, the right, in highly unusual situations where adequate protection of public health and safety would be compromised, to consider imposing joint and several liability on minority co-owners when one or more co-owners have defaulted on their contractual obligations. On December 28, 1998, the NRC announced commencement of a rulemaking proceeding initiated by a group of utilities which are nonoperating joint owners of nuclear plants. These utilities request that the enforcement provisions of the NRC regulations be amended to clarify NRC policy regarding the potential liability of joint owners if other joint owners become financially incapable of bearing their share of the burden for safe operation or decommissioning of a nuclear power plant. On March 22, 1999, the Authority filed comments in support of the rule proposed by the group of utilities. In addition to the above Policy Statement, the NRC is proposing to amend its regulations on decommissioning funding to reflect conditions expected from deregulation of the electric power industry. LIPA is unable to predict how such increased stringency may affect the results of operations or financial condition of NMP2.

Independent System Operator Proposal. Pursuant to FERC Order No. 888 as modified on rehearing, applicable to, among others, the investor-owned electric utilities (the "IOUs") in New York, which, along with NYPA, comprise the New York Power Pool ("NYPP"), the IOUs undertook, with NYPA, to develop an arrangement for providing non-discriminatory open-access transmission over all of the electric transmission lines in New York. As a result of this effort, the IOUs and NYPA filed a proposal (as most recently revised, the "Proposal") with FERC to provide open access to their transmission lines. In addition, the Proposal would establish the Reliability Council (as defined herein) and the New York Power Exchange ("NYPE"). The NYPP will be replaced by the independent system operator ("ISO"), Reliability Council and NYPE. Under the Proposal, the IOUs and NYPA would form a not-for-profit corporation, the ISO, which would have responsibility for the operation of most of the transmission lines of the participants. The ISO would be responsible for scheduling the use of the lines by its members and others that wished to use the lines for transmission of electricity, and would be responsible for collecting fees from transmission customers. Each member and NYPA would retain ownership, and would be responsible for maintenance, of their respective transmission lines. The customers of the ISO, including the IOUs and NYPA, would pay fees to the ISO. Any ISO member may withdraw from the arrangement contemplated by the Proposal, on 90-days' notice to the board of directors of the ISO but, in the case of an IOU, such withdrawal requires FERC approval unless the IOU has an "open access" transmission facilities tariff on file with FERC.

A significant feature of the ISO's tariff will be its use of a schedule of flexible transmission rates to take account of the cost of energy at its destination along the transmission network in meeting competing demands for the transmission facilities subject to the ISO's jurisdiction.

Under the Proposal, the IOUs and NYPA would be the first members of the ISO, and LIPA may join. The Proposal also allows any "Market Participant" (which would include any person engaged in the wholesale sale, transmission or purchase of electric energy) to join the ISO by becoming a signatory to the ISO Agreement. Finally, non-Market Participants (e.g. environmental and consumer organizations) have the opportunity to participate in the governance of the ISO. The ISO would be governed by a Board of Directors consisting of the executive director of the ISO and nine individuals selected by a selection committee composed of representatives of members, other interested parties and the PSC. No member of the board of directors will be able to own shares in or have a continuing business relationship with any Market Participant. The chief executive officer of the ISO will be chosen by the Board of Directors and will be responsible for the day-to-day operation of the ISO.

Pursuant to FERC's June 1998 Order conditionally approving the ISO, the governance provisions of the ISO are being revised. On October 23, 1998, the members of the NYPP, including NYPA and the Authority, submitted a settlement agreement to FERC to modify certain governance provisions in response to FERC's June 1998 Order. Signatories to the settlement agreement include seventeen entities other than the members of NYPP (the transmission owners), including the PSC and representatives of consumer, environmental and other organizations. Among other things, the proposed agreement modifies the structure of the management, operations and business issues committees to facilitate a more diverse representation, reduces the percentage that the votes of the transmission owners as a group and any individual transmission owner may constitute of the required vote for adoption of proposals, requires annual updating of membership on these committees and requires the ISO board to publicly announce the process for selecting members of these committees. This proposal must be approved by FERC before it can be implemented.

The Reliability Council proposed to be established concurrently with the ISO will be a separate not-for-profit corporation or limited liability company which will establish safety and reliability standards for all entities, including the ISO, engaging in electric power transactions on the ISO's transmission system. An executive committee consisting of thirteen members will govern the Reliability Council. FERC's June 1998 Order approved the proposed structure and governance of the Reliability Council.

Certain members of the ISO have reserved the right to seek a determination of the United States Internal Revenue Service (the "IRS") that participation in the arrangement contemplated by the Proposal will not adversely affect the federal tax-exempt status of any obligations issued by such a member nor adversely affect its ability to issue future federal tax-exempt obligations. FERC has conditionally authorized the establishment of the ISO but has not approved the rates or terms and conditions of service. In December 1998, the Authority approved LIPA's participation in the ISO provided that certain modifications are made to the Proposal and approved by FERC which would protect the tax-exempt status of the Authority's debt in light of LIPA's participation in the ISO. By order dated January 27, 1999, FERC conditionally accepted, with modifications, the proposed ISO tariff and the proposed market rules of the ISO and granted the request for market-based rates. The January 27, 1999 order called for public hearings on certain aspects of the proposed rates and provided for settlement judge proceedings.

Environmental

Electric utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures which regulate the environmental impact of electric utilities are subject to change. These changes may arise from continuing legislative, regulatory and judicial action regarding such standards and procedures. No assurance can be given that new standards and procedures will not be imposed or that existing standards and procedures will not be changed. An inability to comply with environmental standards could result in additional capital expenditures to comply, reduced operating levels or the complete shutdown of individual electric generating units, including NMP2 and those under contract to LIPA under the PSA, not in compliance. See "Legal Proceedings - Environmental."

Nuclear Plant Matters

The Energy Policy Act provides, among other things, that utilities with nuclear reactors will contribute an aggregate total of $150 million annually, based upon an assessment, for a period of 15 years, up to a total of $2.25 billion (in 1992 dollars), for the costs for the decommissioning and decontamination of the DOE nuclear fuel enrichment facilities.

In accordance with the Nuclear Waste Policy Act of 1982, Niagara Mohawk, as the operator of Nine Mile Point, in August 1995, entered into a contract with DOE, under which DOE, commencing not later than January 31, 1998, would accept and dispose of spent nuclear fuel. However, it appears unlikely that DOE will accept any spent nuclear fuel from Niagara Mohawk or others before 2010. The contract provides that Niagara Mohawk will pay quarterly to DOE a fee based on nuclear generation and sales of electricity from Nine Mile Point at a specified rate.

The NRC has adopted decommissioning rules which require reactor operators to certify that sufficient funds will be available for decommissioning the contaminated portion of nuclear plants in the form of prepayments or external sinking funds, either of which must be segregated from the licensee's assets and outside its administrative control, or by the surety of insurance payable to a trust established for decommissioning costs. LILCO established such an external decommissioning trust fund in 1990 to meet these regulatory requirements. LIPA expects that by the expiration of NMP2's operating license in 2026, there will be funds in LIPA's decommissioning trust fund sufficient to meet the current estimated costs for its 18% share of the decommissioning costs of Nine Mile Point 2. If the estimated NMP2 decommissioning costs should increase, based on future site specific studies or NRC regulatory changes, LIPA expects to increase its contributions into the decommissioning trust fund to meet the revised requirements.

The Federal Low-Level Radioactive Waste Policy Act, as amended in 1985, requires states to join compacts or to individually develop their own low-level radioactive waste disposal site. In response to the Federal law, New York State had decided to develop its own site because of the large volume of such waste generated in New York, and had committed to develop a plan for the management of the low-level radioactive waste in New York State during the interim period until the disposal facility was available. LIPA cannot predict when such a facility may be available.

Niagara Mohawk presently ships the low-level radioactive waste generated at Nine Mile Point to a disposal facility in Barnwell, South Carolina. During the period July 1, 1994, to June 30, 1995, the legislature of South Carolina denied access to the facility to out-of-region low-level radioactive waste generators, including those in New York State. LIPA cannot predict whether the Barnwell facility will be closed again to out-of-region low-level radioactive waste generators at some future date before the New York State disposal facility becomes available.

NMP2 has a spent fuel pool ("SFP") to store the spent fuel assemblies discharged from normal plant operations. The SFP has a total designed capacity to house 4,049 spent fuel assemblies. There are 1,400 spent fuel assemblies currently residing in the NMP2 SFP.

SFP capacity will be reached in the year 2012. Therefore, starting in the time frame of 2008-2010, the operator of NMP2 is expected to focus on one of the following options available at that time for the management of its spent fuel: use of a permanent repository, use of a central interim storage facility mandated by Congress or the creation and use of additional storage capacity at Nine Mile Point.

Niagara Mohawk procures public liability and property insurance for NMP2, and LIPA reimburses Niagara Mohawk for its 18% share of those costs. The Price-Anderson Amendments Act mandates that nuclear power plants secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $200 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 110 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $88.1 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of $15.9 million, per incident, through assessments of $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor. These assessments are subject to periodic inflation indexing and to a 5% surcharge if funds prove insufficient to pay claims.

Niagara Mohawk has also procured $500 million primary nuclear property insurance with the Nuclear Insurance Pools and approximately $2.3 billion of additional protection (including decontamination costs) in excess of the primary layer through Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $1.6 million per loss. This level of insurance is in excess of the NRC required $1.06 billion of coverage.

LIPA has obtained insurance coverage from NEIL for the extra expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, should losses exceed the accumulated reserves of NEIL, each member, including LIPA would be liable for its share of deficiency. LIPA's maximum liability per incident under the replacement power coverage, in the event of a deficiency, is approximately $700,000.

The NRC has notified all utilities operating nuclear power plants that they are required to inform the NRC of steps they are taking to see that computer systems will function properly by the year 2000. In connection therewith, each such utility was required to submit a written indication of, among things, whether or not they are pursuing and continuing to pursue a plan to solve their Year 2000 issue, such as, or similar to, that outlined in the publication Nuclear Utility Year 2000 Readiness published by the Nuclear Energy Institute and the Nuclear Utilities Software Management Group (the "NEI/NUSM Plan"). In addition, not later than July 1, 1999, each such utility must submit a written response confirming that its plant is Year 2000 ready, or if not ready, the utility must provide a status report of work remaining to be done. Niagara Mohawk submitted its required response indicating that it has pursued and is continuing a Year 2000 readiness program similar to that recommended in the NEI/NUSM Plan.

Item 2. *Properties*

The location and general character of the principal properties of LIPA are described in Item 1, "Business" under the headings "The Transmission and Distribution System" and "Nine Mile Point Nuclear Power Station, Unit 2."

Item 3. *Legal Proceedings*

LIPA has been named as a nominal defendant in a derivative suit pending in the United States District Court for the Eastern District of New York entitled Sylvester v. Catacosinos, et al. A motion to dismiss on behalf of LIPA was filed on September 23, 1998 and argued on January 28, 1999. In addition, LIPA has been named as a defendant in an action brought by the County of Suffolk that is pending in New York State Supreme Court, Suffolk County, entitled County of Suffolk v. KeySpan et al. The response date has been postponed until such time as it is determined whether the action will be consolidated with a consolidated class action pending in New York State Supreme Court, Nassau County, entitled In re KeySpan Corporation Shareholder Litigation. Former officers and directors of LILCO also have been named as defendants in each of these actions.

The complaints in the foregoing actions allege in substance that certain former officers of LILCO received excessive compensation which totaled approximately $67 million in connection with the closing of Brooklyn Union's merger with LILCO and with the Authority's acquisition of the common stock of LILCO. The Sylvester lawsuit seeks damages of an unspecified amount. The complaint brought by the County of Suffolk seeks that the defendants make restitution, or pay damages, of $67 million.

Because the cases are in an early state, at which no discovery has yet taken place, LIPA cannot express an opinion as to the likelihood of any liability. LIPA has notified KeySpan of its entitlement to indemnification pursuant to an indemnification agreement dated June 26, 1997, for any losses LIPA suffers as a result of these lawsuits. LIPA expects that KeySpan will honor the request for indemnification. LIPA also understands that the Attorney General of the State of New York is investigating the actions and statements of certain former officers of LILCO in connection with such compensation.

On September 28, 1998, Suffolk County and the Towns of Huntington and Babylon (collectively, the "Plaintiffs") brought a class action on behalf of themselves and all electric utility ratepayers in Suffolk County (the "Ratepayers") against the Authority, LIPA, KeySpan and others in the United States District Court for the Eastern District of New York entitled County of Suffolk et al. v. Long Island Power Authority, et al. (the "Huntington Lawsuit"). The Huntington Lawsuit alleges, among other things, that: (i) LIPA and the Authority failed to refund alleged capital gains directly to Ratepayers as a result of the Merger, unlawfully depriving Ratepayers of their property under federal and state constitutional provisions; and (ii) LIPA failed to refund to Ratepayers certain deferred tax reserves carried on LILCO's books at the time of the Merger, unjustly enriching KeySpan.

Based on these allegations, Plaintiffs are seeking judgments, among other things: (i) awarding damages against KeySpan and LIPA for impairment of contract, breach of contract and conversion; and (ii) declaring that KeySpan holds the proceeds of the Merger attributable to the capital gains and the deferred tax reserve in trust for the benefit of the Ratepayers and ordering KeySpan to make a full accounting of such proceeds. LIPA believes that, although the recovery sought by Plaintiffs could be material in amount, any such recovery would not have a material financial impact on LIPA or its Customers.

In an action commenced on May 26, 1998 (Schulz et al. v. New York State Public Authorities Control Board et al., United States District Court, Northern District of New York), plaintiff's complaint, in several claims for relief, sought a judgment declaring, inter alia, the resolution of the PACB authorizing the Authority to issue bonds to be null and void on State and federal constitutional grounds and sought a temporary restraining order or preliminary injunction prohibiting and enjoining the issuance of bonds. On May 27, 1998, the District Court denied the plaintiff's request for a temporary restraining order or preliminary injunction and dismissed the plaintiff's action on the ground that the plaintiffs lack standing to assert the claims pleaded in the complaint. On February 8, 1999, the United States Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the plaintiff's action.

On May 27, 1998, the Initiative for Competitive Energy (the "ICE") filed an action in the Supreme Court of the State of New York, County of Suffolk, against the Authority seeking, *inter alia,* an injunction enjoining the Authority from selling bonds "whose purpose is to finance the proposed Shoreham Property Tax Settlement, the Shoreham Rebates, Credits and Suffolk Surcharge." The action further requested a judgment declaring invalid and directing the rescission of the sale of such bonds. By decision dated October 7, 1998, the Supreme Court dismissed the complaint and ruled in favor of the Authority on all issues. On October 28, 1998, the ICE filed a notice of appeal.

In May 1995, eight participants of LILCO's Retirement Income Plan ("RIP") filed a lawsuit against LILCO, the RIP and Robert X. Kelleher, the Plan Administrator, in the United States District Court for the Eastern District of New York. In January 1996, the Court ordered that this action be maintained as a class action. This proceeding arose in connection with the plaintiffs' withdrawal, approximately 25 years ago, of contributions made to the RIP, thereby resulting in a reduction of their pension benefits. On January 7, 1999, a settlement agreement was filed with the Court providing for the payment of $7.75 million to the plaintiffs. The Authority would be responsible for approximately $5.4 million. The settlement is subject to judicial review. Amended settlement papers were filed on February 22, 1999 and a hearing date is scheduled for July 27, 1999.

In December 1997, Suffolk County brought a suit against the Authority and others in the Supreme Court of the State of New York County of Nassau seeking a judgment, among other things: (i) annulling and vacating the acceptance by the Authority of certain conditions contained in the July 1997 PACB resolution approving the Authority's acquisition of LILCO and related transactions; (ii) declaring that all or any actions taken by the Authority to implement or carry out the PACB conditions are null and void; and (iii) directing that the Authority take no further action to acquire the stock or assets of LILCO unless and until such acquisition has been approved by the PACB in the manner approved by law. A decision was rendered in March 1998 which held for the Authority on all substantive issues. Suffolk County filed a notice of appeal to the Appellate Division of the State of New York.

LIPA is involved in various legal proceedings which are routine litigation matters incidental to the conduct of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material adverse effect on the financial position, results of operations or cash flows of LIPA. See "Business—Shoreham Tax Matters."

Environmental

In connection with the Merger, KeySpan and LIPA entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and LIPA on the basis of whether they relate to assets transferred to KeySpan or retained by LIPA as part of the Merger. In addition, to clarify and supplement these agreements, KeySpan and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan after the Merger (the "Transferred Business").

KeySpan is responsible for all liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those currently or formerly operated by KeySpan or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, KeySpan is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business may be recoverable by KeySpan as part of the capacity charge under the PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities that exist as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan.

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection ("DEP") and the DEC separately have issued Administrative Consent Orders ("ACOs") in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound. The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA is working cooperatively with the Suffolk County Department of Health, the DEC and Novartis to conduct studies and monitoring activities in connection with the presence of this herbicide.

Superfund Sites

Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA", also commonly referred to as the "Superfund Legislation"), parties who generated or arranged for disposal of hazardous substances are liable for costs incurred by the EPA in responding to a release or threat of release of the hazardous substances.

Metal Bank. In December 1997, the EPA issued its Record of Decision ("ROD"), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is $17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 PRPs, including LIPA, for the remedial design and for remedial action at the site. LIPA can not predict with reasonable certainty the actual cost of the selected remedy, who will implement the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability of $1.6 million representing its estimated share of the additional cost to remediate this site.

PCB Treatment Inc. LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing PCBs. According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and have developed a work plan for investigating environmental conditions at the site. The EPA provided LILCO with documents indicating that LILCO was responsible for less than 1% of the materials that were shipped to this site. LIPA is currently unable to determine its share of the cost to remediate these sites.

Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA

Asharoken. In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (*Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company*). The Village is seeking monetary damages and injunctive relief based upon theories of negligence, gross negligence and nuisance in connection with the LILCO design and construction of the Northport Power Plant which the Village alleges upset the littoral drift, thereby causing beach erosion. In November 1996, the court decided LILCO's motion to dismiss the lawsuit, dismissing two of the three causes of action. The court limited monetary damages on the surviving continuous nuisance claim to three years prior to the commencement of the action. The liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility

Other Superfund Sites. In connection with a lawsuit filed against LILCO and nine other PRPs by the Town of Oyster Bay for indemnification for remediation and investigation costs for a federal Superfund site in Syosset, New York, a settlement agreement has been reached and is subject to court approval. If approved, the settlement would not have a material adverse effect on LIPA's financial position, cash flows or results of operations. In addition, LILCO was notified by the Attorney General of the State of New York that it may be responsible for the disposal of wastes and/or for the generation of hazardous substances that may have been disposed of at the Blydenburgh Superfund site. LILCO conducted a search of its corporate records and did not locate any documents concerning waste disposal practices associated with this landfill. Based on current information, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The DEC investigation is in its preliminary stages, and LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site.

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

On October 12, 1998, LIPA commenced a tender offer for its 7.30% Debentures Due 2000, 6.25% Debentures Due 2001, 7.05% Debentures Due 2003, 7.00% Debentures Due 2004, 7.125% Debentures Due 2005 and 9.00% Debentures Due 2022 (collectively, the "Debentures").

In conjunction with the tender offers, LIPA also commenced a consent solicitation from the holders of the Debentures to effect an amendment to the indentures under which the Debentures were issued. The amendment deletes an inoperative provision in the indentures. The tender of a Debenture constituted a consent. As of October 26, 1998, the requisite consents for the amendment to the indentures were received. For each series of Debentures the following table lists as of November 9, 1998; 5:00 p.m., New York City time, the expiration date of the tender offer, the principal amount validly tendered pursuant to the tender offer and the principal amount remaining outstanding on such date:

	Amount Tendered	Amount Outstanding
7.30% due 2000	$ 35,733,000	$ 267,000
6.25% due 2001	$136,566,000	$ 8,434,000
7.05% due 2003	$144,310,000	$ 5,690,000
7.00% due 2004	$ 56,105,000	$ 2,895,000
7.125% due 2005	$186,389,000	$13,611,000
9.00% due 2022	$427,438,000	$23,562,000

PART II.

Item 5. *Market for Registrant's Common Equity and Related Stockholder Matters*

None.

Item 6. *Selected Financial Data*

(In thousands of dollars except per share amounts)

	LIPA	LILCO					
	May 29, 1998 to December 31, 1998	April 1, 1998 to May 28, 1998	For the Year Ended March 31, 1998	For the Year Ended March 31, 1997	For the Year Ended December 31, 1996	For the Year Ended December 31, 1995	For the Year Ended December 31, 1994
Revenues							
Electric	$1,377,605	$330,011	$2,478,435	$2,464,957	$2,466,435	$2,484,014	$2,481,637
Operating Expenses							
Operations - fuel and purchased power	408,192	91,762	658,338	646,448	640,610	570,697	568,738
Operations and maintenance	398,193	68,993	403,944	376,064	386,322	399,215	418,011
Depreciation and amortization	121,969	22,986	131,186	129,183	128,534	121,980	111,996
Base financial component amortization	—	16,014	100,971	100,971	100,971	100,971	100,971
Rate moderation component amortization	—	(39,574)	(35,079)	(2,999)	(24,232)	21,933	197,656
Regulatory liability component amortization	—	(14,048)	(79,359)	(79,359)	(79,359)	(79,359)	(79,359)
1989 Settlement credits amortization	—	—	(9,213)	(9,213)	(9,214)	(9,214)	(9,214)
Other regulatory amortization	—	14,694	36,039	96,100	109,532	155,532	(4,883)
Operating taxes	157,561	60,885	388,592	390,584	390,861	375,164	336,263
Customer rebates	168,806	—	—	—	—	—	—
Federal income tax - current	—	(79,081)	76,890	52,737	42,197	14,596	10,784
Federal income tax - deferred and other	—	1,219	133,495	126,730	138,307	168,377	156,646
Total Operating Expenses	1,254,721	143,850	1,805,804	1,827,246	1,824,529	1,839,892	1,807,609
Operating Income	122,884	186,161	672,631	637,711	641,906	644,122	674,028
Other Income and (Deductions)							
Rate moderation component carrying charges	—	—	23,632	25,279	25,259	25,274	32,321
Other income and deductions, net	25,041	(28,581)	(7,455)	10,107	14,237	30,750	31,620
Class Settlement	—	—	(15,623)	(19,895)	(20,772)	(21,669)	(22,730)
Allowance for other funds used during construction	—	374	1,881	1,563	1,400	1,354	686
Federal income tax - current	—	(67,259)	594	—	—	—	—
Federal income tax - deferred and other	—	(22,094)	1,104	(89)	1,456	2,688	3,353
Total Other Income and (Deductions)	25,041	(117,560)	4,133	16,965	21,580	38,397	45,250
Income from Continuing Operations Before Interest Charges	147,925	68,601	676,764	654,676	663,486	682,519	719,278
Interest Charges							
Interest on long-term debt, net	76,392	56,258	351,261	372,108	384,198	412,512	437,751
Interest on advances from and note payable to the Authority	142,882	—	—	—	—	—	—
Other interest	9,933	9,800	57,805	66,818	67,130	63,461	62,345
Allowance for borrowed funds used during construction	(1,301)	(540)	(4,593)	(3,707)	(3,699)	(3,938)	(4,284)
Total Interest Charges	227,906	65,518	404,473	435,219	447,629	472,035	495,812
Income\(loss) from Continuing Operations	(79,981)	3,083	272,291	219,457	215,857	210,484	223,466
Income from Discontinued Operations	—	(4,480)	89,949	102,952	100,607	92,802	78,386
Net Income (Loss)	(79,981)	(1,397)	362,240	322,409	316,464	303,286	301,852
Preferred stock dividend requirements	—	8,037	51,813	52,113	52,216	52,620	53,020
Earnings (Loss) for Common Stock	$ (79,981)	$ (9,434)	$ 310,427	$ 270,296	$ 264,248	$ 250,666	$ 248,832
Average Common Shares Outstanding (000)	N/A	121,864	121,415	120,620	120,360	119,195	115,880
Basic and Diluted Earnings from continuing operations per common share	N/A	$ (.04)	$ 1.82	$ 1.39	$ 1.36	$ 1.32	$ 1.47
Basic and Diluted Earnings per common share	N/A	$ (.08)	$ 2.56	$ 2.24	$ 2.20	$ 2.10	$ 2.15
Common stock dividends declared per share	N/A	$ .30	$ 1.78	$ 1.78	$ 1.78	$ 1.78	$ 1.78
Common stock dividends paid per share	N/A	$ .30	$ 1.78	$ 1.78	$ 1.78	$ 1.78	$ 1.78
Book value per common share at	N/A		$ 21.88	$ 21.07	$ 20.89	$ 20.50	$ 20.21
Common shares outstanding at (000)	—		121,681	120,987	120,781	119,655	118,417
Common shareowners of record at	—		78,314	77,691	86,607	93,088	96,491
Balance Sheet Data:							
Total Assets	$7,672,483		$11,900,725	$11,849,574	$12,209,679	$12,527,597	$12,479,289
Long-Term Debt	$ 778,075		$ 4,381,949	$ 4,457,047	$ 4,456,772	$ 4,706,600	$ 5,145,397
Preferred Stock - redemption required	N/A (1)		$ 562,600	$ 638,500	$ 638,500	$ 639,550	$ 644,350
Preferred Stock - no redemption required	N/A (1)		$ —	$ 63,598	$ 63,664	$ 63,934	$ 63,957
Common Shareowners' (Deficit) Equity	$ (79,981)		$ 2,662,447	$ 2,549,049	$ 2,523,369	$ 2,452,953	$ 2,393,628

(1) Items marked N/A are not meaningful due to the significant change in the capital structure as a result of the merger and because no public equity of LIPA is outstanding as of December 31, 1998.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO, pursuant to an Agreement and Plan of Merger dated as of June 26, 1997 by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy "KeySpan"), the Authority and LIPA Acquisition Corp., (the "Merger Agreement"). As a result of the Merger, there was a change in control of LILCO which effectively resulted in the creation of a new reporting entity, LIPA. See Note 2 of Notes to Financial Statements. Accordingly, the accompanying financial statements for the periods prior to and including May 28, 1998 are not comparable to the financial statements presented subsequent to May 28, 1998. Therefore, a black line has been drawn on the accompanying financial statements to distinguish between LIPA and LILCO balances and activity.

The amounts presented in the financial statements for LILCO reflect the presentation of the gas business (as transferred to a KeySpan subsidiary pursuant to the Merger Agreement) as a discontinued operation, in accordance with the provisions of Accounting Principles Board ("APB") Statement No. 30.

On April 11, 1997, LILCO changed its year-end from December 31 to March 31. Subsequent to the Merger, LIPA adopted a calendar year-end. Accordingly, unless otherwise indicated, references to December 1998 and December 1997 represent the nine month periods ended December 31, 1998 and December 31, 1997, respectively. References to March 31, 1998 and March 31, 1997 represent the twelve-month periods then ended, while references to all other periods refer to the respective calendar years ended December 31.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services to LIPA's transmission and distribution system through the MSA. LIPA contracts for capacity from the fossil fired generating plants of KeySpan through the PSA. Energy is purchased by KeySpan on LIPA's behalf through the EMA. See "Business - System Operation."

The following table combines the condensed results of operations of both LIPA and LILCO in order to facilitate comparison of the nine months ended December 31, 1998 and 1997.

	LIPA	LILCO	Total	LILCO
	May 29, 1998 to December 31, 1998	April 1, 1998 to May 28, 1998	April 1, 1998 to December 31, 1998	April 1, 1997 to December 31, 1997
	(in thousands)	(in thousands)	(in thousands)	(in thousands)
Electric Revenues	$1,377,605	$ 330,011	$1,707,616	$1,922,752
Operating Expenses	1,254,721	143,850	1,398,571	1,406,248
Other Income and (Deductions)	25,041	(117,560)	(92,519)	(5,161)
Interest Charges	227,906	65,518	293,424	304,446
Income (Loss) from Continuing Operations	$ (79,981)	$ 3,083	$ (76,838)	$ 206,897

The table highlights the effects of the Merger, which include lower electric revenues as a result of LIPA's rate reduction (approximately 20% for all customers effective May 29, 1998).

As LIPA is a wholly owned subsidiary of the Authority and not an investor owned utility, the PSC does not have jurisdiction with respect to the determination of rates and charges. See, however, Note 4 of Notes to the Financial Statements. Rates and charges for LIPA are determined by the Authority's Board of Trustees.

The excess of the acquisition cost over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35 year period, the weighted average useful life of the net plant assets acquired. The acquisition adjustment principally arose through the eliminaiton of LILCO's regulatory assets and liabilities, totaling $6.3 billion, and net deferred Federal income tax liability of approximately $2.4 billion. Therefore, the amortization of the regulatory assets and liabilities has effectively been replaced by the amortization of the acquisition adjustment. Because of the tax exempt status of LIPA, the results of operations for the period May 29, 1998 to December 31, 1998, do not include a provision for income taxes.

Results of Operations

Earnings

Earnings for the nine month period ended December 31, 1998 and the nine month period ended December 31, 1997 were as follows:

Net losses for the period beginning May 29, 1998 and ending December 31, 1998 were $80 million. The loss was principally due to customer rebates of $168.8 million paid by LIPA. Earnings per share for the period May 29, 1998 to December 31, 1998 is not meaningful due to the significant change in the capital structure as a result of the Merger and because no public equity of LIPA is outstanding as of December 31, 1998.

Net losses for the period beginning April 1, 1998 and ending May 28, 1998 were $9.4 million or $0.08 per common share. Earnings for common stock for the nine months ended December 31, 1997, were $207.4 million or $1.71 per common share. The results for the two month period ended May 28, 1998 were negatively impacted by Merger-related expenses such as legal, accounting, financial and tax consultants, certain severance payments made to LILCO officers, and Federal income taxes resulting from the Merger. These items were partially offset by the positive impact on earnings caused by the change in method of amortizing the Rate Moderation Component ("RMC"), as discussed below.

Earnings for the years ended March 31, 1998 and March 31, 1997 were as follows:

(In millions of dollars and shares, except earnings per share)

	1998	1997
Net income	$ 362.2	$322.4
Preferred stock dividend requirements	51.8	52.1
Earnings for common stock	$ 310.4	$270.3
Average common shares outstanding	121.4	120.6
Basic and diluted earnings per common share	$ 2.56	$ 2.24

For the year ended March 31, 1998, LILCO had higher earnings in the electric business partially offset by lower earnings in the gas business, as compared to the prior year.

The increase in earnings for the year ended March 31, 1998, was primarily due to a change in the method of amortizing the RMC to eliminate the effects of seasonality on monthly operating income, as more fully discussed in the section titled "Rate Moderation Component." This positive contributor to earnings more than offset the effects of reduced interest income and the accruals for certain obligations for key employees, as more fully discussed in Note 3 of Notes to Financial Statements.

The decrease in earnings in the gas business for the year ended March 31, 1998 resulted primarily from the accruals noted above, partially offset by lower operations and maintenance expenses.

Earnings for the years ended December 31, 1996 and December 31, 1995 were as follows:

(In millions of dollars and shares, except earnings per share)

	1996	1995
Net income	$ 316.5	$ 303.3
Preferred stock dividend requirements	52.2	52.6
Earnings for common stock	$ 264.3	$ 250.7
Average common shares outstanding	120.4	119.2
Basic and diluted earnings per common share	$ 2.20	$ 2.10

LILCO's 1996 earnings were higher for both its electric and gas businesses, as compared to 1995, despite an allowed return on common equity in 1996 equal to the prior year. The higher earnings were the result of LILCO's increased investment in electric plant in 1996, as compared to 1995. Also contributing to the increase in electric business earnings was LILCO's ability to reduce operations and maintenance expenses and the efficient use of cash generated by operations to retire maturing debt.

The increase in earnings in the gas business was the result of additional revenues due to the continued growth in the number of gas space heating customers. Also contributing to the increase in gas business earnings was a 3.2% rate increase which became effective December 1, 1995, and an increase in off-system gas sales.

Revenues

Electric Revenues and Sales

The table below provides a summary of both LILCO and LIPA's electric revenues, sales and customers.

	Nine month period ended December 31,		Years Ended March 31,		Years Ended December 31,	
	1998	1997	1998	1997	1996	1995
Revenues (000's)						
Residential	$ 800,170	$ 920,391	$1,206,640	$1,199,976	$1,205,133	$1,204,987
Commercial and industrial	809,834	941,610	1,194,725	1,178,471	1,174,499	1,194,014
Other system revenues	28,537	36,069	47,832	50,499	50,513	52,472
Total system revenues	1,638,541	1,898,070	2,449,197	2,428,946	2,430,145	2,451,473
Other revenues	69,075	24,682	29,238	36,011	36,290	32,541
Total Revenues	$1,707,616	$1,922,752	$2,478,435	$2,464,957	$2,466,435	$2,484,014
Sales - millions of kWh						
Residential	5,743	5,400	7,170	7,121	7,203	7,156
Commerical and industrial	6,737	6,410	8,375	8,209	8,242	8,336
Other system sales	294	306	415	437	441	460
Total system sales	12,774	12,116	15,960	15,767	15,886	15,952
Customers - at year end						
Residential	939,346	931,917	928,580	922,330	920,930	915,162
Commercial and industrial	106,990	105,700	105,795	104,703	104,488	103,669
Total	1,046,336	1,037,617	1,034,375	1,027,033	1,025,418	1,018,831

Nine Months Ended December 31, 1998 and 1997

Revenues decreased approximately $215 million during the nine month period ended December 31, 1998, compared to the similar period in 1997. The decrease in revenue is principally the result of the rate reduction (of approximately 20%), for all customers, effective May 29, 1998. The increase in sales volume, is attributable to the rate reduction (reflecting the price elasticity of demand), the effects of weather (as cooling degree days during the summer months of 1998 were greater than 1997 levels), combined with the addition of new customers.

Years Ended March 31, 1998 and 1997

The slight increase in revenues for the year ended March 31, 1998, when compared to the year ended March 31, 1997, was primarily due to higher system sales volumes resulting in part from the addition of approximately 8,000 new electric customers and higher fuel expense recoveries, partially offset by lower sales to other utilities.

Years Ended December 31, 1996 and 1995

Revenue decreased approximately $18 million during the 12-month period ended December 31, 1996, when compared to the similar period in 1995. This decrease is primarily the result of weather, as the summer cooling season of 1996 included fewer cooling degree days than that of 1995. It should be noted, however, that LILCO experienced a growth in electric system sales in 1996 on a weather-normalized basis compared to 1995. This growth was primarily attributable to the addition of new electric customers.

Operating Expenses

Fuel and Purchased Power

Fuel and purchased power expenses for the nine months ended December 31, 1998 and 1997, the years ended March 31, 1998 and 1997, and for the years ended December 31, 1996 and 1995 were as follows:

	Nine month period ended December 31,		Years Ended March 31,		Years Ended December 31,	
	1998	1997	1998	1997	1996	1995
			(In millions of dollars)			
Fuel for Electric Operations						
Oil	$104	$ 80	$123	$128	$158	$ 98
Gas	119	166	197	170	138	149
Nuclear	7	11	15	15	15	14
Purchased power	248	235	323	333	329	310
	478	492	658	646	640	571
FPPCA	22	—	—	—	—	—
Total	$500	$492	$658	$646	$640	$571

Fuel and purchased power mix for the nine months ended December 31, 1998 and 1997, the years ended March 31, 1998 and 1997, and years ended December 31, 1996 and 1995 were as follows:

MWh = Megawatt hours

	Nine Months Ended December 31,				Years Ended March 31,				Years Ended December 31,			
	1998		1997		1998		1997		1996		1995	
	MWH	%	MWH	%	MWH	%	MWH	%	MWH	%	MWH	%
Oil	3,983	28%	2,229	17%	3,434	20%	3,278	19%	4,219	24%	3,099	17%
Gas	4,358	31%	5,367	40%	6,212	35%	5,469	31%	4,542	25%	6,344	36%
Nuclear	912	6%	1,151	8%	1,545	9%	1,553	9%	1,558	9%	1,301	7%
Purchased power	4,800	35%	4,651	35%	6,412	36%	7,261	41%	7,388	42%	7,143	40%
Total	14,053	100%	13,398	100%	17,603	100%	17,561	100%	17,707	100%	17,887	100%

Variations in fuel and purchased power expenses have a minimal impact on operating results as LIPA's current rate structure includes a mechanism (the FPPCA mechanism) which provides LIPA with the ability to collect from its customers, and requires LIPA to return to its customers, actual fuel costs which fall outside of the fuel cost tolerance band, which is defined as 1% higher and 1% lower than the base cost of fuel collected through rates. These percentages increase to two percent in 2000 and continue to increase in one percent increments thereafter.

Nine Months Ended December 31, 1998 and 1997

Fuel expense for the nine month period ended December 31, 1998 increased approximately $8 million, when compared to the similar period of 1997, principally as a result of the recognition of an expense associated with the FPPCA mechanism, which totaled approximately $22 million, thereby matching fuel expense with fuel revenue. A corresponding liability was recorded to recognize these overcollections. Fuel expense incurred to generate and or purchase electric energy decreased approximately $14 million (exclusive of the FPPCA mechanism adjustment), despite a 5% increase in energy requirements. This decrease is primarily attributable to decreasing oil prices and slightly lower gas prices partially offset by the fees paid to KeySpan by LIPA under the EMA. Under this agreement, KeySpan is required to deliver the most economical energy available, whether that energy comes from generation owned by KeySpan or purchased from others.

Years Ended March 31, 1998 and 1997

Fuel costs increased as a result of higher system sales volumes. During 1998, the price per kilowatt hours ("kWh") of power purchased increased over 1997. As a result, LILCO changed the mix of generation and purchased power in 1998, when compared to 1997, by generating more electricity using gas and oil rather than purchasing the equivalent energy off-system.

Years Ended December 31, 1996 and 1995

Despite a slight decrease in energy requirements, fuel expense increased as a result of a sharp increase in the cost of natural gas and an increase in the per unit cost of purchased power. LILCO increased generation with oil to minimize the impact of increasing gas prices on generation costs.

Operations and Maintenance Expenses

Nine Months Ended December 31, 1998 and 1997

Operations and Maintenance ("O&M") expenses, excluding fuel and purchased power, were $467 million and $304 million for the nine month periods ended December 31, 1998 and 1997, respectively. The increase is primarily due to the manner in which LILCO classified certain expenses such as depreciation and amortization, property taxes and other operating taxes. These costs are incurred by LIPA as part of the costs of contracts with KeySpan for the management of LIPA's assets and are classified as O&M expense by LIPA. These expenses were separately reported by LILCO. In addition, there were charges incurred by LIPA related to the overhead expenses of the Authority, and charges incurred by LILCO for certain employee benefit expenses, including non-officer incentives and previously deferred vacation accruals, which were recognized during the period April 1, 1998 through May 28, 1998.

Years Ended March 31, 1998 and 1997

O&M expenses, excluding fuel and purchased power, were $404 million and $376 million, for the years ended March 31, 1998 and 1997, respectively. This increase in O&M was primarily due to the recognition of higher performance-based employee incentives and certain other charges for employee benefits related to the Merger.

Years Ended December 31, 1996 and 1995

O&M expenses, excluding fuel and purchased power, were $386 million and $399 million, for the years ended December 31, 1996 and 1995, respectively. This decrease in O&M was primarily due to LILCO's cost containment program which resulted in lower plant maintenance, distribution and administrative and general expenses.

Rate Moderation Component ("RMC")

The RMC represented the difference between LILCO's revenue requirements under conventional ratemaking and the revenues provided under LILCO's electric rate structure. In addition, the RMC was adjusted for the operation of LILCO's Fuel Moderation Component ("FMC") mechanism and the difference between LILCO's share of actual operating costs at Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2") and amounts provided for in electric rates.

In April 1998, the PSC authorized a revision to LILCO's method for recording its monthly RMC amortization. Prior to this revision, the amortization of the annual level of RMC was recorded monthly on a straight-line, levelized basis over LILCO's rate year which ran from December 1 to November 30. However, revenue requirements fluctuated from month to month based upon consumption, which is greatly impacted by the effects of weather. Under the revised method, effective December 1, 1997, the monthly amortization of the annual RMC level varied based upon each month's forecasted revenue requirements, which more closely aligned such amortization with LILCO's cost of service. As a result of this change, for the fiscal year ended March 31, 1998, LILCO recorded approximately $65.1 million more of non-cash RMC credits to income (representing accretion of the RMC balance), or $42.5 million net of tax, representing $.35 per share more than it would have under the previous method.

Nine Months Ended December 31, 1998 and 1997

As mentioned above, adjustments were made on May 29, 1998 to eliminate all regulatory assets and liabilities from the balance sheet; accordingly, the results of operations for the nine months ended December 31, 1998 include only amortization for the period April 1, 1998 through May 28, 1998.

Years Ended March 31, 1998 and 1997

For the years ended March 31, 1998 and March 31, 1997, LILCO recorded non-cash credits to income of approximately $52 million and $30 million, respectively, representing the amount by which its revenue requirements exceeded revenues provided for under the electric rate structure then in effect. Partially offsetting these accretions was the effect of the FMC mechanism and the difference between actual NMP2 costs and the amounts provided for in electric rates. The adjustments to the accretion of the RMC totaled $17 million and $27 million, respectively, of which $12 million and $23 million, respectively, were derived from the operation of the FMC mechanism.

Years Ended December 31, 1996 and 1995

For the year ended December 31, 1996, LILCO recorded a non-cash credit to income of approximately $50 million, representing the amount by which revenue requirements exceeded revenues provided for under the electric rate structure then in effect. Partially offsetting this accretion were the effects of the FMC mechanism and the difference between actual NMP2 costs and the amounts provided for in electric rates. The adjustments to the accretion of the RMC totaled $26 million, of which $24 million was derived from the operation of the FMC mechanism.

For the year ended December 31, 1995, LILCO recorded a non-cash charge to income of approximately $22 million, after giving effect to the credits generated principally by the operation of the FMC mechanism.

For a further discussion of the RMC, see Note 3 of Notes to Financial Statements.

Other Regulatory Amortization

The significant components of LILCO's other regulatory amortization were as follows:

	(Income) Expense					
	Nine Months Ended December 31,		Years Ended March 31,		Years Ended December 31,	
	1998	1997	1998	1997	1996	1995
			(In millions of dollars)			
Net Margin	$—	$13	$ 2	$(5)	$ 3	$ 64
LRPP Amortization	—	—	—	42	59	53
Excess Earnings	(2)	(5)	(3)	21	10	3
Shoreham Post Settlement Costs	5	23	31	30	29	27
Other	12	5	6	8	9	9
	$15	$36	$36	$96	$110	$156

Net Margin — An electric business unit revenue reconciliation mechanism, established under the LRPP (as discussed below), which eliminated the impact on earnings of sales that were above or below those amounts provided in electric rates by providing a fixed annual net margin level (defined as sales revenue, net of fuel and gross receipts taxes). Variations in electric revenue resulting from the differences between the actual net margin sales levels and those provided for in rates were deferred on a monthly basis during the rate year through a charge or credit to other regulatory amortization. These deferrals were then refunded to or recovered from customers as explained below under "LRPP Amortization."

LRPP Amortization — Under LILCO Ratemaking and Performance Plan ("LRPP"), deferred balances resulting from the net margin, electric property tax expense reconciliation, earned performance incentives, and associated carrying charges were accumulated during each rate year. The first $15 million of the total deferral was recovered from or credited to electric customers by increasing or decreasing the RMC balance. Amounts deferred in excess of $15 million, upon approval by the PSC, were refunded to or recovered from customers through the Fuel Cost Adjustment ("FCA") mechanism over a subsequent 12-month period, with the offset being recorded in other regulatory amortization.

For the rate years ended November 30, 1997 and 1996, the total amount deferred under the LRPP was $4.0 and $15.0 million, respectively. Such amounts were credited against the RMC balance.

Nine Months Ended December 31, 1998 and 1997

As mentioned above, adjustments were made on May 29, 1998 to eliminate all regulatory assets and liabilities from the balance sheet; accordingly, the results of operations for the nine months ended December 31, 1998 include only amortization for the period April 1, 1998 through May 28, 1998.

Years Ended March 31, 1998 and 1997

For the year ended March 31, 1998, there was no LRPP amortization, as LILCO had not received approval from the PSC to begin refunding $26 million of the remaining deferred LRPP balance in excess of $15 million for the rate year ended November 30, 1995. For the year ended March 31, 1997, LILCO recognized $42.4 million of non-cash charges to income representing the amortization of the deferred LRPP balance related to the rate year ended November 30, 1994.

Years Ended December 31, 1996 and 1995

For the year ended December 31, 1996, LILCO recognized $58.7 million of non-cash charges to income representing the amortization of the deferred LRPP balance related to the rate year ended November 30, 1994.

For the year ended December 31, 1995, LILCO recognized $52.9 million of non-cash charges to income representing the amortization of the deferred LRPP balance related to the rate year ended November 30, 1993.

For a further discussion of the LRPP, see Note 3 of Notes to Financial Statements.

Excess Earnings — Also recorded in other regulatory amortization, if applicable, were non-cash charges representing: (a) 100% of electric earnings generated by LILCO in excess of amounts provided for in electric rates, which was returned to electric customers through a reduction to the RMC balance; and (b) 50% of the gas earnings generated by LILCO in excess of amounts provided for in gas rates, which was returned to firm gas customers. Effective February 5, 1998, LILCO, in accordance with PSC guidelines, established a gas balancing account in order to defer excess gas earnings for future disposition. For the rate year ended November 30, 1997, the electric business earned $4.8 million in excess of its allowed return on common equity and the firm gas customers' portion of the gas business earnings was $6.3 million.

Shoreham Post Settlement Costs - Represented the amortization of Shoreham decommissioning costs, fuel disposal costs, PILOT's, carrying charges and other costs over a forty-year period on a straight line remaining life basis.

Nine Months Ended December 31, 1998 and 1997

As previously indicated, adjustments were made on May 29, 1998 to eliminate all regulatory assets and liabilities on the balance sheet; accordingly, the results of operations for the nine months ended December 31, 1998 only include amortization for the period April 1, 1998 through May 28, 1998.

Years Ended March 31, 1998 and 1997

Other regulatory amortization was a non-cash charge to income of $36 million and $96 million for the years ended March 31, 1998 and 1997, respectively. For the year ended March 31, 1997, LILCO recognized approximately $42 million of charges representing the amortization of the deferred LRPP balance associated with the rate year ended November 30, 1994. For the year ended March 31, 1998, there was no LRPP amortization, as LILCO had not received approval from the PSC to begin refunding $26 million of the remaining deferred LRPP balance in excess of $15 million for the rate year ended November 30, 1995. Also contributing to the decrease in other regulatory amortization was the timing of the recognition of electric excess earnings for the rate years ended November 30, 1997 and 1996.

Years Ended December 31, 1996 and 1995

Other regulatory amortization was a non-cash charge to income of $110 million and $156 million for the years ended December 31, 1996 and 1995, respectively. This decrease is primarily attributable to the operation of the net margin discussed above. For the year ended December 31, 1995, the amount deferred related to the net margin amounted to $64 million compared to $3 million for the year ended December 31, 1996.

Depreciation and Amortization

Nine Months Ended December 31, 1998 and 1997

Depreciation and amortization expense increased approximately $47 million for the nine month period ended December 31, 1998, when compared to the similar period of the prior year, primarily due to the amortization of the acquisition adjustment totaling approximately $10 million per month beginning June 1998. This increase was partially offset by the absence of depreciation expense on LILCO's non-nuclear generating assets which is included in O&M, as a component of the PSA billings.

Operating Taxes

Nine Months Ended December 31, 1998 and 1997

Operating taxes were $218 million and $296 million for the nine month periods ended December 31, 1998 and 1997, respectively. The decrease is principally the result of the absence of property and payroll taxes related to the operation of the non-nuclear generating facilities of LILCO and reduced revenue taxes (due to lower revenues), partially offset by PILOTS on the Shoreham Nuclear Power Station (LILCO was able to capitalize these PILOTS under its electric rate structure).

Years Ended December 31, 1996 and 1995

Operating taxes were $390 million and $375 million for the years ended December 31, 1996 and 1995, respectively. The increase in 1996, as compared to 1995, is primarily related to higher property taxes.

Customer Rebates

Nine Months Ended December 31, 1998 and 1997

During the period May 29, 1998 to December 31, 1998, LIPA paid customer rebates of $169 million relating to Shoreham property tax over assessments (for a further discussion see Note 13 of the Notes to Financial Statements). Such rebates were contemplated as a part of the Merger and were recognized as an expense in the period.

Federal Income Tax

Nine Months Ended December 31, 1998 and 1997

LIPA was not subject to Federal income tax for seven of the nine months in this reporting period (May 29 to December 31, 1998), which contributed significantly to the $241 million decrease in operating Federal income tax expense when compared to the similar period in 1997. In addition, adjustments related to the Merger, recorded during the two month period April 1 to May 28, 1998, also contributed to this decrease.

The increase in non-operating Federal income tax expense of approximately $85 million for the nine months ended December 31, 1998, when compared to the similar period in 1997, was principally the result of events which took place during the period April 1, 1998 to May 28, 1998, including, an increase in non-operating pretax income and various adjustments related to the Merger. These increases were partially offset by the impact of LIPA's exemption from Federal income taxes.

Years Ended March 31, 1998 and 1997

Federal income tax was $210 million and $179 million for the years ended March 31, 1998 and 1997, respectively. The increase in federal income tax was primarily attributable to higher pre-tax earnings partially offset by the utilization of investment tax credits.

Other Income and Deductions, Net

Years Ended March 31, 1998 and 1997

Other income and deductions was a $7 million charge to income for the year ended March 31, 1998, compared to a $10 million credit to income for the same period in 1997. The difference of approximately $17 million, relates primarily to a charge of approximately $31 million for certain benefits earned by LILCO officers recorded in 1998. For a further discussion of this matter, see Note 10 of Notes to Financial Statements.

Years Ended December 31, 1996 and 1995

Other income and deductions totaled a credit to income of $14 million for the year ended December 31, 1996, compared to $31 million for the same period in 1995. The decrease in 1996, when compared to 1995, is primarily attributable to the recognition of non-recurring expenditures associated with one of LILCO's wholly-owned subsidiaries, a decrease in non-cash carrying charge income associated with regulatory assets not currently in rate base and the recognition in 1995 of certain litigation proceeds related to the construction of the Shoreham Nuclear Power Station.

Interest Expense

Nine Months Ended December 31, 1998 and 1997

Interest expense for the nine month period ended December 31, 1998 is approximately $11 million less than that of the similar 1997 period. This decrease is principally attributable to the lower borrowing rates of LIPA relative to the borrowing rates of LILCO. This decrease in interest expense was partially offset by the higher levels of debt that LIPA has outstanding during this period, when compared to LILCO during the similar 1997 period. This increase in the level of debt is due to the refinancing by LIPA of LILCO's equity.

Years Ended March 31, 1998 and 1997

Interest expense for the year ended March 31, 1998 totaled $404 million compared to $435 million for the year ended March 31, 1997. This decrease is primarily attributable to lower outstanding debt levels, as LILCO retired $250 million of the General and Refunding Bonds in February 1997.

Years Ended December 31, 1996 and 1995

Interest expense for the year ended December 31, 1996 totaled $448 million, compared to $472 million for the year ended December 31, 1995. This decrease is primarily attributable to lower outstanding debt levels, partially offset by higher letter of credit and commitment fees associated with the change in LILCO's credit rating in 1996.

Liquidity and Capital Resources

Liquidity

During the period May 29, 1998 to December 31, 1998, LIPA received approximately $6.7 billion from the Authority to finance the Merger, as more fully discussed in Note 7 of Notes to the Financial Statements, in exchange for a Promissory Note. All cash from customers payments and other sources is collected by the Authority. The Authority makes all disbursements on LIPA's behalf. Accordingly, all operating cash amounts are held at the Authority. Cash collections and disbursements by the Authority on LIPA's behalf increase or decrease amounts due the Authority by LIPA. LIPA has repaid approximately $448 million of its debt to the Authority because cash collected by the Authority from customers and other sources during this period exceeded cash paid on LIPA's behalf by the Authority.

Pursuant to the Authority's Electric System General Revenue Bond Resolution dated May 13, 1998, all amounts to be paid by the Authority to LIPA in respect of the debt obligations of LIPA are subordinated in right of payment to the payment of amounts due on the debt obligations of the Authority. As a result, all debt assumed from LILCO is structurally subordinated in right of payment to the Authority's debt obligations.

At December 31, 1998, the Authority's and LIPA's cash and cash equivalents amounted to approximately $517 million. In addition, LIPA has designated funds aggregating $195 million on hand, $62 million of which are available to fund capital expenditures.

During 1998, pursuant to a tender offer and a notice of redemption for certain debentures, LIPA refinanced approximately $1.5 billion of the debentures assumed from LILCO. In addition, during 1998, LIPA defeased $323 million of the New York State Energy Research and Development Authority ("NYSERDA") Notes assumed from LILCO. For further discussion of the Bond refundings and defeasance see Note 7 of the Notes to the Financial Statements. Subsequent to December 31, 1998, LIPA retired approximately $133 million of debt. In March 1999, LIPA converted certain of its variable rate NYSERDA Bonds to a fixed rate, as more fully described in Note 15 of Notes to the Financial Statements. LIPA believes that cash from operations for 1999 will be sufficient to meet its operating, capital and debt service requirements. However, LIPA will access the capital markets in 1999 in order to finance capital expenditures and to refinance higher cost debt, if conditions prove favorable.

LIPA estimates that for 1999, capital spending will total approximately $124 million. With respect to debt maturities subsequent to 1998, the Authority will use cash generated from operations to satisfy such maturities.

The Authority also expects to use cash from operations to make optional redemptions of debt in 1999. Such actions are consistent with the Authority's plan to retire in 16 years, the approximately $4 billion it borrowed to purchase the Shoreham regulatory assets from LILCO.

During 1998, the Authority issued rebate checks to all of its customers in the amount of $232 for each Nassau County and Rockaway customer and $101 for each Suffolk County customer. The total amount of the rebate program was approximately $169 million. In addition, on May 29, 1998, LIPA began issuing credits to the bills of customers arising from the proposed settlement of the Shoreham Property Tax Litigation. Credits will be issued over the five years after May 29, 1998, in the total amount of $106.3 million for Suffolk County customers and $208 million for Nassau County and Rockaway customers. The Authority has issued $145.7 million of bonds and has proposed to issue additional bonds over the next four years to finance the cost of the proposed settlement. Beginning in May 2004, a surcharge will be levied upon the Suffolk County customers in order to repay the bonds. See Note 13 of Notes to Financial Statements—Shoreham Tax Matters.

Capital Requirements

Capital expenditures are expected to be made by LIPA in the ordinary course of business for purposes of the normal upgrading and expansion of the T&D System. LIPA considers the T&D System to be adequate and in good condition. The actual amount and timing of future financing will depend upon actual capital expenditures, the timeliness and adequacy of rate increases, the availability and cost of capital and the ability to meet interest and fixed charge coverage requirements. The Authority has been advised by KeySpan that the amount of capital expenditures budgeted to be made in 1999 is adequate to maintain system reliability and insures customer and employee safety.

Investment Rating

Securities of the Authority and LIPA, which are not supported by letters of credit, are rated by Fitch IBCA, Inc. ("Fitch"), Moody's Investors Services, Inc. ("Moody's") and Standard & Poor's Rating Services, a division of the McGraw-Hill Companies, Inc. ("S&P").

The rating for each of the Authority's and LIPA's principal securities is as follows:

	S&P	Moody's	Fitch
LIPA Debt			
Debentures	A-	Baa1	BBB+
NYSERDA's	A-	Baa3	BBB+
Authority Debt			
General Revenue Bonds, Series 1998A (Insured)	AAA	Aaa	AAA
General Revenue Bonds, Series 1998A	A-	Baa1	A-
General Revenue Bonds, Series 1998B (Insured)	AAA	Aaa	AAA
General Revenue Bonds, Series 1998B	A-	Baa1	A-
Subordinated Revenue Bonds, Series 1-2*	AAA	Aaa	AAA
Subordinated Revenue Bonds, Series 3-4*	AAA	Aaa	AAA
Subordinated Revenue Bonds, Series 5-6*	AA+	Aaa	AA+
Subordinated Revenue Bonds, Series 7 (Insured)	AAA	Aaa	AAA
Subordinated Revenue Bonds, Series 8 (Insured)	AAA	Aaa	AAA

*Supported by letters of credit - ratings reflect those of the banks issuing those letters of credit.

The Board of Trustees of the Authority has adopted a resolution directing management of the Authority and LIPA to implement procedures to improve the ratings on the debt of the Authority and LIPA. To date, no such procedures have been implemented and there can be no assurance that such procedures, if and when implemented will improve the ratings.

Impact of Year 2000

General.

A portion of the computer hardware and software and embedded technology (such as microcontrollers and microprocessors contained in equipment and machinery) used by the Authority and LIPA, as well as KeySpan and the subsidiaries of KeySpan that are parties to the MSA, EMA and PSA and others with whom the foregoing have business arrangements, was not designed to recognize calendar years after 1999 (the "Year 2000 Issue").

The Authority recently purchased new computer software to support certain activities of LIPA and believes that these systems are Year 2000 ready. Management also believes that, based on available information, it will be able to manage its Year 2000 transition for systems and infrastructure, without any material adverse effect on its business operations or financial prospects. However, there can be no assurance that failure to resolve any issue relating to such transition would not have a material adverse effect on LIPA. LIPA has had continuing discussions with KeySpan, their largest vendor, who is responsible for the management and operation of LIPA's transmission and distribution system, and KeySpan indicates that they have evaluated the extent to which modifications to computer software, hardware and databases will be necessary to accommodate the year 2000.

KeySpan's computer applications are generally based on two digits and do require additional programming to recognize the new millennium. A corporate-wide program has been established by KeySpan and its subsidiaries. The program includes both information technology ("IT") and non-IT systems. The critical non-IT systems are generally in the areas of electric production, distribution, transmission, gas distribution and communications. The readiness of suppliers and vendor systems is also under review. The project is under the direction of KeySpan's Year 2000 Program Office, chaired by the Vice President, Technology Operations and Corporate Y2K Officer. Each of KeySpan's critical business processes is being reviewed to: identify and inventory sub-components; assess for Year 2000 compliance; establish repair plans as necessary; and test in a Year 2000 environment. The inventory phase for the IT systems and non-IT systems is 100% complete. The assessment phase is 100% complete for the IT systems, and over 90% complete for non-IT systems. The assessment phase is expected to be complete by July 1, 1999.

KeySpan's hardware, software and embedded systems are being tested and certified to be Year 2000 compliant. Repair and testing to sustain operability is now 73% complete for the IT systems and approximately 75% for the non-IT systems. Components needed to support the critical business process and associated business contingency plans are expected to be ready for the year 2000 by July 1, 1999.

KeySpan's vendors and business partners needed to support the critical business processes of KeySpan are also being reviewed for their year 2000 compliance. At this time, none of these vendors have indicated to Key Span that they will be materially affected by the year 2000 problem.

KeySpan has analyzed each of the critical business processes to identify possible Year 2000 risks. Each of KeySpan's critical businesses will be certified by the responsible KeySpan officer as being Year 2000 ready. However, the most reasonable likely worst case scenarios are also being identified. Business operating procedures at KeySpan will be reviewed to ensure that risks are minimized when entering the Year 2000 and other high risk dates. KeySpan is developing contingency plans to address possible failure points in each critical business process.

While KeySpan must plan for the following worst case scenarios, management believes that these events are improbable.

Loss of generating flexibility:

KeySpan's generation subsidiary receives gas delivery from multiple national and international pipelines and, therefore the effects of a loss in any one pipeline can be mitigated through the use of other pipelines. Complete loss of all the supply lines is not considered a reasonable scenario. Nevertheless, the impact of the loss of any one pipeline is dependent on temperature and vaporization rate. The partial loss of gas supply will not affect KeySpan's ability to supply electricity since many of the plants have the ability to operate on oil.

Loss of electric grid inter-connections/KeySpan operated electric distribution facilities:

Electric utilities are physically connected on a regional basis to manage electric load. This is often referred to as the regional grid. Presently, KeySpan is working with other regional utilities to develop a coordinated operating plan. Should there be an instability in the grid, KeySpan has the ability to remove LIPA's operations from the grid, and operate independently.

Certain electric system components such as individual generating units, transmission and distribution system facilities, and the electric energy management system have the potential to malfunction due to Year 2000 problems. KeySpan has inventoried electric system components and developed a plan to certify mission critical processes as Year 2000 compliant. Contingency plans are being developed, where appropriate, for loss of critical system elements. KeySpan presently estimates that contingency plans regarding its electric facilities should be completed by July 1999.

Loss of telecommunications:

KeySpan has a substantial dependency on many telecommunication systems and services for both internal and external communications. External communications with the public and the ability of customers to contact KeySpan in cases of emergency response is essential. KeySpan intends to coordinate its emergency response efforts with the offices of emergency management of the various local governments within its service territory. Internally, there are a number of critical processes in both the gas and electric operating areas that rely on external communication providers. Contingency plans will address methods for manually monitoring these functions. These contingency plans, KeySpan presently estimates, should be finalized by July 1999.

In addition to the above, KeySpan is also planning for the following scenarios: short-term reduction in system power generating capability; limitation of fuel oil operation; reduction in quality of power output; loss of automated meter reading; loss of ability to read, bill and collect; and loss of the purchasing/materials management system.

KeySpan believes that, with modifications to existing software and conversions to new hardware and software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed on time, and contingency plans fail the Year 2000 issue could have a material adverse impact on the operations of LIPA.

LIPA's Contingency Plans

In order to insure that the Year 2000 will have a minimal impact on the operations of LIPA, LIPA is closely monitoring the initiatives and progress of KeySpan's Year 2000 Program Office. In addition, LIPA is working with various other governmental agencies to insure communication between LIPA and such other governmental entities is uninterrupted.

Rate Matters

For a discussion of Rate Matters, see Note 4 of Notes to Financial Statements.

Competitive Environment

Fostering competition in wholesale and retail electric power has become a significant policy goal in many states, including New York, as well as at the federal level. The fostering of competition has been accompanied by and requires separating power supply services and costs from electric transmission and distribution services and costs. In New York and many other states, there have been regulatory actions to promote competition in the supply of power by requiring, among other things, that utilities sell all or part of their non-nuclear generating plants. Federal regulation of transmission has been the focus of increasing action and attention as transmission is viewed as the vehicle for delivery of competitively priced generation to wholesale and retail customers. In general, transmission and distribution is viewed as an inherently monopoly function that must remain regulated.

The Merger accomplished the disaggregation of ownership of power supply (with the exception of the 18% interest in NMP2) from the provision of transmission and distribution services in the Service Area. Through the Merger, the ownership and operation of the transmission and distribution system on Long Island became LIPA's business and responsibility, and the on-island generating resources became owned by, and the responsibility of, KeySpan. The PSA provides for KeySpan to supply LIPA with all of the capacity and to the extent LIPA requests, energy from the electric generation facilities on Long Island previously owned by LILCO. LIPA continues to own an 18% interest in NMP2, which is not on Long Island and which is operated by Niagara Mohawk Power Corporation.

The Authority's effort at creating competition in power supply resources is to gradually create a competitive retail market for power supply. The Authority has adopted a customer retail choice plan intended to lead to full choice among power suppliers by all retail customers by 2003. Under the retail choice plan, the Authority will initially provide customers representing an aggregate load of 400 MW the option of selecting competitive suppliers of electric capacity and energy. During this initial phase of the retail choice plan, anticipated to begin by August 1, 1999, available program load will be apportioned among residential and other classes of customers. Approximately 90,000 residential customers will be eligible to participate.

Regardless of a customer's choice of electricity supplier, LIPA will remain the sole provider of transmission and distribution services to customers in the Service Area. LIPA plans to set rates for delivery service to include all costs that are not avoidable once customers choose alternative suppliers, with the intent that the Authority be kept revenue neutral. Costs that the Authority will not be able to avoid, and therefore will be included in the rates for delivery service, include its debt service obligations and any long-term power purchase contracts, among other items. The Authority's retail choice plan has been designed to assume that LIPA will continue to recover all costs needed for safe and reliable T&D System operation and to meet its financial obligations, regardless of customer participation in the Authority's retail choice program.

Customers could reduce LIPA's role of supplying and delivering electric capacity and energy through the installation of their own generating facilities. Self-generation is most attractive to customers who are high energy load factor users, such as hospitals, or manufacturers with multiple shift operations. There are few such customers of significant size on Long Island.

Recent Accounting Pronouncements

Derivative Instruments

In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. LIPA will adopt SFAS No. 133 in the first quarter of fiscal year 2000. LIPA does not expect any material earnings effect from adoption of this statement.

Plant Decommissioning

In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear plant decommissioning. Over the past two years, this exposure draft has been the source of continual debate. The FASB has committed to completing the project and is proceeding toward issuance of another exposure draft (expected in the second quarter of 1999). If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. LIPA can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition of LIPA.

Investments

GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," was implemented during the period ending December 31, 1998. The statement generally requires that investments should be reported in the balance sheet at fair value and that realized and unrealized gains and losses on investments flow through the statement of operations. The impact of this statement did not have a material impact on LIPA.

Item 7A. *Quantative and Qualitative Disclosures About Market Risk*

The table below provides information about the Authority's and LIPA's debt instruments that are sensitive to interest rates.

	Expected Maturity Date							
	1999	2000	2001	2002	2003	Thereafter	Total	Fair Value
				(In thousands of dollars)				
Long Term Debt:								
Fixed Rate	$398,000	$ 1,278	$ 9,460	$ 3,500	$ 9,390	$ 682,083	$1,103,711	$1,269,784
Average Interest Rate	7.30%	7.50%	6.60%	7.50%	7.20%	7.10%		
Variable Rate	$203,580	$127,960	$147,130	$167,385	$161,515	$5,606,779	$6,414,349	$6,625,862
Average Interest Rate	5.90%	4.10%	4.30%	4.60%	4.40%	5.00%		

Item 8. *Financial Statements and Supplementary Data*

Report of Independent Accountants

To the Board of Directors
Long Island Lighting Company d/b/a LIPA

In our opinion, the accompanying balance sheet and statement of capitalization and the related statements of operations, (accumulated deficit) retained earnings and of cash flows present fairly, in all material respects, the financial position of Long Island Lighting Company d/b/a LIPA ("LIPA") at December 31, 1998, and the results of its operations and its cash flows for the period May 29, 1998 to December 31, 1998 in conformity with generally accepted accounting principles. These financial statements are the responsibility of LIPA's management; our responsibility is to express an opinion on these financial statements based on our audit. The accompanying financial statements of the Long Island Lighting Company as of March 31, 1998 and December 31, 1996 and for the years ended March 31, 1998 and December 31, 1996 and for the three months ended March 31, 1997 were audited by other auditors whose report thereon dated May 22, 1998, expressed an unqualified opinion on those statements, before the restatement described in Note 2 to the financial statements. We conducted our audit of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

We also audited the adjustments described in Note 2 that were applied to restate the statement of operations for the years ended March 31, 1998 and December 31, 1996 and the three months ended March 31, 1997, for discontinued operations treatment. In our opinion, such adjustments are appropriate and have been properly applied.

The year 2000 supplementary information on page 74 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures required by professional standards because the disclosure criteria specified by TB 98-1, as amended, are not sufficiently specific and, therefore, preclude the prescribed procedures from providing meaningful results. In addition, we do not provide assurance that LIPA is or will become year 2000 compliant, that LIPA's year 2000 remediation efforts will be successful in whole or in part, or that parties with which LIPA does business are or will become year 2000 compliant.

PricewaterhouseCoopers LLP
Melville, New York

March 5, 1999

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

Long Island Power Authority:

We have audited the accompanying statements of income and cash flows of Long Island Lighting Company (a New York corporation) for the period April 1, 1998 to May 28, 1998. These financial statements are the responsibility of Long Island Lighting Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statements of income and cash flows are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the statements of income and cash flows. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statements of income and cash flows referred to above present fairly, in all material respects, the results of operations and cash flows of Long Island Lighting Company for the period April 1, 1998 to May 28, 1998 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

New York, New York
February 12, 1999

Report of Ernst & Young LLP, Independent Auditors

To the Shareowners and Board of Directors of Long Island Lighting Company:

We have audited the accompanying balance sheet of Long Island Lighting Company and the related statement of capitalization as of March 31, 1998 and December 31, 1996 and the related statements of income (prior to restatement to present the gas business as a discontinued operations), retained earnings and cash flows for the year ended March 31, 1998, the three months ended March 31, 1997 and the year ended December 31, 1996. Our audits also included the financial statement schedule listed in the index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. We did not audit the restatements described in Note 2 to present the operations of the gas business as a discontinued operation for the years ended March 31, 1998 and December 31, 1996 and the three months ended March 31, 1997.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Long Island Lighting Company at March 31, 1998 and December 31, 1996 and the results of its operations (prior to restatement) and its cash flows for the year ended March 31, 1998, the three months ended March 31, 1997 and the year ended December 31, 1996, in conformity with generally accepted accounting principles. Also, in our opinion the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

During the year ended March 31, 1998 the Company changed its method of accounting for revenues provided for under the Rate Moderation Component.

ERNST & YOUNG LLP

Melville, New York
May 22, 1998

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Balance Sheet
(Thousands of Dollars)

	LIPA	LILCO	
	December 31, 1998	March 31, 1998	December 31, 1996
Assets			
Utility Plant			
Electric	$2,047,992	$ 4,031,510	$ 3,882,297
Gas	—	1,233,281	1,154,543
Common	3,827	290,221	260,268
Construction work in progress	52,897	118,808	112,184
Nuclear fuel in process and in reactor	17,053	18,119	15,454
	2,121,769	5,691,939	5,424,746
Less- Accumulated depreciation and amortization	50,287	1,877,858	1,729,576
Total Net Utility Plant	2,071,482	3,814,081	3,695,170
Regulatory Assets			
Base financial component, net of accumulated amortization of $883,496 at March 31, 1998, $757,282 at December 31, 1996	—	3,155,334	3,281,548
Rate moderation component	—	434,004	402,213
Shoreham post-settlement costs	—	1,005,316	991,795
Shoreham nuclear fuel	—	66,455	69,113
Unamortized cost of issuing securities	—	159,941	194,151
Postretirement benefits other than pensions	—	340,109	360,842
Regulatory tax asset	—	1,737,932	1,772,778
Other	—	192,763	199,879
Total Regulatory Assets	—	7,091,854	7,272,319
Current Assets			
Cash and cash equivalents	—	180,919	279,993
Special deposits	—	95,790	38,266
Customer accounts receivable (less allowance for doubtful accounts of $20,211, $23,483 and $25,000, respectively)	119,161	297,889	255,801
Other accounts receivable	10,096	43,744	65,764
Accrued unbilled revenues	78,414	124,464	169,712
Promissory note receivable	398,000	—	—
Materials and supplies at average cost	—	54,883	55,789
Fuel oil at average cost	—	32,142	53,941
Gas in storage at average cost	—	14,634	73,562
Deferred tax asset - net operating loss	—	—	145,205
Prepayments and other current assets	28,583	13,807	8,569
Total Current Assets	634,254	858,272	1,146,602
Promissory Note Receivable	646,902	—	—
Designated Funds	194,972	—	—
Nonutility Property and Other Investments	19,410	50,816	18,597
Deferred Charges	78,507	85,702	76,991
Acquisition Adjustment (net of accumulated amortization of $68,766 at December 31, 1998)	4,026,956	—	—
Total Assets	$7,672,483	$11,900,725	$12,209,679

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

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Balance Sheet
(Thousands of Dollars)

	LIPA	LILCO	
	December 31, 1998	March 31, 1998	December 31, 1996
Capitalization and Liabilities			
Capitalization			
Long-term debt	$ 778,075	$4,395,555	$4,471,675
Unamortized discount on debt	—	(13,606)	(14,903)
Note Payable - the Authority	5,355,085	—	—
Due to the Authority	855,684	—	—
	6,988,844	4,381,949	4,456,772
Preferred Stock - redemption required	—	562,600	638,500
Preferred Stock - no redemption required	—	—	63,664
Total Preferred Stock	—	562,600	702,164
Common stock	—	608,635	603,921
Premium on capital stock	—	1,146,425	1,127,971
Capital stock expense	—	(47,501)	(49,330)
(Accumulated deficit) retained earnings	(79,981)	956,092	840,867
Treasury stock, at cost	—	(1,204)	(60)
Total Common Shareowners' (Deficit) Equity	(79,981)	2,662,447	2,523,369
Total Capitalization	6,908,863	7,606,996	7,682,305
Regulatory Liabilities			
Regulatory liability component	—	99,199	198,398
1989 Settlement credits	—	59,397	127,442
Regulatory tax liability	—	78,913	102,887
Other	—	151,922	139,510
Total Regulatory Liabilities	—	389,431	568,237
Current Liabilities			
Current maturities of long-term debt	398,000	101,000	251,000
Current redemption requirements of preferred stock	—	139,374	1,050
Due to the Authority	70,880	—	—
Due to KeySpan	75,085	—	—
Accounts payable and accrued expenses	35,921	228,583	289,141
LRPP payable	—	30,118	40,499
Accrued taxes	79,021	34,753	63,640
Accrued interest	29,851	146,607	160,615
Dividends payable	—	58,748	58,378
Class Settlement	—	60,000	55,833
Customer deposits	23,205	28,627	29,471
Total Current Liabilities	711,963	827,810	949,627
Deferred Credits			
Deferred federal income tax - net	—	2,539,364	2,442,606
Class Settlement	—	46,940	98,497
Other	34,059	22,529	39,447
Total Deferred Credits	34,059	2,608,833	2,580,550
Operating Reserves			
Pensions and other postretirement benefits	—	401,401	381,996
Claims and damages	17,598	66,254	46,964
Total Operating Reserves	17,598	467,655	428,960
Commitments and Contingencies	—		
Total Capitalization and Liabilities	$ 7,672,483	$11,900,725	$12,209,679

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

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Statement of Operations
(Thousands of Dollars—Except Per Share Information)

	LIPA	LILCO			
	May 29, 1998 to December 31, 1998	April 1, 1998 to May 28, 1998	Year Ended March 31, 1998	Three Months Ended March 31, 1997	Year Ended December 31, 1996
Electric Revenue	$1,377,605	$ 330,011	$2,478,435	$557,791	$2,466,435
Expenses					
Operations - fuel and purchased power	408,192	91,762	658,338	165,140	640,610
Operations and maintenance	398,193	68,993	403,944	90,875	386,322
Depreciation and amortization	121,969	22,986	131,186	31,993	128,534
Base financial component amortization	—	16,014	100,971	25,243	100,971
Rate moderation component amortization	—	(39,574)	(35,079)	5,907	(24,232)
Regulatory liability component amortization	—	(14,048)	(88,572)	(22,143)	(88,573)
Other regulatory amortization	—	14,694	36,039	10,159	109,532
Operating taxes	157,561	60,885	388,592	92,398	390,861
Customer rebates	168,806	—	—	—	—
Federal income tax - current	—	(79,081)	76,890	23,378	42,197
Federal income tax - deferred and other	—	1,219	133,495	6,548	138,307
Total Expenses	1,254,721	143,850	1,805,804	429,498	1,824,529
Operating Income	122,884	186,161	672,631	128,293	641,906
Other Income and (Deductions)					
Other income and deductions, net	25,041	(28,581)	554	1,263	18,724
Allowance for other funds used during construction	—	374	1,881	530	1,400
Federal income tax - current	—	(67,259)	594	—	—
Federal income tax - deferred and other	—	(22,094)	1,104	1,068	1,456
Total Other Income and (Deductions)	25,041	(117,560)	4,133	2,861	21,580
Income from Continuing Operations Before Interest Charges	147,925	68,601	676,764	131,154	663,486
Interest Charges and (Credits)					
Interest on long-term debt, net	76,392	56,258	351,261	90,168	384,198
Interest on advances from and note payable to the Authority	142,882	—	—	—	—
Other interest	9,933	9,800	57,805	16,659	67,130
Allowance for borrowed funds used during construction	(1,301)	(540)	(4,593)	(949)	(3,699)
Total Interest Charges	227,906	65,518	404,473	105,878	447,629
Income (loss) from continuing operations	(79,981)	3,083	272,291	25,276	215,857
Income (loss) from discontinued operations net of taxes of zero, ($1,946), $23,966, $27,355, and $30,209, respectively	—	(4,480)	89,949	62,421	100,607
Net Income (Loss)	(79,981)	(1,397)	362,240	87,697	316,464
Preferred stock dividend requirements	—	8,037	51,813	12,969	52,216
Earnings (Loss) for Common Stock	$ (79,981)	$ (9,434)	$ 310,427	$ 74,728	$ 264,248
Basic and diluted earnings (loss) per common share from continuing operations (a)	N/A	$ (.04)	$ 1.82	$ .10	$ 1.36
Basic and diluted earnings (loss) per common share from discontinued operations (a)	N/A	$ (.04)	$ .74	$ .52	$ .84
Average Common Shares Outstanding (000) (a)	N/A	121,864	121,415	120,995	120,360
Basic and Diluted Earnings per Common Share (a)	N/A	$ (.08)	$ 2.56	$ .62	$ 2.20
Dividends Declared per Common Share (a)	N/A	$ .30	$ 1.78	$ .45	$ 1.78

(a) Share and per share data are not meaningful on or after May 29, 1998 because of the significant change in the capital structure in connection with the Merger and because no public equity of LIPA is outstanding as of December 31, 1998.

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

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Statement of Cash Flows
(Thousands of Dollars)

	LIPA	LILCO			
	May 29, 1998 to December 31, 1998	April 1, 1998 to May 28, 1998	Year Ended March 31, 1998	Three Months Ended March 31, 1997	Year Ended December 31, 1996
Operating Activities					
Net Income (loss)	$ (79,981)	$ (1,397)	$ 362,240	$ 87,697	$ 316,464
Adjustments to reconcile net income to net cash provided by (used in) operating activities					
Depreciation and amortization	121,969	27,743	158,537	38,561	153,925
Base financial component amortization	—	16,014	100,971	25,243	100,971
Rate moderation component amortization	—	(39,574)	(35,079)	5,907	(24,232)
Regulatory liability component amortization	—	(14,048)	(79,359)	(19,840)	(79,359)
Other regulatory amortization	—	14,858	38,059	9,915	118,074
Rate moderation component carrying charges	—	(6,411)	(23,632)	(5,919)	(25,259)
Class Settlement	—	2,018	15,623	4,496	20,772
Amortization of cost of issuing and redeeming securities	1,705	4,964	30,823	8,087	34,611
Federal income tax - deferred and other	—	(60,820)	146,859	32,835	167,060
Pensions and Other Post Retirement Benefits	—	12,873	48,512	13,496	14,952
Other	1,973	41,050	87,618	2,381	51,671
Changes in operating assets and liabilities					
Accounts receivable, net and accrued unbilled revenue	34,568	101,230	8,334	(26,817)	92,334
Materials and supplies, fuel oil and gas in storage	—	(31,238)	14,391	67,242	(34,531)
Accounts payable and accrued expenses	35,921	21,068	1,668	(58,952)	28,258
Net change in due to KeySpan	(136,712)	—	—	—	—
Pensions and other post retirement benefits	—	(250,000)	—	—	—
Accrued taxes	56,358	15,924	—	—	—
Accrued interest	29,850	(38,393)	—	—	—
Class Settlement	—	(6,918)	(56,503)	(11,006)	(42,084)
Special deposits	—	66,492	(58,159)	635	25,146
Other	45,657	(54,725)	(86,819)	(14,394)	(26,460)
Net Cash Provided by (Used in) Operating Activities	111,308	(179,290)	674,084	159,567	892,313
Investing Activities					
Construction and nuclear fuel expenditures	(71,030)	(66,493)	(257,402)	(50,375)	(239,896)
Shoreham post settlement costs	—	(6,650)	(39,828)	(12,104)	(51,722)
Merger costs, net of cash transferred	(61,498)	—	—	—	—
Acquisition of common stock	(2,497,500)	—	—	—	—
Investment in interest rate hedge	—	—	(30,000)	—	—
Other	—	(2,009)	(1,987)	160	(4,806)
Net Cash Used in Investing Activities	(2,630,028)	(75,152)	(329,217)	(62,319)	(296,424)
Cash flows from Non-Capital related financing activities					
Proceeds of note payable-Authority	2,640,000	—	—	—	—
Net cash provided by non-capital and related financing activities	2,640,000	—	—	—	—
Cash flows from Capital and related financing activities					
Proceeds from notes receivable	3,000	—	—	—	—
Proceeds from sale of common stock	—	4,184	43,218	4,640	18,837
Issuance of notes payable	—	350,000	—	—	—
Net proceeds from Authority loan	926,564				
Proceeds of note payable - Authority	4,137,992	—	—	—	—
Repayment of note payable - Authority	(1,422,908)	—	—	—	—
Redemption of securities	—	—	(2,050)	(250,000)	(419,800)
Redemption of long-term debt	(3,338,659)	(100,000)	—	—	—
Issuance of preferred stock	—	75,000	—	—	—
Redemption of preferred stock	(221,600)	(116,390)	—	—	—
Bond issuance costs	(81,706)	—	—	—	—
Preferred stock dividends paid	—	(5,711)	(51,833)	(12,969)	(52,264)
Common stock dividends paid	—	(54,147)	(215,790)	(53,749)	(213,753)
Other	(3,991)	(2,749)	(2,032)	(624)	(369)
Net cash provided by (used in) capital and related Financing Activities	(1,308)	150,187	(228,487)	(312,702)	(667,349)
Net Increase (Decrease) in Cash and Cash Equivalents	119,972	(104,255)	116,380	(215,454)	(71,460)
Cash and cash equivalents at beginning of period	75,000	180,919	64,539	279,993	351,453
Cash and cash equivalents at end of period*	$ 194,972	$ 76,664	$ 180,919	$ 64,539	$ 279,993
Interest paid	$ 178,564	$ 59,733	$ 364,864	$112,981	$ 404,663
Federal income tax paid	$ —	$ 13,428	$ 108,980	$ —	$ 45,050

*Cash and cash equivalents include designated funds

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

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Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)

Statement of (Accumulated Deficit) Retained Earnings
(In thousands of dollars)

	LIPA	LILCO		
	December 31, 1998	March 31, 1998	March 31, 1997	December 31, 1996
Balance at beginning of period	$ —	$861,751	$840,867	$ 790,919
Net income (loss) for the period	(79,981)	362,240	87,697	316,464
	(79,981)	1,223,991	928,564	1,107,383
Deductions:				
Cash dividends declared on common stock	—	216,086	53,844	214,255
Cash dividends declared on preferred stock	—	51,812	12,969	52,240
Other	—	1	—	21
Balance at end of period	$ (79,981)	$956,092	$861,751	$ 840,867

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

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Statement of Capitalization
(In thousands of dollars)

	Shares LIPA December 31, 1998	Shares LILCO March 31, 1998	Shares LILCO December 31, 1996	LIPA December 31, 1998	LILCO March 31, 1998	LILCO December 31, 1996
Common Shareowners' Equity						
Common stock, $5.00 par value	—	121,727,040	120,784,277	$ —	$ 608,635	$ 603,921
Common stock, $1.00 par value	1	—	—			
Premium on capital stock	—	—	—	—	1,146,425	1,127,971
Capital stock expense	—	—	—	—	(47,501)	(49,330)
(Accumulated deficit) Retained earnings .	—	—	—	(79,981)	956,092	840,867
Treasury stock, at cost	—	(46,281)	(3,485)	—	(1,204)	(60)
Total Common Shareowners' (Deficit) Equity				(79,981)	$2,662,447	$2,523,369
Preferred Stock - Redemption Required						
Par value $100 per share						
7.40% Series L	—	150,500	161,000	—	$15,050	$16,100
7.66% Series CC	—	570,000	570,000	—	57,000	57,000
Series called for redemption	—	(150,500)	—	—	(15,050)	(1,050)
				—	57,000	72,050
Par value $25 per share						
7.95% Series AA	—	14,520,000	14,520,000	—	363,000	363,000
$1.67 Series GG	—	880,000	880,000	—	22,000	22,00[illegible]
$1.95 Series NN	—	1,554,000	1,554,000	—	38,850	38,8[illegible]
7.05% Series QQ	—	3,464,000	3,464,000	—	86,600	86,6[illegible]
6.875% Series UU	—	2,240,000	2,240,000	—	56,000	56,000
Series called for redemption	—	(1,554,000)	—	—	(38,850)	—
Mandatory redemption of preferred stock .	—	(880,000)	—	—	(22,000)	—
				—	505,600	566,450
Total Preferred Stock - Redemption Required				—	$ 562,600	$ 638,500
Preferred Stock - No Redemption Required						
Par value $100 per share						
5.00% Series B	—	100,000	100,000	—	10,000	10,000
4.25% Series D	—	70,000	70,000	—	7,000	7,000
4.35% Series E	—	200,000	200,000	—	20,000	20,000
4.35% Series F	—	50,000	50,000	—	5,000	5,000
5 1/8% Series H	—	200,000	200,000	—	20,000	20,000
5 3/4% Series I -Convertible	—	14,743	16,637	—	1,474	1,664
Series called for redemption	—	(634,743)	—	—	(63,474)	—
Total Preferred Stock - No Redemption Required				—	—	63,664
Total Preferred Stock				—	$ 562,600	$ 702,164

Long Island Lighting Company d/b/a LIPA
(a wholly owned subsidiary of the Long Island Power Authority)
Statement of Capitalization (continued)
(In thousands of dollars)

	Maturity	Interest Rate	Series	LIPA December 31, 1998	LILCO March 31, 1998	LILCO December 31, 1996
General and Refunding Bonds						
	February 15, 1997	8.75%		$ —	$ —	$ 250,000
	April 15, 1998	7.63%		—	100,000	100,000
	May 15, 1999	7.85%		—	56,000	56,000
	April 15, 2004	8.63%		—	185,000	185,000
	May 15, 2006	8.50%		—	75,000	75,000
	July 15, 2008	7.90%		—	80,000	80,000
	May 1, 2021	9.75%		—	415,000	415,000
	July 1, 2024	9.63%		—	375,000	375,000
Total General and Refunding Bonds				—	1,286,000	1,536,000
Debentures						
	July 15, 1999	7.30%		397,000	397,000	397,000
	January 15, 2000	7.30%		278	36,000	36,000
	July 15, 2001	6.25%		8,460	145,000	145,000
	March 15, 2003	7.05%		5,890	150,000	150,000
	March 1, 2004	7.00%		2,999	59,000	59,000
	June 1, 2005	7.13%		14,307	200,000	200,000
	March 1, 2007	7.50%		—	142,000	142,000
	July 15, 2019	8.90%		—	420,000	420,000
	November 1, 2022	9.00%		26,877	451,000	451,000
	March 15, 2023	8.20%		270,000	270,000	270,000
Total Debentures				725,811	2,270,000	2,270,000
Authority Financing Notes						
Industrial Development Revenue Bonds						
	December 1, 2006	7.50%	1976 A,B	—	2,000	2,000
Pollution Control Revenue Bonds						
	December 1, 2006	7.50%	1976 A	26,375	27,375	28,375
	December 1, 2009	7.80%	1979 B	19,100	19,100	19,100
	October 1, 2012	8.25%	1982	—	17,200	17,200
	March 1, 2016	3.58%	1985 A,B	138,120	150,000	150,000
Electric Facilities Revenue Bonds						
	September 1, 2019	7.15%	1989 A,B	35,030	100,000	100,000
	June 1, 2020	7.15%	1990 A	73,900	100,000	100,000
	December 1, 2020	7.15%	1991 A	26,560	100,000	100,000
	February 1, 2022	7.15%	1992 A,B	13,455	100,000	100,000
	August 1, 2022	6.90%	1992 C,D	28,060	100,000	100,000
	November 1, 2023	3.70%	1993 A	—	50,000	50,000
	November 1, 2023	3.70%	1993 B	50,000	50,000	50,000
	October 1, 2024	3.70%	1994A	50,000	50,000	50,000
	August 1, 2025	3.70%	1995 A	50,000	50,000	50,000
	December 1, 2027	3.55%	1997A	-	24,880	—
Total Authority Financing Notes				510,600	940,555	916,675
Unamortized discount and deferred amortization				(60,336)	(13,606)	(14,903)
Subtotal				1,176,075	4,482,949	4,707,772
Note Payable - the Authority	(a)	4.71%		5,355,085	—	—
Due to the Authority	(a)	4.71%		926,564	—	—
Total				7,457,724	4,482,949	4,707,772
Less Current Maturities				468,880	101,000	251,000
Total Long-Term Debt				6,988,844	4,381,949	4,456,772
Total Capitalization				$6,908,863	$7,606,996	$7,682,305

(a) Weighted average interest rate on debt of the Authority as of December 31, 1998.

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

Long Island Lighting Company d/b/a LIPA
(a wholly-owned subsidiary of the Long Island Power Authority)

Notes to Financial Statements

Note 1. Basis of Presentation

As used herein, the term "LILCO" refers to the Long Island Lighting Company, the publicly owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger, as described in Note 2, and the term "LIPA" refers to that company as it exists after the LIPA/LILCO Merger as a wholly-owned electric utility subsidiary company of the Long Island Power Authority (the "Authority"), doing business as LIPA.

The Authority was established as a corporate municipal instrumentality of the State of New York, constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the "LIPA Act"). As such, it is a component unit of the State and is included in the State's annual financial statements.

On April 11, 1997, LILCO changed its year-end from December 31 to March 31. Subsequent to the LIPA/LILCO Merger, LIPA adopted a calendar year-end. Accordingly, unless otherwise indicated, references to December 1998 and December 1997 represent the nine month periods ended December 31, 1998 and December 31, 1997, respectively . References to March 31, 1998 represent the twelve month period then ended. References to March 31, 1997 represent the three month period then ended, while references to all other periods refer to the calendar years ended December 31.

Note 2. Merger/Change in Control

On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO (the "Merger") pursuant to an Agreement and Plan of Merger dated as of June 26, 1997, by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy, "KeySpan"), the Authority and LIPA Acquisition Corp., (the "Merger Agreement").

Pursuant to the Merger Agreement, immediately prior to the Merger, all of the assets and liabilities of LILCO related to the conduct of its gas distribution business and its non-nuclear electric generation business, and all common assets used by LILCO in the operation and management of its electric transmission and distribution business and its gas distribution business and/or its non-nuclear electric generation business (the "Transferred Assets") were sold to KeySpan. The consideration received by LILCO for the Transferred Assets consisted of: (i) 3,440,625 shares of the common stock of KeySpan; (ii) 553,000 shares of the Series B Preferred Stock of KeySpan; and (iii) 197,000 shares of the Series C Preferred Stock of KeySpan.

The value of the consideration was determined by KeySpan and LILCO to be equal to the net fair market value of the Transferred Assets. The transfer of assets and liabilities was effected by a Bill of Sale, dated as of May 28, 1998, made and executed by LILCO and acknowledged by KeySpan.

As a result of the Merger, the Authority became the holder of 1 share of LILCO's common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately $1.048 billion. The interest rate and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO Long Island Lighting Company d/b/a LIPA (a wholly-owned subsidiary of the Long Island Power Authority)indebtedness assumed by the LIPA in the Merger. KeySpan is required to make principal and interest payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA then transfers those amounts to debtholders in accordance with the original debt repayment schedule.

The former holders of LILCO's common stock, primarily individual public shareowners, became entitled to receive a pro-rata share of: (i) cash consideration of $2.497 billion; and (ii) 3,440,625 shares of the common stock of KeySpan, which were received by LILCO in exchange for the Transferred Assets. Pursuant to the Merger Agreement, the former holders of LILCO's common stock (other than holders of dissenting shares) were deemed to have subscribed for additional shares of the common stock of KeySpan, with an aggregate purchase price equal to the cash consideration. In order to effect the Merger, it was necessary to: (i) retire all shares of LILCO's preferred stock, whether by conversion, redemption or cancellation; and (ii) redeem certain of LILCO's bonds, at a cost to LIPA of approximately $1.557 billion. The cash consideration required for the Merger was obtained by the Authority from the proceeds of the issuance and sale of its Electric System General Revenue Bonds, Series

1998A and Electric System Subordinated Revenue Bonds, Series 1 through Series 6. The proceeds from the sale of the bonds were then transferred by the Authority to LIPA in exchange for a promissory note of approximately $4.949 billion. As a result of the Merger, there was a change in control of LILCO which effectively resulted in the creation of a new reporting entity, LIPA. Accordingly, the accompanying financial statements for the periods prior to and including May 28, 1998 are not comparable to the financial statements presented subsequent to May 28, 1998. Therefore, a black line has been drawn on the accompanying financial statements to distinguish between LIPA and LILCO balances and activity.

The remaining assets and liabilities of LILCO acquired by LIPA consist of: (i) LILCO's electric transmission and distribution system; (ii) its net investment in Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2"); (iii) certain regulatory assets and liabilities associated with its electric business, (iv) allocated accounts receivable and other assets and liabilities; and (v) substantially all of its long-term debt.

The financial statements of LIPA include the push down of the Authority's basis, including costs related to the acquisition, in the assets acquired and liabilities assumed. Because of the manner in which LIPA's rates and charges will be established by the Authority's Board of Trustees, the original net book value of the transmission and distribution and nuclear generation assets acquired in the Merger is considered to be their fair value. The excess of the acquisition costs over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35 year period, the weighted average useful life of the net plant assets acquired. The acquisition adjustment principally arose through the elimination of LILCO's regulatory assets and liabilities, totaling $6.3 billion, and net deferred federal income tax liability of approximately $2.4 billion. Therefore, the amortization of the regulatory assets and liabilities has effectively been replaced by the amortization of the acquisition adjustment. In addition, as a wholly-owned subsidiary of the Authority, LIPA is exempt from Federal, state and local income taxes. Accordingly, adjustments were made by LIPA on May 28, 1998 to eliminate deferred tax assets and liabilities. Therefore, the results of operations for the period May 29, 1998 to December 31, 1998 do not include a provision for income taxes.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services for LIPA's transmission and distribution system through a management services agreement. Therefore, LIPA pays KeySpan directly for their services and KeySpan, in turn, pays the salaries of their employees. LIPA has no employees, however LIPA is charged a management fee by the Authority to oversee LIPA's operations of which the salaries of the Authority's employees is a significant component. LIPA contracts for capacity from the fossil fired generating plants of KeySpan through a power supply agreement. Energy and fuel are purchased by KeySpan on LIPA's behalf through an energy management agreement (collectively; the "Operating Agreements").

The electric transmission and distribution system is located in the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways. The service area covers an area of approximately 1,230 square miles and the population of the service area is approximately 2.75 million persons, including approximately 98,500 persons who reside in Queens County within the City of New York. LIPA receives approximately 49% of its revenues from residential sales, 48% from sales to commercial and industrial customers, and the balance from sales to other utilities and public authorities.

Discontinued Operations

The statement of operations of LILCO for the period April 1, 1998 to May 28, 1998 has been prepared to present the gas business (as transferred to KeySpan subsidiaries pursuant to the Merger Agreement) as a discontinued operation, in accordance with the provisions of Accounting Principles Board Opinion No. 30. The statements of operations for the years ended March 31, 1998 and December 31, 1996 and the three months ended March 31, 1997, have also been restated to present the gas business in a similar manner.

The income from discontinued operations includes revenue from the gas business of approximately $79.9 million, $645.6 million, $684.2 million and $293.4 million for the period April 1, 1998 to May 28, 1998, the years ended March 31, 1998 and December 31, 1996 and the three months ended March 31, 1997, respectively.

Note 3. Summary of Significant Accounting Policies

General

LIPA complies with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," LIPA also complies with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

LILCO maintained its accounting records in accordance with the Uniform Systems of Accounts prescribed by the Public Service Commission of the State of New York ("PSC") and the Federal Energy Regulatory Commission ("FERC"). Its financial statements reflected the ratemaking policies and actions of these Commissions in conformity with generally accepted accounting principles for rate-regulated enterprises.

Accounting for the Effects of Rate Regulation

Under current New York law, the Authority is empowered to set rates for electric service in LIPA's service area without being required by law to obtain the approval of the New York State Public Service Commission (the "PSC") or any other State regulatory body.

Both LILCO and LIPA are subject to the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, LIPA records these future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

Regulatory assets represent probable future revenues associated with previously incurred costs that are expected to be recovered from customers. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be refunded to customers through the ratemaking process.

Utility Plant

Utility plant is stated at cost for LILCO, and fair values, at the date of the Merger, for LIPA. Additions to and replacements of utility plant are capitalized at original cost, which includes material, labor, indirect costs associated with an addition or replacement, plus an allowance for funds used during construction. The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, is charged to accumulated depreciation. The cost of repairs and minor renewals is charged to maintenance expense. Mass properties (such as poles, wire and meters) are accounted for on an average unit cost basis by year of installation.

Depreciation

The provisions for depreciation result from the application of straight-line rates to the original cost for LILCO, fair values at the date of the Merger for LIPA, by groups, of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The average depreciation rate as a percentage of respective average depreciable plant costs was as follows:

	Electric		Gas
	LIPA	LILCO	LILCO
7 months ended 12/31/98	2.9%	—	—
2 months ended 5/28/98	—	3.07%	2.04%
12 months ended 3/31/98	—	3.07%	2.04%
3 months ended 3/31/97	—	3.12%	2.04%
12 months ended 12/31/96	—	3.00%	2.00%

Allowance for Funds Used During Construction

The Allowance For Funds Used During Construction ("AFC") is the net cost of borrowed funds used for construction purposes and a reasonable rate of return upon a utility's equity when so used. AFC is not an item of current cash income. AFC is computed monthly on a portion of construction work in progress.

The average AFC rate, was as follows:

	LIPA	LILCO
7 Months Ended 12/31/98	4.71%(a)	—
2 Months Ended 5/28/98		9.42%
12 Months Ended 3/31/98		9.29%
3 Months Ended 3/31/97		9.04%
12 Months Ended 12/31/96		9.02%

(a) Cost of borrowed funds only.

Designated Funds

Designated funds are certificates of deposit and highly liquid investments with maturities of three months or less when purchased and are valued at amortized cost, which approximates market value at December 31, 1998. These funds have been designated by the Authority's Board of Trustees to be used for specific purposes, including debt service and capital expenditures. LIPA's designated funds are held by the Authority in an investment pool that is administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. The certificates of deposit are either insured by the FDIC or collateralized by securities held by the Authority's custodian bank in the Authority's name. Investments are comprised of commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record.

Statement No. 3 of the Governmental Accounting Standards Board, "Investments, including Repurchase Agreements" ("GASB 3"), requires state and local governments to classify their investments in three defined categories of credit risk. Category one includes investments that are insured or registered, or securities that are held by the Authority or its agent in the Authority's name. The investments held by the Authority are classified as Category one at December 31, 1998.

Fair Values of Financial Instruments

The fair values for LILCO's and LIPA's long-term debt and redeemable preferred stock are based on quoted market prices, where available. The fair values for all other long-term debt and redeemable preferred stock were estimated using discounted cash flow analyses based upon LILCO or LIPA's current incremental borrowing rate for similar types of securities.

Revenues

Revenues are comprised of cycle billings rendered to customers and the accrual of electric and/or gas revenues for services rendered to customers not billed at month-end.

LILCO's electric rate structure provided for a revenue reconciliation mechanism which eliminated the impact on earnings of electric sales that were above or below the levels reflected in rates. LIPA's rate structure does not include a similar mechanism.

LILCO's gas rate structure provided for a weather normalization clause which reduced the impact on revenues of experiencing weather which was warmer or colder than normal.

Fuel and Purchased Power Cost Adjustment ("FPPCA")

LIPA's rates include the FPPCA mechanism whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA is designed to ensure that LIPA will recover from or return to customers any fuel costs that fall outside an established base fuel and purchased power tolerance band. The tolerance band is equal to 1% above and 1% below LIPA's base cost of fuel and purchased power costs for 1999. The tolerance band increases to two percent in 2000 and continue to increase in one percent increments annually thereafter. Expenses for fuel and purchased power costs in excess of or below this level will be recovered from or returned to customers beginning the following year. Should fuel and purchased power costs increase in excess of five percent cumulatively over the original base cost, the FPPCA will recover, from that year forward, all costs in excess of the original base.

Under LIPA's current tariffs, the measurement of the under or over recovery of fuel costs was scheduled to begin January 1, 1999. However, as a result of decreasing fuel costs, LIPA recovered from customers approximately $22 million more for fuel than was incurred for the period May 29, 1998, through December 31, 1998. In order to preserve this benefit for customers, LIPA recorded a liability for the full amount of the over recovery. This amount is included in deferred credits.

Fuel Cost Adjustments

LILCO's electric and gas tariffs included fuel cost adjustment ("FCA") clauses which provided for disposition of the difference between actual fuel costs and the fuel costs allowed in LILCO's base tariff rates (base fuel costs). LILCO deferred the differences to future periods in which they would be billed or credited to customers, except for base electric fuel costs in excess of actual electric fuel costs, which were credited to the Rate Moderation Component ("RMC") as incurred. Gas fuel costs were excluded from base fuel costs and recovered through Gas fuel adjustment clause under LILCO's tariff.

Federal Income Tax

LIPA is exempt from Federal, state and local income taxes.

LILCO provided deferred federal income tax with respect to items with different bases for financial and tax reporting purposes.

LILCO deferred the benefit of 60% of pre-1982 gas and pre-1983 electric and 100% of all other investment tax credits, with respect to regulated properties, when realized on its tax returns. Accumulated deferred investment tax credits were amortized ratably over the lives of the related properties.

For ratemaking purposes, LILCO provided deferred federal income tax with respect to certain differences between income before income tax for financial reporting purposes and taxable income for federal income tax purposes. Also, certain accumulated deferred federal income taxes were deducted from rate base and amortized or otherwise applied as a reduction in federal income tax expense in future years.

Reserves for Claims and Damages

Losses arising from claims against LIPA, including workers' compensation claims, property damage, extraordinary storm costs and general liability claims, are partially self-insured. Reserves for these claims and damages are based on, among other things, experience and risk of loss. Extraordinary storm losses incurred by LIPA are partially insured by various commercial insurance carries. These insurance carriers provide partial insurance coverage for individual storm losses to the transmission and distribution system between $15 million and $35 million. Storm losses which are outside of this range are self-insured by LIPA.

Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified in the financial statements to conform with the current period presentation.

Recent Accounting Pronouncements

Derivative Instruments

In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement established accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. LIPA will adopt SFAS No. 133 in the first quarter of fiscal year 2000. LIPA does not expect any material earnings effect from adoption of this statement.

Plant Decommissioning

In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear plant decommissioning. Over the past two years, this exposure draft has been the source of continual debate. The FASB has committed to completing the project and is proceeding toward issuance of another exposure draft (expected in the second quarter of 1999). If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. LIPA can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition of LIPA.

Investments

GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," was implemented during the period ending December 31, 1998. The statement generally requires that investments should be reported in the balance sheet at fair value and that realized and unrealized gains and losses on investments flow through the statement of operations. The adoption of this statement did not have a material impact on LIPA.

Regulatory Assets and Liabilities of LILCO

Base Financial Component and Rate Moderation Component

Pursuant to the 1989 Settlement (as described in Note 11), LILCO recorded a regulatory asset known as the Financial Resource Asset ("FRA"). The FRA was designed to provide LILCO with sufficient cash flows to assure its financial recovery. The FRA had two components, the Base Financial Component ("BFC") and the RMC.

The BFC represented the present value of the future net-after-tax cash flows which the Rate Moderation Agreement ("RMA"), one of the constituent documents of the 1989 Settlement, provided LILCO for its financial recovery. The BFC was granted rate base treatment under the terms of the RMA and was included in LILCO's revenue requirements through amortization included in rates over a forty-year period on a straight-line basis which began July 1, 1989.

The RMC reflected the difference between LILCO's revenue requirements under conventional ratemaking and the revenues resulting from the implementation of the rate moderation plan provided for in the RMA. The RMA was adjusted, on a monthly basis, for LILCO's share of certain NMP2 operations and maintenance expenses, fuel credits resulting from LILCO's electric fuel cost adjustment clause and gross receipts tax adjustments related to the FRA.

In April 1998, the PSC authorized a revision to LILCO's method for recording its monthly RMC amortization. Prior to this revision, the amortization of the annual level of RMC was recorded monthly on a straight-line basis, levelized basis over LILCO's rate year which ran from December 1 to November 30. However, revenue requirements fluctuated from month to month based upon consumption, which was greatly impacted by the effects of weather. Under the revised method, effective December 1, 1997, the monthly amortization of the annual RMC level varied based upon each month's forecasted revenue requirements, which more closely aligned such amortization with LILCO's cost of service. As a result of this change, for the period April 1, 1998 through May 28, 1998, and for the fiscal year ended March 31, 1998, LILCO recorded approximately $51.5 and $65.1 million, respectively, more of non-cash RMC credits to income (representing accretion of the RMC balance), or $33.5 million and $42.5 million net of tax, more than it would have under the previous method.

Shoreham Post-Settlement Costs

Shoreham post-settlement costs consisted of Shoreham decommissioning costs, fuel disposal costs, Payments-In-Lieu-Of-Taxes ("PILOT's"), carrying charges and other costs. These costs were being capitalized and amortized and recovered through rates over a forty-year period on a straight-line remaining life basis which began July 1, 1989.

Shoreham Nuclear Fuel

Shoreham nuclear fuel principally reflected the unamortized portion of Shoreham nuclear fuel which was reclassified from Nuclear Fuel in Process and in Reactor at the time of the 1989 Settlement. This amount was being amortized and recovered through rates over a forty-year period on a straight-line remaining life basis which began July 1, 1989.

Unamortized Cost of Issuing Securities

Unamortized cost of issuing securities represented the unamortized premiums or discounts and expenses related to the issues of long-term debt that had been retired by LILCO prior to maturity and the costs associated with the early redemption of those issues. In addition, this balance included the unamortized capital stock expense and redemption costs related to certain series of preferred stock that had been refinanced by LILCO. These costs were amortized and recovered through rates, as provided by the PSC, over the shorter of the life of the redeemed issue or the new issue.

Postretirement Benefits Other Than Pensions

LILCO deferred as a regulatory asset the difference between postretirement benefits expense recorded in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and postretirement benefits expense reflected in rates. Pursuant to a PSC order, the ongoing annual SFAS No. 106 benefit expense was phased into and fully reflected in rates by November 30, 1997, with the accumulated deferred asset to be recovered in rates over the fifteen-year period which began December 1, 1997.

Regulatory Tax Asset and Regulatory Tax Liability

LILCO had recorded a regulatory tax asset for amounts that if would have collected in future rates for the portion of its deferred tax liability that had not been recognized for ratemaking purposes. The regulatory tax asset was comprised principally of the tax effect of the difference in the cost basis of the BFC for financial and tax reporting purposes, depreciation differences not normalized and the allowance for equity funds used during construction.

The regulatory tax liability was primarily attributable to deferred taxes previously recognized by LILCO at rates higher than the then current enacted tax law, unamortized investment tax credits and tax credit carryforwards.

Regulatory Liability Component

Pursuant to the 1989 Settlement (as discussed in Note 12), certain tax benefits attributable to the Shoreham abandonment were to be shared between electric customers and shareowners. A regulatory liability of approximately $794 million was recorded in June 1989 to preserve an amount equivalent to the customer tax benefits attributable to the Shoreham abandonment. This amount was being amortized over a ten-year period on a straight-line basis which began July 1, 1989.

1989 Settlement Credits

Represented the unamortized portion of an adjustment of the book write-off to the negotiated 1989 Settlement amount. A portion of this amount was being amortized over a ten-year period which began on July 1, 1989. The remaining portion was not being recognized for ratemaking purposes.

LRPP Payable

Under the provisions of LILCO's rate structure, the LRPP Payable represented the then current portion of amounts due to ratepayers that resulted from the revenue and expense reconciliations, performance-based incentives and associated carrying charges as established under the LILCO Ratemaking and Performance Plan ("LRPP").

Note 4. LIPA Rate Matters

Under current New York law, the Authority is empowered to set rates for electric service in its service area without being required by law to obtain the approval of the PSC or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the Merger by the New York State Public Authorities Control Board (the "PACB"), that it will not impose any permanent increase, nor extend or reestablish any portion of a temporary rate increase, in average customer rates over a 12 month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. Another of the PACB conditions requires that the Authority reduce average rates within LIPA's service area by no less than 14% over a ten year period commencing on the date when LIPA began providing electric service, when measured against LILCO's base rates in effect on July 16, 1997 (excluding the impact of the proposed Shoreham tax settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events.)

The LIPA Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Authority; PILOT's; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

LIPA's rates include the FPPCA to adjust rates to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA is designed to ensure that LIPA will recover from or return to customers any fuel costs that fall outside an established base fuel and purchased power tolerance band. The tolerance band is equal to 1% above and 1% below LIPA's base cost of fuel and purchased power costs for 1999. The tolerance band increases to two percent in 2000 and continues to increase in one percent increments annually thereafter. Expenses for fuel and purchased power costs in excess of or below this level will be recovered from or returned to customers beginning the following year. Should fuel and purchased power costs increase in excess of five percent cumulatively over the original base cost, the FPPCA will recover, from that year forward, all costs in excess of the original base.

LIPA's rates are largely based on LILCO's pre-Merger rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, LIPA's rates include the FPPCA, a PILOT payments recovery rider, a rider providing for the Shoreham settlement and a rider providing for the RICO Credits

(credits to the bills of customers as a result of the settlement by LILCO of a RICO action in connection with the construction and completion of nuclear generating facilities).

The LIPA Act requires LIPA to make PILOTs for certain New York State and local revenue taxes which would otherwise have been imposed on LILCO. The PILOT payments recovery rider allows for LIPA's rate adjustments to accommodate the PILOTs.

For a further discussion on the Shoreham tax settlement see Note 13.

Note 5. Utility Plant

Utility Plant consists of:

	LIPA	LILCO	
	December 31, 1998	March 31, 1998	December 31, 1996
		(in millions)	
Generation - non nuclear	$ —	$1,077.2	$ 1,035.8
Generation - nuclear	662.9	887.8	883.9
Transmission and distribution	1,385.1	2,066.5	1,962.6
Gas	—	1,233.3	1,154.5
Common	3.8	290.3	260.3
Construction work inprogress	52.9	118.7	112.1
Nuclear fuel in process and in reactor	17.1	18.1	15.5
	2,121.8	5,691.9	5,424.7
Less - Accumulated depreciation and amortization	50.3	1,877.9	1,729.5
Total Net Utility Plant	$2,071.5	$3,814.0	$ 3,695.2

Note 6. Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2")

As a result of the Merger, LIPA acquired an undivided 18% interest in NMP2, located in Scriba, New York which is operated by Niagara Mohawk Power Corporation ("NMPC"). The owners of NMP2 and their respective percentage ownership are as follows: LIPA (18%), NMPC (41%), New York State Electric & Gas Corporation ("NYSEG") (18%), Rochester Gas Electric Corporation ("RG&E") (14%) and Central Hudson Gas & Electric Corporation (9%). LIPA's share of the rated capability is approximately 205 MW. LIPA's net utility plant investment, excluding nuclear fuel, was approximately $650 million at December 31, 1998, $689 million at March 31, 1998 and $715 million at December 31, 1996. The accumulated provision for depreciation, excluding decommissioning costs, was approximately $13 million and $196 million at December 31, 1998 and March 31, 1998, respectively, and $169 million at December 31, 1996. The provision for accumulated depreciation was re-established at zero on May 28, 1998, pursuant to the Merger. Generation from NMP2 and operating expenses incurred by NMP2 are shared in the same proportions as the cotenant's respective ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

NMPC has contracted with the United States Department of Energy for the disposal of spent nuclear fuel. LIPA reimburses NMPC for its 18% share of the cost under the contact at a rate of $1.00 per megawatt hour of net generation less a factor to account for transmission line losses.

Nuclear Plant Decommissioning

NMPC expects to commence the decommissioning of NMP2 in 2026, shortly after the cessation of plant operations, using a method which provides for the removal of all equipment and structures and the release of the property for unrestricted use. LIPA's share of decommissioning costs, based upon a "Site-Specific" 1995 study (1995 study), is estimated to be $407 million in 2026 dollars ($161 million in 1998 dollars using a 3.5% escalation

factor). LIPA's share of the estimated decommissioning costs is currently being provided for in electric rates and is being charged to operations as depreciation expense over the service life of NMP2. The amount of decommissioning costs recorded as depreciation expense for the seven months ended December 31, 1998 totaled $3.9 million, for the two months ended May 28, 1998 totaled $0.4 million, for the year ended March 31, 1998 and the three months ended March 31, 1997, totaled $2.2 million and $0.5 million, respectively, and $3.9 million for the year ended December 31, 1996. The accumulated decommissioning costs collected in rates through December 31, 1998, March 31, 1998 and December 31, 1996 amounted to $20.2 million, $18.3 million and $15.6 million, respectively.

LIPA has acquired external trust funds established for the decommissioning of the contaminated portion of the NMP2 plant. It is currently estimated that the cost to decommission the contaminated portion of the plant will be approximately 76% of the total decommissioning costs. These funds comply with regulations issued by the NRC and the FERC governing the funding of nuclear plant decommissioning costs. LIPA's policy is to fund these trusts at least annually. As of December 31, 1998, the balance in these funds, including reinvested net earnings, was approximately $19 million. These amounts are included in Nonutility Property and Other Investments. The trust fund investments consist of U.S. Treasury debt securities and cash equivalents. The carrying amounts of these investments approximate fair market value.

Reference is made to Note 3 under the subcaption "Recent Accounting Pronouncements" for details of the proposed changes in accounting for nuclear decommissioning costs.

In 1996, NMPC and RG&E announced plans to establish a joint nuclear operating company to be known as New York Nuclear Operating Company ("NYNOC"). NYNOC was envisioned to assume full responsibility for operation of all nuclear plants in New York. In 1997, NYPA, Con Edison, Niagara Mohawk and Rochester Gas and Electric Corporation, the four utilities operating nuclear generating facilities in New York State, executed a joint announcement which expressed their desire to move forward with plans to form NYNOC, and stated that the four utilities will initiate the steps to assure that NYNOC will have the necessary leadership, personnel and structure to operate the six nuclear units now operated independently by such utilities. The joint announcement also stated that during the transition phase, while necessary governmental approvals are sought, the utilities would continue with and add to the cooperative initiatives the companies have already begun. NYNOC, a limited liability company, would operate the six nuclear plants currently operated by the four entities to achieve economies of scale and increase cost effectiveness. The plants would continue to be owned, and the output of the plants marketed, by the respective owners of the plants. It is contemplated that NYNOC would become the operator under the plants' NRC operating licenses, while other aspects of the NRC licenses would remain with the owners of the plants. It is uncertain what effect Niagara Mohawk's participation in such an arrangement will have on LIPA; nor can LIPA predict the effect on such an arrangement of the auction proposal in the staff report.

On or about June 15, 1998, NYSEG, one of the owners of the Nine Mile 2 Plant, commenced an action against NMPC (which is the operator of the Nine Mile 2 Plant) in Supreme Court of the State of New York, Tompkins County, demanding, among other things, judgment to: (i) enjoin NMPC from transferring operating responsibility of the Nine Mile 2 Plant to NYNOC; and (ii) declare that NMPC may not transfer its operational responsibility for the Nine Mile 2 Plant to NYNOC without NYSE&G's consent. LIPA can make no prediction as to the outcome of this litigation.

NMPC and NYSE&G have announced that they plan to pursue the sale of their nuclear assets including its interest in NMP2. LIPA is reviewing its rights and remedies under the agreements governing its 18% interest in NMP2. LIPA has not received an offer to purchase its 18% interest in NMP2 and is not pursuing a sale at this time.

On August 27, 1997, the PSC Staff ("Staff") issued a "Notice Soliciting Comments on Nuclear Generation" requesting comments and alternative approaches by interested parties on a "Staff Report on Nuclear Generation" ("Nuclear Report"). The Nuclear Report concludes that nuclear generation along with non-nuclear generation facilities, should be subject to the discipline of market-based pricing.

On March 20, 1998, the PSC initiated a proceeding to examine a number of issues raised by the Nuclear Report and the comments received in response to it. In reviewing the Nuclear Report and parties' comments, the PSC: (a) adopted as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, with parties challenging that premise having to bear a substantial burden of persuasion; (b) characterized the proposals in the Staff paper as by and large consistent in concept with the PSC's goal of a competitive, market-based electricity industry; (c) questioned PSC Staff's position that would leave funding and other decommissioning responsibilities with the sellers of nuclear power interests; and, (d) indicated interest in the potential for the NYNOC to benefit customers through efficiency gains and directed pursuit of that matter in this nuclear generating proceeding or separately upon the filing of a formal NYNOC proposal. The proceeding is expected to be completed in 1999.

The NRC issued a policy statement on the Restructuring and Economic Deregulation of the Electric Utility Industry ("Policy Statement") in 1997. The Policy Statement addresses NRC's concerns about the adequacy of decommissioning funds and about the potential impact on operational safety and reserves to the NRC the right, in highly unusual situations where adequate protection of public health and safety would be compromised, to consider imposing joint and several liability on minority co-owners when one or more co-owners have defaulted on their contractual obligations. On December 28, 1998, the NRC announced commencement of a rulemaking proceeding initiated by a group of utilities which are non-operating joint owners of nuclear plants. These utilities request that the enforcement provisions of the NRC regulations be amended to clarify NRC policy regarding the potential liability of joint owners if other joint owners become financially incapable of bearing their share of the burden for safe operation or decommissioning of a nuclear power plant. On March 22, 1999, the Authority filed comments in support of the rule proposed by the group of utilities. In addition to the above Policy Statement, the NRC is proposing to amend its regulations on decommissioning funding to reflect conditions expected from deregulation of the electric power industry. LIPA is unable to predict how such increased stringency may affect the results of operations or financial condition of the Nine Mile 2 Plant.

On July 5, 1998, the Nine Mile 2 Plant completed its sixth refueling outage, which commenced on May 2, 1998. It is scheduled to commence its seventh refueling outage in March 2000.

Radioactive Waste

NMPC has contracted with the U.S. Department of Energy ("DOE") for disposal of high-level radioactive waste ("spent fuel") from the Nine Mile 2 Plant. Despite a court order reaffirming the DOE's obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. LIPA has been advised by NMPC that the Nine Mile 2 Plant spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required.

Nuclear Plant Insurance

NMPC procures public liability and property insurance for NMP2, and LIPA reimburses NMPC for its 18% share of those costs.

The Price-Anderson Amendments Act mandates that nuclear power secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $200 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 108 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $88.1 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of $15.9 million, per incident, through assessments of up to $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor. These assessments are subject to periodic inflation indexing and to a 5% surcharge if funds prove insufficient to pay claims.

NMPC has also procured $500 million primary nuclear property insurance with the Nuclear Insurance Pools and approximately $2.3 billion of additional protection (including decontamination costs) in excess of the primary layer through Nuclear Electric Insurance Limited (NEIL). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $1.6 million per loss. This level of insurance is in excess of the NRC required minimum of $1.06 billion of coverage.

LIPA has obtained insurance coverage from NEIL for the extra expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, should losses exceed the accumulated reserves of NEIL, each member, including LIPA, would be liable for its share of deficiency. LIPA's maximum liability per incident under the replacement power coverage, in the event of a deficiency, is approximately $700,000.

The NRC has notified all utilities operating nuclear power plants that they are required to inform the NRC of steps they are taking to see that computer systems will function properly by the year 2000. In connection therewith, each such utility was required to submit a written indication of, among other things, whether or not they are pursuing and continuing to pursue a plan to solve their Year 2000 issue, such as, or similar to, that outlined in the publication Nuclear Utility Year 2000 Readiness published by the Nuclear Energy Institute and the Nuclear Utilities Software Management Group (the "NEI/NUSM Plan"). In addition, not later than July 1, 1999, each such utility must submit a written response confirming that its plant is Year 2000 ready, or if not ready, the utility must provide a status report of work remaining to be done. Niagara Mohawk submitted its required response indicating that it has pursued and is continuing a Year 2000 readiness program similar to that recommended in the NEI/NUSM Plan.

Note 7. Debt

Note Payable to the Authority

The debt of LIPA consists of certain debt assumed as of result of the Merger, titled Long-Term Debt, a Note payable to the Authority, and amounts due to the Authority for advances for the day-to-day operations of LIPA. The note payable to the Authority represents the proceeds from the sale of Authority bonds which were then transferred to LIPA in exchange for a promissory note. Such proceeds were used by LIPA to finance the Merger, and to refinance certain of the assumed debt as part of the Merger. The initial borrowing under this promissory note was approximately $6.7 billion. As of December 31, 1998, the balance owed to the Authority was approximately $5.4 billion. This promissory note transferred to the Authority all of LIPA's right, title and interest in and to the revenue it generates from the operation of the transmission and distribution system, including the right to collect and receive that revenue. Therefore, cash receipts from customers are collected by the Authority thereby reducing the note payable to the Authority. The note payable to the Authority bears interest at a rate equal to the weighted average interest rate on the bonds issued by the Authority, approximately 4.71% at December 31, 1998.

Bonds issued by the Authority provided the funds to loan to LIPA. The Authority bonds outstanding at December 31, 1998, consist of:

	(in thousands)
Electric System General Revenue Bonds, Series A	$3,449,528
Electric System General Revenue Bonds, Series B	1,313,800
Electric System Subordinated Revenue Bonds, Series 1-6	1,500,000
Electric System Subordinated Revenue Bonds, Series 7	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	218,300
	$6,731,628

Interest Rate Swaps

The Authority has entered into interest rate swap agreements to reduce the impact of changes in interest rates on certain variable rate long-term debt of the Authority. At December 31, 1998, the Authority had interest rate swap agreements outstanding having a total notional amount of $150 million and $100 million, respectively. These agreements effectively change the Authority's interest rate exposure on its $250 million variable rate notes due 2025 to a fixed rate of 4.208 percent. The interest rate swap agreements mature at the time the related notes mature with optional earlier termination at the Authority's discretion. The Authority is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the Authority does not anticipate nonperformance by the counterparties.

Due to the Authority

All cash receipts from customers are collected by the Authority and are used to repay the Note Payable to the Authority. Operating expenditures of LIPA are paid by the Authority, and are recorded by LIPA as a loan-Due to the Authority. The balance at December 31, 1998, totaled approximately $927 million. The interest rate on this loan is equal to that on the Note Payable to the Authority.

Long Term Debt

Long Term Debt represents debt of LILCO assumed by LIPA as part of the Merger, and consisted of $1.186 billion of G&R bonds, which were defeased by LIPA immediately upon the closing of the Merger, debentures totaling $2.2 billion, and tax exempt debt of $916 million. As part of the Merger, KeySpan and LIPA executed Promissory Notes whereby KeySpan is obligated to LIPA for approximately $1.048 billion of the assumed debt (the "Promissory Notes"). KeySpan is also required to pay LIPA principal and interest on the Promissory Notes 30 days in advance of the date amounts are due to bond holders. At December 31, 1998, the balance of the Promissory Notes between KeySpan and LIPA totaled $1.045 billion of which $398 million will be collected in 1999.

The tax exempt debt assumed by LIPA were notes issued by LILCO to the New York State Research and Development Authority ("NYSERDA") to secure tax-exempt Industrial Development Revenue Bonds, Pollution Control Revenue Bonds ("PCRBs"), and Electric Facilities Revenue Bonds ("EFRBs") issued by NYSERDA.

Letters of Credit

The 1995, 1994 and 1993 EFRBs and the 1985 PCRBs are supported by letters of credit pursuant to which a letter of credit bank has agreed to pay the principal, interest and premium, if applicable, in the aggregate, up to $326 million in the event of default. Subsequent to December 31, 1998, EFRBs and PCRBs were converted to fixed rate securities and LIPA cancelled the letters of credit.

Bond Defeasance/Refundings

A portion of the proceeds of the Authority's Electric System General Revenue Bonds and Subordinated Bonds (which includes fixed and variable rate debt) were used to refund all the General and Refunding Bonds, certain Debentures and certain NYSERDA Notes issued by LILCO that were assumed by LIPA as a result of the Merger. The purpose of these refundings was to achieve debt service savings.

General and Refunding Bonds

On May 29, 1998, LIPA refunded all the G&R Bonds totaling $1.186 billion by depositing $1.190 billion in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on these obligations were sufficient to pay the principal and interest on the G&R Bonds which were redeemed on June 29, 1998.

The Authority will realize gross debt service savings from this refunding of approximately $588 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $576 million.

Debentures

In October 1998, LIPA commenced a tender offer for its 7.30% Debentures Due 2000, 6.25% Debentures Due 2001, 7.05% Debentures Due 2003, 7.00% Debentures Due 2004, 7.125% Debentures Due 2005 and 9.00% Debentures Due 2022 (collectively, the "Debentures"). The tender offers for the Debentures expired in November, and LIPA purchased an aggregate principal amount of Debentures including accrued interest in the amount of $1.13 billion pursuant to the tender offers. Payment for Debentures purchased pursuant to the tender offers was made from the sale of $1.31 billion Electric System General Revenue Bonds, Series 1998B (the "Refinancing Bonds") of the Authority which closed in November. Under the terms of the financing agreement dated as of May 1, 1998, between LIPA and the Authority, a portion of the proceeds from the sale of the Refinancing Bonds were advanced to LIPA to fund payment for the tendered Debentures.

In October 1998, LIPA sent a notice of redemption to the holders of its 7.50% Debentures Due 2007 calling for redemption in November of all such debentures at a redemption price equal to 103.54% of the $142 million aggregate principal amount outstanding. In addition, LIPA sent a notice of redemption to the holders of its 8.90% Debentures Due 2019 calling for redemption in November of all such debentures at a redemption price equal to 105.94% of the $420 million aggregate principal amount outstanding.

As a result of the refundings described above, the Authority will realize gross debt service savings of approximately $547 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $376 million.

NYSERDAs

The Authority deposited $379 million in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing Principal of and interest on such securities will be sufficient to pay the principal, interest and applicable call premium on the following issues of NYSERDA Notes: $11.9 million Series 1985A, $50 million Series 1989A, $15 million Series 1989B, $26 million Series 1990A, $73 million Series 1991A, $50 million Series 1992A, $36.5 million Series 1992B, $50 million Series 1992C and $22 million Series 1992D, (collectively, the "Refunded NYSERDA Notes").

As a result of the refunding and the deposit with the Escrow Agent, the Refunded NYSERDA Notes are deemed to have been paid, and they cease to be a liability of LIPA. Accordingly, the Refunded NYSERDA Notes (and the related deposit with the Escrow Agent) are excluded from the Balance Sheet. The Authority will realize gross debt service savings from this refunding of approximately $287 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $66 million.

In November 1998, LIPA sent a notice of redemption to the holders of its 1982 NYSERDA Notes calling for redemption in December of all such NYSERDA notes at a redemption price equal to the $17.2 million aggregate principal amount outstanding.

The Authority will realize gross debt service savings from the refunding of approximately $14.9 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $6.5 million.

Deferred Amortization

A debt refinancing charge of $61.9 million resulted from the transactions described above primarily because of the difference between the amounts paid for refundings, including amounts deposited with the Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, the $61.9 million has been deferred and is shown in the Balance Sheet as Deferred Amortization within long term debt and is being amortized.

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Notes to Financial Statements—(continued)

Fair Values of Long-term Debt

	LIPA	LILCO	
(In thousands of dollars)	December 31, 1998	March 31, 1998	December 31, 1996
Fair Value			
General and Refunding Bonds	$ —	$1,288,470	$1,571,745
Debentures	745,822	2,407,178	2,271,095
NYSERDA Notes	536,401	987,646	950,758
Total	$1,282,223	$4,683,294	$4,793,598
Carrying Amount			
General and Refunding Bonds	$ —	$1,286,000	$1,536,000
Debentures	725,811	2,270,000	2,270,000
NYSERDA Notes	510,600	940,555	916,675
Total	$1,236,411	$4,496,555	$4,722,675

Debt Maturity Schedule

The total long-term debt maturity in each of the next five years ending December 31 is as follows: 1999, $398 million; 2000, $1.3 million; 2001, $9.4 million; 2002, $3.5 million; and 2003, $9.4 million.

Note 8. Capital Stock

Common Stock

LIPA has 1 share of $1 par value common stock authorized, issued and outstanding. All such shares are held by the Authority. LILCO had 150,000,000 shares of authorized common stock, of which 121,727,040 were issued and 46,281 shares were held in Treasury at March 31, 1998.

Preferred Stock

LILCO had 7,000,000 authorized shares, cumulative preferred stock, par value $100 per share and 30,000,000 authorized shares, cumulative preferred stock, par value $25 per share. Dividends on preferred stock were paid in preference to dividends on common stock or any other stock ranking junior to preferred stock.

Preferred Stock Subject to Mandatory Redemption

The aggregate fair value of LILCO's redeemable preferred stock with mandatory redemptions at March 31, 1998 and December 31, 1996 amounted to approximately $675, and $637 million, respectively, compared to carrying amounts of $639, and $640 million, respectively.

Note 9. Federal Income Tax

As a wholly-owned subsidiary of the Authority, LIPA is exempt from Federal, state and local income taxes. Accordingly, adjustments were made by LIPA on May 28, 1998, to eliminate from the financial statements, deferred tax assets and liabilities, and, the results of operations for the period May 29, 1998 through December 31, 1998, do not include a provision for income taxes. The significant components of LILCO's deferred tax assets and liabilities calculated under the provisions of SFAS No. 109, "Accounting for Income Taxes," were as follows:

	March 31, 1998	December 31, 1996
	(In thousands of dollars)	
Deferred Tax Assets		
Net operating loss carryforwards	$ —	$ 145,205
Reserves not currently deductible	39,667	58,981
Tax depreciable basis in excess of book	10,559	34,314
Excess credits	24,858	27,700
Credit carryforwards	40,318	135,902
Other	261,729	186,907
Total Deferred Tax Assets	$ 377,131	$ 589,009
Deferred Tax Liabilities		
1989 Settlement	$2,169,909	$2,163,239
Accelerated depreciation	650,562	642,702
Call premiums	38,698	44,846
Rate case deferrals	564	2,127
Other	56,762	33,496
Total Deferred Tax Liabilities	2,916,495	2,886,410
Net Deferred Tax Liability	$2,539,364	$2,297,401

SFAS No. 109 requires utilities to establish regulatory assets and liabilities for the portion of its deferred tax assets and liabilities that have not yet been recognized for ratemaking purposes. The major components of these regulatory assets and liabilities were as follows:

	March 31, 1998	December 31, 1996
Regulatory Assets		
1989 Settlement	$1,652,412	$1,660,871
Plant items	100,661	125,976
Other	(15,141)	(14,069)
Total Regulatory Assets	$1,737,932	$1,772,778
Regulatory Liabilities		
Carryforward credits	$ 38,720	$ 68,421
Other	40,193	34,466
Total Regulatory Liabilities	$ 78,913	$ 102,887

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

The table below sets forth the reasons for such differences.

	April 1, 1998 - May 28, 1998	Year Ended March 31, 1998	Three Months Ended March 31, 1997	Year Ended December 31, 1996
		(In thousands of dollars)		
Income before federal income tax	$ 8,148	$594,893	$143,910	$525,721
Statutory federal income tax rate	35%	35%	35%	35%
Statutory federal income tax	2,852	208,213	50,369	184,002
Additions (reductions) in federal income tax				
Excess of book over tax depreciation	2,859	17,912	4,356	18,339
1989 Settlement	666	4,212	1,053	4,212
Interest capitalized	570	2,962	588	2,270
Tax credits	(3,656)	(2,464)	(940)	(4,383)
Tax rate change amortization	—	2,223	815	3,686
Net Gain on KeySpan Transaction	4,863	—	—	—
Allowance for funds used during construction	(370)	(2,953)	(583)	(2,305)
Other items	1,761	2,549	555	3,436
Total Federal Income Tax Expense	$ 9,545	$232,654	$56,213	$209,257
Effective Federal Income Tax Rate	117.1%	39.1%	39.1%	39.8%

LILCO had tax credit carryforwards of approximately $189 million at March 31, 1998. The carryforward credits were comprised of investment tax credits ("ITC") carryforwards, net of the 35% reduction required by the Tax Reform Act of 1986, totaling approximately $30 million, research and development ("R&D") credits totaling approximately $9 million, and alternative minimum tax ("AMT") credits of approximately $150 million.

In May 1998, as a result of the Merger, LILCO recognized a net federal income tax liability of approximately $70 million, after the utilization of all of the company's ITC and R&D credit carryforwards of approximately $39 million and the utilization of AMT credits of approximately $16 million.

In May 1998, LILCO reached a final settlement with the Internal Revenue Service on its federal income tax returns for the years 1981 through 1989. The settlement provided for the payment of taxes and interest of approximately $9 million and $35 million, respectively, which LILCO paid. LILCO had previously provided reserves adequate to pay such taxes and interest.

Note 10. Retirement Benefit Plans

LILCO

Pension Plans

LILCO maintained a defined benefit pension plan which covered substantially all employees (Primary Plan), a supplemental plan which covered officers and certain key executives (Supplemental Plan) and a retirement plan which covered the Board of Directors (Directors' Plan). LILCO also maintained 401(k) plans for its union and non-union employees to which it did not contribute.

Primary Plan

LILCO's funding policy was to contribute annually to the Primary Plan a minimum amount consistent with the requirements of the Employees Retirement Income Security Act of 1974, plus such additional amounts, if any, as LILCO determined to be appropriate. Pension benefits were based upon years of participation in the Primary Plan and compensation.

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The Primary Plan's funded status and amounts recognized on the Balance Sheet at March 31, 1998 and December 31, 1996 were as follows:

	March 31, 1998	December 31, 1996
Actuarial present value of benefit obligation		
Vested benefits	$ 661,075	$547,002
Nonvested benefits	59,268	55,157
Accumulated Benefit Obligation	$ 720,343	$602,159
Plan assets at fair value	$ 919,100	$746,400
Actuarial present value of projected benefit obligation	825,159	689,661
Projected benefit obligation less than plan assets	93,941	56,739
Unrecognized net obligation	62,652	71,085
Unrecognized net gain	(163,034)	(123,759)
Net (Accrued) Prepaid Pension Cost	$ (6,441)	$ 4,065

The increase in the present value of the accrued benefit at March 31, 1998, compared to December 31, 1996, was due to the change in the discount rate from 7.25% to 7.00% and the use of updated actuarial assumptions relating to mortality.

Periodic pension cost for the Primary Plan and the significant assumptions consisted of the following:

	April 1, 1998 - May 28, 1998	Year Ended March 31, 1998	Three Months Ended March 31, 1997	Year Ended December 31, 1996
		(In thousands of dollars)		
Service cost - benefits earned during the period	$ 3,447	$ 21,114	$ 4,645	$ 17,384
Interest cost on projected benefits obligation and service cost	9,162	56,379	12,494	47,927
Actual return on plan assets	(10,378)	(200,025)	(3,694)	(81,165)
Net amortization and deferral	263	151,438	(9,446)	33,541
Net Periodic Pension Cost	$ 2,494	$ 28,906	$ 3,999	$ 17,687
	May 28, 1998	March 31, 1998	March 31, 1997	December 31, 1996
Discount rate for obligation	7.00%	7.00%	7.00%	7.25%
Discount rate for expense	7.00%	7.00%	7.25%	7.25%
Rate of future compensation increases	4.50%	4.50%	5.00%	5.00%
Long-term rate of return on assets	8.50%	8.50%	7.50%	7.50%

The Primary Plan assets at fair value included cash, cash equivalents, group annuity contracts, bonds and equity securities.

In 1993, the PSC issued an Order which addressed the accounting and ratemaking treatment of pension costs in accordance with SFAS No. 87, "Employers' Accounting for Pensions." Under the Order, LILCO was required to recognize any deferred net gains or losses over a ten-year period rather than using the corridor approach method. LILCO believed that this method of accounting for financial reporting purposes resulted in a better matching of revenues and LILCO's pension cost. LILCO deferred the differences between pension rate allowances and pension expense under the Order. In addition, the PSC required LILCO to measure and pay a carrying charge on amounts in excess of the pension rate allowance and the annual pension contributions contributed into the pension fund.

In addition, effective December 1, 1997, LILCO deferred the difference between the sum of gas pension and gas postretirement benefit costs other than pension and the amounts provided for in rates, to the extent that such differences were in excess of or below three percent of LILCO's pretax net income from gas operations. Such excess was transferred to a gas balancing account.

Supplemental Plan

The Supplemental Plan provided supplemental death and retirement benefits for officers and other key executives without contribution by those employees. The Supplemental Plan was a non-qualified plan under the Internal Revenue Code. For the year ended March 31, 1998, LILCO recorded a charge of approximately $31 million relating to certain benefits earned by its officers relating to the termination of their annuity benefits earned through the supplemental retirement plan and other executive retirement benefits. These charges, the cost of which were borne by LILCO's shareowners, resulted from provisions of the officers' employment contracts, including employment contract of LILCO's Chairman, and the pending transactions with LIPA and KeySpan which affected the timing of when these costs were recorded. The provision for plan benefits totaled approximately $200,000 for the period April 1, 1998 through May 28, 1998, $700,000 for the three months ended March 31, 1997 and $2.7 million for the year ended December 31, 1996.

Directors' Plan

The Directors' Plan provided benefits to directors who were not officers of LILCO. Directors who had served in the capacity for more than five years qualified as participants under the plan. The Directors' Plan was a non-qualified plan under the Internal Revenue Code. The provision for retirement benefits, which were unfunded, totaled approximately $245,000 for the period April 1, 1998 through May 28, 1998, $132,000 for the year ended March 31, 1998, $34,000 for the three months ended March 31, 1997 and $127,000 for the year ended December 31, 1996.

Postretirement Benefits Other Than Pensions

In addition to providing pension benefits, LILCO provided certain medical and life insurance benefits to retired employees. Substantially all of LILCO's employees became eligible for such benefits if they had reached retirement age after working for LILCO for a minimum of five years. These and similar benefits for active employees were provided by LILCO or by insurance companies whose premiums are based on the benefits paid during the year. Effective January 1, 1993, LILCO adopted the provisions of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which required LILCO to recognize the expected cost of providing postretirement benefits when employee services were rendered rather than when paid. As a result, LILCO, in 1993, recorded an accumulated postretirement benefit obligation and a corresponding regulatory asset of approximately $376 million.

The PSC required LILCO to defer as a regulatory asset the difference between postretirement benefit expense recorded for accounting purposes in accordance with SFAS No. 106 and the postretirement benefit expense reflected in rates. The ongoing annual postretirement benefit expense was phased into and fully reflected in rates which began December 1, 1996, with the accumulated regulatory asset to be recovered in rates over a 15-year period, beginning December 1, 1997. In addition, LILCO was required to recognize any deferred net gains or losses over a ten-year period.

In addition, effective December 1, 1997, LILCO deferred the difference between the sum of gas pension and gas postretirement benefit costs other than pension and the amounts provided for through rates, to the extent that such differences were in excess of or below three percent of LILCO's pretax net income from gas operations. Such excess was transferred to a gas balancing account.

In 1994, LILCO maintained Voluntary Employee's Beneficiary Association trusts for union and non-union employees for the funding of incremental costs collected in rates for postretirement benefits. LILCO funded the trusts with approximately $21 million for the year ended March 31, 1998, $5 million for the three months ended

March 31, 1997 and $18 million for the year ended December 31, 1996. In May 1998, LILCO contributed an additional $250 million into the trusts, representing obligations related to the electric business unit employees. LILCO secured a bridge loan to fund these trusts.

Accumulated postretirement benefit obligation other than pensions at March 31, 1998, and December 31, 1996 was as follows:

	March 31, 1998	December 31, 1996
	(In thousands of dollars)	
Retirees	$ 157,380	$ 156,181
Fully eligible plan participants	60,711	56,950
Other active plan participants	140,850	152,627
Accumulated postretirement benefit obligation	358,941	365,758
Plan assets	108,165	74,692
Accumulated postretirement benefit obligation in excess of plan assets	250,776	291,066
Unrecognized prior service costs	(175)	(188)
Unrecognized net gain	102,346	75,309
Accrued Postretirement Benefit Cost	$ 352,947	$ 366,187

At March 31, 1998, and December 31, 1996 the Plan assets, which were recorded at fair value, included cash and cash equivalents, fixed income investments and approximately $100,000 of listed equity securities of LILCO.

Periodic postretirement benefit cost other than pensions and the significant assumptions of LILCO consisted of the following:

	April 1, 1998 - May 28, 1998	Year Ended March 31, 1998	Three Months Ended March 31, 1997	Year Ended December 31, 1996
		(In thousands of dollars)		
Service cost - benefits earned during the period	$ 1,566	$ 12,204	$ 2,821	$ 10,690
Interest cost on projected benefits obligation and service cost	3,989	27,328	6,642	25,030
Actual return on plan assets	(1,900)	(6,632)	(591)	(3,046)
Net amortization and deferral	(1,843)	(10,000)	(3,446)	(12,175)
Net Periodic Pension Cost	$ 1,812	$ 22,900	$ 5,426	$ 20,499

	April 1, 1998 - May 28, 1998	March 31, 1998	March 31, 1997	December 31, 1996
Discount rate for obligation	7.00%	7.00%	7.00%	7.25%
Discount rate for expense	7.00%	7.00%	7.25%	7.25%
Rate of future compensation increases	4.50%	4.50%	5.00%	5.00%
Long-term rate of return on assets	8.50%	8.50%	7.50%	7.50%

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The actuarial assumptions used for postretirement benefit plans of LILCO were:

	April 1, 1998 - May 28, 1998	March 31, 1998	March 31, 1997	December 31, 1996
		(In millions of dollars)		
Health care cost trend	5.00%(a)	5.00%(a)	8.00%(b)	8.00%(b)
Effect of one percent increase in health care cost trend rate:				
On cost components	$ 1	$ 7	$ 1	$ 5
On accumulated benefit obligation	$ 43	$ 42	$ 59	$ 43

(a) Per year indefinitely
(b) Gradually declining to 6.0% in 2001 and thereafter.

Note 11. The Class Settlement

The Class Settlement, which became effective in June 1989, resolved a civil lawsuit against LILCO brought under the federal Racketeer Influenced and Corrupt Organizations Act. The lawsuit, which the Class Settlement resolved, had alleged that LILCO made inadequate disclosures before the PSC concerning the construction and completion of nuclear generating facilities.

The Class Settlement continues to provide the electric rate payers with rate reductions which will total $390 million over a ten-year period which began on June 1, 1990. As of December 31, 1998, the remaining rate reductions, which are being reflected as adjustments to customer's bills, total approximately $85 million and consists of approximately $25 million for the five-month period beginning January 1, 1999 and $60 million for the 12-month period beginning June 1, 1999. Such reductions to LIPA's customer's are reimbursed by KeySpan, in accordance with the Merger Agreement.

Note 12. The 1989 Settlement

In February 1989, LILCO and the State of New York entered into the 1989 Settlement resolving certain issues relating to LILCO and provided for the transfer of Shoreham to the Authority. The Settlement also included provisions for the decommissioning of Shoreham and the recovery by the Authority of the costs of decommissioning from LILCO, and in turn the recovery of those costs by LILCO from customers. In February 1992, LILCO transferred ownership of Shoreham to the Authority. In May 1995, the NRC terminated the Authority's possession-only license for Shoreham which signified the NRC's approval that decommissioning was complete and that the site was suitable for unrestricted use.

Upon the effectiveness of the 1989 Settlement, in June 1989, LILCO recorded the FRA on its Balance Sheet and the retirement of its investment of approximately $4.2 billion, principally in Shoreham.

Pursuant to the 1989 Settlement, LILCO was required to reimburse the Authority for all of its costs associated with the decommissioning of Shoreham. The PSC had determined that all costs associated with Shoreham which were prudently incurred by LILCO subsequent to the effectiveness of the 1989 Settlement were decommissioning costs. The RMA provided for the recovery of such costs through electric rates over the balance of a forty-year period ending 2029. At March 31, 1998, Shoreham post-settlement costs totaled approximately $1.2 billion, consisting of $587 million of property taxes and PILOTS, and $568 million of decommissioning costs, fuel disposal costs and all other costs incurred at Shoreham after June 30, 1989.

Note 13. Commitments and Contingencies

Legal Proceedings

Shoreham Tax Matters

Through November 1992, Suffolk County and the following Suffolk County political subdivisions (collectively, the "Suffolk Taxing Jurisdictions"), the Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and the Shoreham-Wading River Library District (which was succeeded by the North Shore Library District), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments, claiming the Shoreham plant was overassessed. To date, the Authority has made such payments, in whole or in part, pursuant to interim PILOT agreements and collected the costs thereof pursuant to the PILOTs rider which is part of LIPA's rates.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding $868 million, including interest as of the date of the judgement. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain of the Suffolk Taxing Jurisdictions sought to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

The Authority had proposed a settlement agreement with the Suffolk Taxing Jurisdictions and Nassau County. The proposed settlement agreement would, among other things, cause the Authority: (i) not to enforce the judgment in favor of LILCO; and (ii) not to make any claim for a refund of what the Authority believes is an overpayment of PILOT's, in exchange for the payment by the Suffolk Taxing Jurisdictions to the Authority of $625 million.

On February 1, 1999, a lawsuit was filed in the Supreme Court of the State of New York, Nassau County, by the Association for a Better Long Island against the Authority and LIPA. This lawsuit seeks: (i) to require the Authority to collect the full amount of the judgment obtained by the Authority in the Shoreham Property Tax Litigation as well as certain overpaid PILOTs; and (ii) to declare that the offer of the Authority to settle the Shoreham Property Tax Litigation is void and legally unenforceable. No assurance can be given as to the method, amount (if any) or timing of any recovery by the Authority related to the Shoreham Property Tax Litigation.

The proposed settlement agreement with the Suffolk Taxing Jurisdictions was not accepted and on March 1, 1999, the Authority withdrew its offer to settle the Shoreham Property Tax Litigation including claims related to the Authority's overpayment of PILOTs on the Shoreham plant for $625 million and indicated that any settlement would have to be at a higher amount. On that date, the Authority also demanded that the Suffolk Taxing Jurisdictions pay refunds of real estate taxes in the amount of approximately $784 million consisting of: (i) refunds and interest due as of the entry of the judgment on March 26, 1997, for the period from and after January 15, 1987, (the effective date of the LIPA Act), of approximately $675 million; and (ii) accrued post-judgment interest in the amount of approximately $109 million. Post-judgment interest will continue to accrue until the judgment is satisfied.

On September 15, 1998, Suffolk County filed an action against the Authority in the Supreme Court of the State of New York, Suffolk County seeking to enjoin the Authority from recovering tax refunds based upon the over-assessment of the Shoreham nuclear plant. The action claims that the Authority does not have the right to recover property taxes previously assessed against LILCO for tax years 1984-1985 through 1991-1992. On March 19, 1999, the Court ruled that the Authority was not entitled to collect any refund of property taxes assessed against the Shoreham plant. In addition, the court stated that the Authority has a duty to discontinue and abandon all proceedings which seek the repayment of all or part of the taxes assessed against the Shoreham plant. The Authority intends to appeal this decision. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's or LIPA's financial condition. Further, the court stated that under a ruling of the State Court of Appeals, the Authority is not prohibited from seeking refunds of PILOTs paid on over-assessments of the Shoreham plant.

The New York State Court of Appeals in a separate case has ruled that the Act does not prohibit the Authority from seeking refunds plus interest if it has overpaid PILOTs based on an over-assessment of Shoreham. The Authority has made PILOT payments of approximately $345 million which it believes were based on such an over-assessment. On February 24, 1999, the Authority filed an action against the Suffolk Taxing Jurisdictions in the Supreme Court of the State of New York, Nassau County seeking a judgment in an amount equal to the total amount of PILOTs overpaid by the Authority, plus interest.

On March 23, 1999, the Shoreham Wading River Central School District filed an action against the Authority in the Supreme Court of the State of New York, County of Nassau seeking an order directing the Authority to pay approximately $6.4 million of PILOTs which the plaintiff alleges are due and owing and approximately $24.6 million of PILOTs which the plaintiff alleges is the cumulative deficiency as of June 1, 1998. The Authority does not believe that an adverse decision in this litigation will have a material adverse effect on the Authority's or LIPA's financial condition.

Merger Matters

LIPA has been named as a nominal defendant in a derivative suit pending in the United States District Court for the Eastern District of New York entitled Sylvester v. Catacosinos, et al. A motion to dismiss on behalf of LIPA was filed on September 23, 1998 and argued on January 28, 1999. In addition, LIPA has been named as a defendant in an action brought by the County of Suffolk that is pending in New York State Supreme Court, Suffolk County, entitled County of Suffolk v. KeySpan et al. The response date has been postponed until such time as it is determined whether the action will be consolidated with a class action pending in New York State Supreme Court, Nassau County, entitled In re KeySpan Corporation Shareholder Litigation. Former officers and directors of LILCO also have been named as defendants in each of these actions.

The complaints in the foregoing actions allege in substance that certain former officers of LILCO received excessive compensation which totaled approximately $67 million in connection with the closing of the Brooklyn Union merger with LILCO and with the Authority's acquisition of the common stock of LILCO. The Sylvester lawsuit seeks damages of an unspecified amount. The complaint brought by the County of Suffolk seeks to make the defendants pay restitution, or damages, of $67 million.

Because the cases are in an early state, at which no discovery has yet taken place, LIPA cannot express an opinion as to the likelihood of any liability. LIPA has notified KeySpan of its entitlement to indemnification pursuant to an indemnification agreement dated June 26, 1997 for any losses LIPA suffers as a result of these lawsuits. LIPA expects that KeySpan will honor the request for indemnification. LIPA also understands that the Attorney General of the State of New York is investigating the actions and statements of certain former officers of LILCO in connection with such compensation.

On September 28, 1998, Suffolk County and the Towns of Huntington and Babylon (collectively, the "Plaintiffs") brought a class action on behalf of themselves and all electric utility ratepayers in Suffolk County (the "Ratepayers") against the Authority, LIPA, KeySpan and others in the United States District Court for the

Eastern District of New York entitled County of Suffolk et al. v. Long Island Power Authority, et al. (the "Huntington Lawsuit"). The Huntington Lawsuit alleges that (i) LIPA and the Authority failed to refund alleged capital gains directly to Ratepayers as a result of the Merger, unlawfully depriving Ratepayers of their property under federal and state constitutional provisions and (ii) LIPA failed to refund to Ratepayers certain deferred tax reserves carried on LILCO's books at the time of the Merger, unjustly enriching KeySpan.

Based on these allegations, Plaintiffs are seeking judgments, among other things: (i) awarding damages against KeySpan and LIPA for impairment of contract, breach of contract and conversion; and (ii) declaring that KeySpan holds the proceeds of the Merger attributable to the capital gains and the deferred tax reserve in trust for the benefit of the Ratepayers and ordering KeySpan to make a full accounting of such proceeds. LIPA believes that, although the recovery sought by Plaintiffs could be material in amount, any such recovery would not have a material financial impact on LIPA or its customers.

In an action commenced on May 26, 1998 (*Schulz et al. v. New York State Public Authorities Control Board et al.,* United States District Court, Northern District of New York), plaintiff's complaint, in several claims for relief, sought a judgment declaring, inter alia, the resolution of the PACB authorizing the Authority to issue bonds to be null and void on State and federal constitutional grounds and sought a temporary restraining order or preliminary injunction prohibiting and enjoining the issuance of bonds. On May 27, 1998, the District Court denied the plaintiff's request for a temporary restraining order or preliminary injunction and dismissed the plaintiff's action on the ground that the plaintiffs lack standing to assert the claims pleaded in the complaint. On February 8, 1999, the United States Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the plaintiff's action.

On May 27, 1998, the Initiative for Competitive Energy (the "ICE") filed an action in the Supreme Court of the State of New York, County of Suffolk, against the Authority seeking, *inter alia,* an injunction enjoining the Authority from selling bonds "whose purpose is to finance the proposed Shoreham Property Tax Settlement, the Shoreham Rebates, Credits and Suffolk Surcharge." The action further requested a judgment declaring invalid and directing the rescission of the sale of such bonds. By decision dated October 7, 1998, the Supreme Court dismissed the complaint and ruled in favor of the Authority on all issues. On October 28, 1998, the ICE filed a notice of appeal.

In May 1995, eight participants of LILCO's Retirement Income Plan ("RIP") filed a lawsuit against LILCO, the RIP and Robert X. Kelleher, the Plan Administrator, in the United States District Court for the Eastern District of New York. In January 1996, the Court ordered that this action be maintained as a class action. This proceeding arose in connection with the plaintiff's withdrawal, approximately 25 years ago, of contributions made to the RIP, thereby resulting in a reduction of their pension benefits. On January 7, 1999, a settlement agreement was filed with the Court providing for the payment of $7.75 million to the plaintiffs. The Authority would be responsible for approximately $5.4 million. The settlement is subject to judicial review. Amended settlement papers were filed on February 22, 1999 and a hearing date is scheduled for July 27, 1999.

In December 1997, Suffolk County brought a suit against the Authority and others in the Supreme Court of the State of New York seeking a judgment, among other things: (i) annulling and vacating the acceptance by the Authority of certain conditions contained in the July 1997 PACB resolution approving the Authority's acquisition of LILCO and related transactions; (ii) declaring that all or any actions taken by the Authority to implement or carry out the PACB conditions are null and void; and (iii) directing that the Authority take no further action to acquire the stock or assets of LILCO unless and until such acquisition has been approved by the PACB in the manner approved by law. A decision was rendered in March 1998 which held for the Authority on all substantive issues. Suffolk County filed a notice of appeal to the Appellate Division of the State of New York.

LIPA is involved in various legal proceedings which are routine litigation matters incidental to the conduct of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material adverse effect on the financial position, results of operations or cash flows of LIPA.

Environmental

In connection with the Merger, KeySpan and LIPA entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and LIPA on the basis of whether they relate to assets transferred to KeySpan or retained by LIPA as part of the Merger. In addition, to clarify and supplement these agreements, KeySpan and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan after the Merger (the "Transferred Business").

KeySpan is responsible for all liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those currently or formerly operated by KeySpan or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, KeySpan is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business may be recoverable by KeySpan as part of the capacity charge under the PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities that exist as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan.

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection ("DEP") and the DEC separately have issued Administrative Consent Orders ("ACOs") in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound. The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA is working cooperatively with the Suffolk County Department of Health, the DEC and Novartis to conduct studies and monitoring activities in connection with the presence of this herbicide. The liability, if any, resulting from the use of this herbicide cannot yet be determined. However, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

Superfund Sites

Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA", also commonly referred to as the "Superfund Legislation"), parties who generated or arranged for disposal of hazardous substances are liable for costs incurred by the EPA in responding to a release or threat of release of the hazardous substances.

Metal Bank. In December 1997, the EPA issued its Record of Decision ("ROD"), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is $17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 PRPs, including LIPA, for the remedial design and for remedial action at the site. LIPA can not predict with reasonable certainty the actual cost of the selected remedy, who will implement the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability of $1.6 million representing its estimated share of the additional cost to remediate this site.

PCB Treatment Inc. LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing PCBs. According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and have developed a work plan for investigating environmental conditions at the site. The EPA provided LILCO with documents indicating that LILCO was responsible for less than 1% of the materials that were shipped to this site. LIPA is currently unable to determine its share of the cost to remediate these sites.

Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA

Asharoken. In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company). The Village is seeking monetary damages and injunctive relief based upon theories of negligence, gross negligence and nuisance in connection with the LILCO design and construction of the Northport Power Plant which the Village alleges upset the littoral drift, thereby causing beach erosion. In November 1996, the court decided LILCO's motion to dismiss the lawsuit, dismissing two of the three causes of action. The court limited monetary damages on the surviving continuous nuisance claim to three years prior to the commencement of the action. The liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility

Other Superfund Sites. In connection with a lawsuit filed against LILCO and nine other PRPs by the Town of Oyster Bay for indemnification for remediation and investigation costs for a federal Superfund site in Syosset, New York, a settlement agreement has been reached and is subject to court approval. If approved, the settlement would not have a material adverse effect on LIPA's financial position, cash flows or results of operations. In addition, LILCO was notified by the Attorney General of the State of New York that it may be responsible for the disposal of wastes and/or for the generation of hazardous substances that may have been disposed of at the Blydenburgh Superfund site. LILCO conducted a search of its corporate records and did not locate any documents concerning waste disposal practices associated with this landfill. Based on current information, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The DEC investigation is in its preliminary stages, and LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site.

Other Matters

As a result of the Merger, LIPA has assumed contracts with numerous Independent Power Producers ("IPPs") and the New York Power Authority ("NYPA") for electric generating capacity. Under the terms of the agreement with NYPA, which will expire in May 2014, LIPA may purchase up to 100% of the electric energy produced at the NYPA facility located within LIPA's service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed non-energy payments associated with operating and maintaining the plant.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs it they fail to deliver energy. For purposes of the table below, LIPA has assumed full performance by the IPPs, as no event has occurred to suggest anything less than full performance by these parties.

LIPA has also assumed a contract with NYPA for firm transmission ("wheeling") capacity in connection with a transmission cable which was constructed, in part, for the benefit of LIPA. In accordance with the provisions of this agreement, which expires in 2020, LIPA is required to reimburse NYPA for debt service payments and the cost of operating and maintaining the cables. The cost of such contracts is included in electric fuel expense and is recoverable through rates.

The following table represents LIPA's commitments under purchased power contracts:

	NYPA Holtsville					
	Debt Service	Other Fixed Charges	Energy*	Firm Transmission	IPPs*	Total Business*
			(in millions of dollars)			
For the years ended						
1999	$21.7	$14.0	$ 8.7	$ 26.3	$ 126.6	$ 197.3
2000	21.8	14.4	8.7	26.0	132.5	203.4
2001	21.9	14.8	8.6	28.3	135.5	209.1
2002	22.0	15.2	8.8	28.4	139.3	213.7
2003	22.0	15.5	9.1	28.5	142.6	217.7
Subsequent thereto	215.9	185.2	105.3	514.0	991.1	2,011.5
Total	325.3	259.1	149.2	651.5	1,667.6	3,052.7
Less: Imputed Interest	142.9	121.8	69.5	368.9	683.5	1,386.6
	$182.4	$137.3	$79.7	$282.6	$ 984.1	$1,666.1

* Assumes full performance by the IPPs and NYPA.

Note 14. Related Party Transactions

LIPA, as owner of the transmission and distribution system and as party to the Operating Agreements, conducts the electric business in the Service Area. The Authority is responsible, however, for administering, monitoring and managing the performance by all parties to the Operating Agreements.

The Authority and LIPA are also parties to an Administrative Services Agreement which describes the terms and conditions under which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area.

As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above. For the period May 29, 1998 to December 31, 1998, management fees charged by the Authority amounted to approximately $10.5 million.

Note 15. Subsequent Events

On January 4, 1999, LIPA redeemed $102.6 million of the NYSERDA Electric Facilities Revenue Bonds Series 1982, 1993A, 1993B and 1995A, which were called for redemption prior to December 31, 1998.

Long Island Lighting Company d/b/a LIPA
(a wholly-owned subsidiary of the Long Island Power Authority)

Notes to Financial Statements—(continued)

On March 1, 1999, the variable rate bonds listed below were converted to fixed interest rates of 5.15% on the PCRBs and 5.3% on the EFRBs.

	Maturity	Interest Rate	Balance at December 31, 1998 (In thousands)
PCRBs			
1985 Series A	March 1, 2016	Variable	$58,020
1985 Series B	March 1, 2016	Variable	$50,000
EFRBs			
1993 Series B	November 1, 2023	Variable	$29,600
1994 Series A	October 1, 2024	Variable	$ 2,600
1995 Series A	August 1, 2025	Variable	$15,200

Also, on March 1, 1999, LIPA redeemed $30.1 million of the NYSERDA Pollution Control Revenue Bonds, 1985 Series A.

Note 16. Quarterly Financial Information (Unaudited)

Summarized quarterly financial data for 1998, 1997 and 1996 is as follows:

(in thousands)

3 Months Ended	6/30/98	9/30/98	12/31/99
Operating revenues	$532,750	$693,698	$ 459,155
Operating income (loss)	238,426	196,046	(125,427)
Net income (loss)	21,112	103,982	(206,472)
Earnings (loss) for common stock	13,075	103,982	(206,472)

3 Months Ended	3/31/97	6/30/97	9/30/97	12/31/97	3/31/98
Operating revenues	$557,791	$560,086	$790,331	$ 572,335	$ 555,683
Operating income	128,293	136,498	244,039	135,967	156,126
Net income	87,697	45,161	144,384	56,756	115,939
Earnings for common stock	74,728	32,193	131,435	43,807	102,992
Basic and diluted earnings per common share	.62	.26	1.09	.36	.85

3 Months Ended	3/31/96	6/30/96	9/30/96	12/31/96
Operating revenues	$559,268	$576,963	$780,158	$ 550,046
Operating income	132,486	132,192	238,175	139,052
Net income	81,753	40,524	130,023	64,164
Earnings for common stock	68,682	27,453	116,972	51,141
Basic and diluted earnings per common share	.57	.23	.97	.43

Long Island Lighting Company d/b/a LIPA
(a wholly-owned subsidiary of the Long Island Power Authority)

Notes to Financial Statements—(continued)

Note 17. Change in Fiscal Year End

Effective December 22, 1998, LIPA changed its fiscal year end from March 31 to December 31. The unaudited financial information of LILCO, restated for discontinued operations, for the nine months ended December 31, 1997 is as follows:

(thousands of dollars - except per share information)	Nine Months Ended December 31, 1997 (unaudited)
Revenues	$ 1,922,752
Operating income	$ 1,406,248
Income taxes	$ 158,451
Income from continuing operations	$ 206,897
Income from discontinued operations, net of taxes of $3,297	39,404
Net income	246,301
Preferred stock dividend requirements	38,865
Earnings for common stock	$ 207,436
Basic and diluted earnings per common share from continuing operations	$ 1.38
Basic and diluted earnings per common share from discontinued operations	.33
Basic and diluted earnings per common share	$ 1.71

Long Island Lighting Company d/b/a LIPA
(a wholly-owned subsidiary of the Long Island Power Authority)

Supplementary Information
Impact of Year 2000

General. A portion of the computer hardware and software and embedded technology (such as microcontrollers and microprocessors contained in equipment and machinery) used by the Authority and LIPA, as well as KeySpan and the subsidiaries of KeySpan that are parties to the MSA, EMA and PSA and others with whom the foregoing have business arrangements, was not designed to recognize calendar years after 1999 (the "Year 2000 Issue").

The Authority recently purchased new computer software to support certain activities of LIPA and believes that these systems are Year 2000 ready. Management also believes that, based on available information, it will be able to manage its Year 2000 transition for systems and infrastructure, without any material adverse effect on its business operations or financial prospects. However, there can be no assurance that failure to resolve any issue relating to such transition would not have a material adverse effect on LIPA. LIPA has had continuing discussions with KeySpan, their largest vendor, who is responsible for the management and operation of LIPA's transmission and distribution system, and KeySpan indicates that they have evaluated the extent to which modifications to computer software, hardware and databases will be necessary to accommodate the year 2000.

KeySpan's computer applications are generally based on two digits and do require additional programming to recognize the new millennium. A corporate-wide program has been established by KeySpan and its subsidiaries. The program includes both information technology ("IT") and non-IT systems. The critical non-IT systems are generally in the areas of electric production, distribution, transmission, gas distribution and communications. The readiness of suppliers and vendor systems is also under review. The project is under the direction of KeySpan's Year 2000 Program Office, chaired by the Vice President, Technology Operations and Corporate Y2K Officer. Each of KeySpan's critical business processes is being reviewed to: identify and inventory sub-components; assess for Year 2000 compliance; establish repair plans as necessary; and test in a Year 2000 environment. The inventory phase for the IT systems and non-IT systems is 100% complete. The assessment phase is 100% complete for the IT systems, and over 90% complete for non-IT systems. The assessment phase is expected to be complete by July 1, 1999.

KeySpan's hardware, software and embedded systems are being tested and certified to be Year 2000 compliant. Repair and testing to sustain operability is now 73% complete for the IT systems and approximately 75% for the non-IT systems. Components needed to support the critical business process and associated business contingency plans are expected to be ready for the year 2000 by July 1, 1999.

KeySpan's vendors and business partners needed to support the critical business processes of KeySpan are also being reviewed for their year 2000 compliance. At this time, none of these vendors have indicated to Key Span that they will be materially affected by the year 2000 problem.

Key-Span has analyzed each of the critical business processes to identify possible Year 2000 risks. Each of KeySpan's critical businesses will be certified by the responsible KeySpan officer as being Year 2000 ready. However, the most reasonable likely worst case scenarios are also being identified. Business operating procedures at KeySpan will be reviewed to ensure that risks are minimized when entering the Year 2000 and other high risk dates. KeySpan is developing contingency plans to address possible failure points in each critical business process.

While KeySpan must plan for the following worst case scenarios, management believes that these events are improbable.

Loss of generating flexibility:

KeySpan's generation subsidiary receives gas delivery from multiple national and international pipelines and, therefore the effects of a loss in any one pipeline can be mitigated through the use of other pipelines. Complete loss of all the supply lines is not considered a reasonable scenario. Nevertheless, the impact of the loss of any one pipeline is dependent on temperature and vaporization rate. The partial loss of gas supply will not affect KeySpan's ability to supply electricity since many of the plants have the ability to operate on oil.

Loss of electric grid inter-connections/KeySpan operated electric distribution facilities:

Electric utilities are physically connected on a regional basis to manage electric load. This is often referred to as the regional grid. Presently, KeySpan is working with other regional utilities to develop a coordinated operating plan. Should there be an instability in the grid, KeySpan has the ability to remove LIPA's operations from the grid, and operate independently.

Certain electric system components such as individual generating units, transmission and distribution system facilities, and the electric energy management system have the potential to malfunction due to Year 2000 problems. KeySpan has inventoried electric system components and developed a plan to certify mission critical processes as Year 2000 compliant. Contingency plans are being developed, where appropriate, for loss of critical system elements. KeySpan presently estimates that contingency plans regarding its electric facilities should be completed by July 1999.

Loss of telecommunications:

KeySpan has a substantial dependency on many telecommunication systems and services for both internal and external communications. External communications with the public and the ability of customers to contact KeySpan in cases of emergency response is essential. KeySpan intends to coordinate its emergency response efforts with the offices of emergency management of the various local governments within its service territory. Internally, there are a number of critical processes in both the gas and electric operating areas that rely on external communication providers. Contingency plans will address methods for manually monitoring these functions. These contingency plans, KeySpan presently estimates, should be finalized by July 1999.

In addition to the above, KeySpan is also planning for the following scenarios: short-term reduction in system power generating capability; limitation of fuel oil operation; reduction in quality of power output; loss of automated meter reading; loss of ability to read, bill and collect; and loss of the purchasing/ materials management system.

KeySpan believes that, with modifications to existing software and conversions to new hardware and software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed on time, and contingency plans fail the Year 2000 issue could have a material adverse impact on the operations of LIPA.

LIPA's Contingency Plans

In order to insure that the Year 2000 will have a minimal impact on the operations of LIPA, LIPA is closely monitoring the initiatives and progress of KeySpan's Year 2000 Program Office. In addition, LIPA is working with various other governmental agencies to insure communication between LIPA and such other governmental entities is uninterrupted.

Item 9. Changes in and Disagreements with Accounting and Financial Disclosure

The information regarding change in accountants required under this Item 9 was previously reported by LIPA on Form 8-K filed on June 23, 1998.

PART III.

Item 10. Directors and Executive Officers of LIPA

The following table sets forth the directors and executive officers of LIPA, their ages and the positions held by them with LIPA as of December 31, 1998.

Name	Age	Position
Richard M. Kessel	48	Chairman, President and Chief Executive Officer
Seth D. Hulkower	40	Chief Operating Officer
David P. Warren	44	Chief Financial Officer
Stanley B. Klimberg	53	General Counsel and Secretary
Edward P. Murphy, Jr.	55	Vice President and Controller
Richard J. Bolbrock	52	Vice President - Power Markets
Bert J. Cunningham	51	Vice President of Communications
Patrick J. Foye	41	Director
Michael Affrunti	74	Director
Harvey Auerbach	71	Director
Thomas A. Doherty	61	Director
Michael L. Faltischek	51	Director
Harriet A. Gilliam	44	Director
Rupert H. Hopkins	47	Director
Joseph F. Janoski	57	Director
Nancy N. Miklos	48	Director
Vincent Polimeni	55	Director
Jonathan Sinnreich	52	Director

Richard M. Kessel has been Chairman, President and Chief Executive Officer of LIPA since May 1998. Mr. Kessel has been Chairman, President and Chief Executive Officer of the Authority since April 1997 and a Trustee of the Authority since 1987. Mr. Kessel was appointed as Executive Director and Chairman of New York State's Consumer Protection Board in January 1984 and served until January 1995. Mr. Kessel served as an ex-officio member of Governor Cuomo's Advisory Commission on Liability Insurance. Since 1981, Mr. Kessel has been a member of the Board of Trustees of Nassau Community College. Mr. Kessel is a graduate of New York University. He received his Masters in Political Science from Columbia University.

Patrick Foye has been a director of LIPA since May 1998 and a Trustee of the Authority since June 1995. Mr. Foye's current term expired August 31, 1998. Pursuant to the Act, Mr. Foye continues to serve until his successor is appointed. Mr. Foye has been Executive Vice President of Apartment Investment and Management Company, a real estate investment trust and the nation's largest owner and manager of multifamily apartment properties since June 1998. He was partner from April 1989 to June 1998 in the law firm of Skadden, Arps, Slate, Meagher & Flom LLP. Since October 1998, Mr. Foye has been a trustee of Insignia Property Trust, a real estate investment trust. Mr. Foye is also a director of and executive vice president of the general partners of a number of partnerships. Mr. Foye is a member of Governor Pataki's New York State Privatization Research Council. Mr. Foye is a graduate of Fordham College and Fordham Law School.

Seth D. Hulkower has been Chief Operating Officer of LIPA and the Authority since January 1999. Mr. Hulkower was Executive Director of LIPA from May 1998 to January 1999 and Executive Director of the Authority from July 1996 to January 1999. From December 1994 to June 1996, Mr. Hulkower was a Vice President of Merrill International Ltd., an energy project development and consulting company. From May 1992 to November 1994, Mr. Hulkower was a Vice President of JFG Associates, Inc., a financial advisory and management consulting firm. He has also held positions with the consulting firm of Putnam, Hayes, & Bartlett, Inc., New England Power Company and Stone & Webster Engineering Company, Mr. Hulkower received his S.M.

in Technology and Policy from the Massachusetts Institute of Technology and his B.S. in Mechanical Engineering and B.A. in Economics from Tufts University.

David P. Warren has been Chief Financial Officer of LIPA since May 1998 and Chief Financial Officer of the Authority since January 1998. From 1995 to 1998, Mr. Warren was Deputy Treasurer of the State of Connecticut where he administered the State's public finance program. Before entering the public sector, Mr. Warren was a vice president in public finance at CS First Boston. Mr. Warren holds an M.B.A. from the Yale School of Management and a B.A. from Wesleyan University.

Stanley B. Klimberg has been General Counsel of LIPA since May 1998 and General Counsel of the Authority since September 1995. Mr. Klimberg joined the Authority in March 1987 as General Counsel and Acting Executive Director and has served in various capacities with the Authority. Before joining the Authority, Mr. Klimberg was General Counsel of the New York State Energy Office from 1979 to 1987, and before that he was Assistant General Counsel and Staff Counsel of the New York State Public Service Commission. Mr. Klimberg received his J.D. from the New York University School of Law and his B.A. in History with high honors from Lehigh University.

Edward P. Murphy, Jr. has been Vice President and Controller of LIPA since May 1998 and Vice President and Controller of the Authority since April 1998. Prior to his employment at LIPA, Mr. Murphy held several management positions at Brooklyn Union Gas Company. From 1995 to 1997, he was Vice President for Business Transformation. Mr. Murphy was Vice President for Public Affairs from 1988 to 1994. From 1982 to 1987, he served as General Auditor and was Budget Director from 1976 to 1982. Prior to this, Mr. Murphy held various positions in operations and accounting at Brooklyn Union. Mr. Murphy received his B.S. in Accounting from Clarkson University and attended the Executive Program in Business Administration at Columbia University.

Richard J. Bolbrock has been Vice President - Power Markets of LIPA and the Authority since May 1998. From 1974 to 1997, Mr. Bolbrock held several positions at New England Power Pool including Director-Planning and Information Technology for ISO New England, Inc., Director of New England Power Planning from 1983 to 1997, and Manager of Billing for the New England Power Exchange from 1979 to 1983. Prior to this, Mr. Bolbrock held various positions at Northeast Utilities and American Electric Power. Mr. Bolbrock received his B. S. in Electrical Engineering and his M.E. in Electric Power Engineering from Rensselaer Polytechnic Institute and is a Registered Professional Engineer.

Bert J. Cunningham has been Vice President of Communications of LIPA and the Authority since September 1998. From October 1992 to September 1998, Mr. Cunningham was President /Chief Operating Officer of The Blankman Cunningham Group, LLC (formerly Howard Blankman Incorporated), a regional public relations and marketing communications firm. From September 1990 to October 1992, he served as Chief of Staff and Executive Director of Government and Community Affairs of The Long Island Rail Road, an operating agency of the Metropolitan Transportation Authority. Mr. Cunningham has also served as Chief of Staff to the Supervisor of the Town of North Hempstead in Nassau County, and Director of Public Affairs for both the New York State Senate Standing Committee on Transportation and the New York State Legislative Commission on Critical Transportation Choices. Mr. Cunningham holds a B.F.A. in Communications from the New York Institute of Technology.

Michael Affrunti has been a Director of LIPA since May 1998, and a Trustee of the Authority since August 1995. Mr. Affrunti is founder of Albertson Electric and has been President since 1957.

Harvey Auerbach has been a director of LIPA since May 1998 and a Trustee of the Authority since 1997. From January 1994 to January 1999, Mr. Auerbach was President of Brookwood Communities Inc., a residential and commercial construction management company. Mr. Auerbach currently serves as a director of the Long Island Commercial Bank and is Trustee and Acting Vice Chair of the City University of New York. Mr. Auerbach graduated from the University of North Carolina and attended New York University Law School.

Thomas A. Doherty has been a director of LIPA since May 1998 and a Trustee of the Authority since September 1995. Since March 1995, Mr. Doherty has been the Chief Administrative Officer of First Quality Enterprises, Inc. Mr. Doherty served as Chairman, President and Chief Executive Officer of Fleet Bank from 1987 through 1995. Mr. Doherty graduated from Fordham University and attended New York University's Graduate School of Business.

Michael L. Faltischek has been a director of LIPA since May 1998 and a Trustee of the Authority since September 1995. Mr. Faltischek has been a partner in the law firm of Ruskin, Moscou, Evans & Faltischek, P.C. since May 1973. Mr. Faltischek graduated from Pace University and Brooklyn Law School.

Harriet A. Gilliam has been a director of LIPA since May 1998 and a Trustee of the Authority since February 1997. Ms. Gilliam has been an attorney in private practice for the past eight years. Ms. Gilliam served as a Councilwoman in the town of Riverhead, New York and a member of the Riverhead Community Development Agency from 1992 to 1995. Ms. Gilliam graduated from Holy Cross College and the University of Pennsylvania Law School.

Rupert H. Hopkins has been a director of LIPA since May 1998 and a Trustee of the Authority since February 1997. Since July 1998, Mr. Hopkins has been President of XSB, Inc., a software research and development company. Mr. Hopkins was the Department Manager for the Center for Agile Sources of Parts at Dayton T. Brown, Inc. from January 1994 to July 1998.

Joseph F. Janoski has been a director of LIPA since May 1998 and a Trustee of the Authority since September 1995. Since 1968, Mr. Janoski has been a teacher in the Middle Country School District in Centereach, New York. From January 1980 to January 1995, Mr. Janoski served as Riverhead Town Supervisor. Mr. Janoski graduated from Wilkes College and received a Master of Education from the University of Pennsylvania.

Nancy N. Miklos has been a director of LIPA since May 1998 and a Trustee of the Authority since April 1998. Since 1994, Ms. Miklos has been a Deputy County Attorney in the Civil Rights and Torts Litigation Bureau of the Nassau County Attorney's Office.

Vincent Polimeni has been a director of LIPA since May 1998 and a Trustee of the Authority since November 1997. Mr. Polimeni is the founder of Polimeni Enterprises, Inc., a real estate firm and other affiliated entities, and has been Chief Executive Officer since September 1983. Mr. Polimeni serves on the Advisory Board for the Hofstra University School of Business.

Jonathan Sinnreich has been director of LIPA since May 1998 and a Trustee of the Authority since September 1995. Mr. Sinnreich has been a partner in the law firm of Sinnreich, Wasserman & Grubin LLP since 1982.

Item 11. *Executive Compensation*

The following table sets forth the total compensation paid or accrued for the nine month period ended December 31, 1998, the fiscal year ended March 31, 1998 and the fiscal year ended December 31, 1996, for LIPA's Chief Executive Officer, LILCO's former Chief Executive Officer and two of its former executive officers, whose salary and bonus for such periods were in excess of $100,000.

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation: Salary ($)(1)	Annual Compensation: Bonus ($)	Long-Term Compensation Payouts: LTIP Payouts ($)	All other Compensation ($)
Richard M. Kessel (2)	1998	54,154	0	0	0
President and Chief Executive Officer	1997/1998	0	0	0	0
	1996	0	0	0	0
William J. Catacosinos (3)	1998	233,333	964,870(4)	1,506,732(5)	39,903,415(6)
Chief Executive Officer	1997/1998	673,333	1,202,972(7)	742,500(8)	23,241(9)
	1996	580,413	153,203(7)	0	18,653(9)
James T. Flynn (3)	1998	247,500	109,354	371,803(10)	1,015,385(11)
Chief Operating Officer and President	1997/1998	310,000	408,956(7)	294,362(8)	8,300(9)
	1996	263,364	90,554(7)	0	5,800(9)
Michael E. Bray (3)	1998	196,875	102,756	166,593(10)	809,712(12)
Senior Vice President - Electric Business Unit	1997/1998	254,334	62,500(7)	0	738(9)
	1996	0	0	0	0

(1) In March 1997, the Board of Directors of LILCO voted to change LILCO's fiscal year end from December 31 to March 31 effective with the three month period ended March 31, 1997. During this period, Mr. Catacosinos and Mr. Flynn received salary payments of $133,234 and $75,000, respectively.

(2) Compensation for Mr. Kessel consists of amounts paid after May 28, 1998, the date of the Merger. Mr. Kessel does not participate in any bonus or other compensation plan.

(3) During 1998, Messrs. Catacosinos, Flynn and Bray left the employ of LILCO.

(4) Consists of (i) cash awards paid under the LILCO Annual Stock Incentive Plan for 1998 in the amount of $218,750, (ii) the dollar value of LILCO Common Stock awards received in connection with the Merger in the amount of $196,567 or 4,361 shares, (iii) the dollar value of LILCO Common Stock awards under the LILCO Annual Stock Incentive Plan for 1997 in the amount of $381,490 or 8,501 shares and (iv) the dollar value of LILCO Common Stock awards received in connection with the LIPA and KeySpan transactions in the amount of $168,063 or 3,727 shares.

(5) Consists of (i) cash awards paid under the LILCO1997/1999 Long Term Incentive Plan in the amount of $743,750 and (ii) the dollar value of LILCO Common Stock awards under the LILCO 1996/1997 Long Term Incentive Plan in the amount of $762,982 or 16,870 shares.

(6) Consists of (i) a severance payment of $2,100,000, (ii) a vacation payment of $50,221, (iii) a retirement payment of $34,284,986, (iv) a consulting contract payment of $2,660,000 and (v) deferred compensation of $808,208.

(7) Represents (i) the dollar value of LILCO Common Stock awards under the Annual Stock Incentive Plan for plan years 1996 (other than for Mr. Bray) and 1997, including applicable tax withholdings and (ii) awards in connection with the LIPA and KeySpan transactions (other than for Mr. Bray). The net amount of the awards in 1996 and 1997 were primarily paid in shares of LILCO Common Stock as follows: Mr.Catacosinos- 27,081 shares, Mr. Flynn - 8,976 shares and Mr. Bray - 1,406 shares.

(8) Represents (i) the dollar value of LILCO Common Stock awards under the Long Term Incentive Plan for plan years 1996-1997, including applicable tax withholdings. The net amount of the awards were paid in shares of LILCO Common Stock as follows: Mr.Catacosinos - 16,703 shares and Mr. Flynn - 6,621 shares.

(9) Includes the cost of life insurance paid by LILCO.

(10) Consists of cash awards paid under the LILCO 1997/1999 Long Term Incentive Plan.

(11) Consists of (i) a severance payment of $990,000 and (ii) a vacation payment of $25,385.

(12) Consists of (i) a severance payment of $787,500 and (ii) a vacation payment of $22,212.

Item 12. *Security Ownership of Certain Beneficial Owners and Management*

The Authority owns 100% of the outstanding Common Stock of LIPA.

Item 13. *Certain Relationships and Related Transactions*

On May 1, 1998, the Authority and LIPA entered into a financing agreement (the "Financing Agreement") providing for their respective duties and obligations relating to the financing and operation of the retail electric business in the Service Area. Pursuant to the Financing Agreement, the Authority has issued and will issue, among other things, all required debt necessary to fund the LIPA/LILCO Merger, the debt necessary to finance the LIPA tender offer for the Debentures and any debt necessary to fund improvements to the system. The proceeds of such debt is treated as being loaned to LIPA (the "LIPA Loan") which will repay such loans from the cash that the Authority receives from its electric business. To secure the loans, LIPA has pledged its revenues to the Authority which has, in turn, pledged such revenues as security for such debt. At December 31, 1998, $5.4 billion was outstanding under the LIPA Loan. See Note 7 to Notes to Financial Statements.

In addition to the LIPA Loan, LIPA's operating expenditures are paid for by the Authority and LIPA records the amounts paid as a payable to the Authority (this is necessary since the Authority collects all customer payments). At December 31, 1998, the amount due to the Authority totaled approximately $856 million.

On May 1, 1998, the Authority and LIPA entered into an administrative services agreement (the "Administrative Services Agreement"). The term of the Administrative Services Agreement commenced on May 1, 1998 and continues to December 31, 2038. Thereafter, the agreement shall be renewed for successive periods of 3 years upon mutual agreement of the parties. Pursuant to the Administrative Services Agreement, the Authority provides personnel and personnel services (including management, supervisory, payroll and otherwise) necessary for LIPA to conduct its business. In addition, the Authority furnishes, or coordinates with LIPA's agents, attorneys and consultants to provide, such other services as LIPA may from time to time request.

All services rendered under the Administrative Services Agreement will be at the actual cost thereof, including a reasonable charge for general and administrative expense. See Note 14 to the Notes to the Financial Statements.

Immediately prior to the Merger, LILCO made payments of severance, change of control and other employee benefits to William J. Catacosinos, the former Chief Executive Officer of LILCO, Joseph W. McDonnell, the former Vice President of Communications of LILCO, Leonard P. Novello, the former Senior Vice President and General Counsel of LILCO and twenty-two other former LILCO executives totaling approximately $67 million which were not disclosed to the Authority at such time.

The Authority considered these payments to be in violation of the merger agreement and related documents, including the MSA and EMA. On June 16, 1998, the Authority approved a resolution which, among other things, instructed the Authority and LIPA to (i) withhold and place in escrow present and future management fees owed to KeySpan and (ii) withhold their consent to the appointment of William J. Catacosinos, Joseph W. McDonnell and Leonard P. Novello to senior executive positions at KeySpan.

On December 15, 1998, the Authority and LIPA, KeySpan and the PSC entered into an agreement by which KeySpan represented and warranted (i) that Mr. Catacosinos tendered his retirement and resignation as Chief Executive Officer and Chairman of the Board of KeySpan effective July 31, 1998; and (ii) that the 24 LILCO executives (other than Catacosinos) who received payments have either been terminated, retired, resigned or been retained as officers on condition that all previously paid severance payments be repaid to KeySpan. In addition, KeySpan agreed to pay to LIPA its cost of providing postage-paid bill return envelopes to its customers for the next three years which cost is expected to be $5.4 million. In return, the Authority and LIPA agreed to release and pay to KeySpan the monies related to the management fees held in escrow by LIPA.

PART IV.

Item 14. *Exhibits, Financial Statement Schedules and Reports on Form 8-K.*

(a) The following documents are included as part of this report:

(3) Exhibits:

3.1 Restated Certificate of Incorporation of LILCO.*

3.2 Form of New By-Laws of LILCO.*

3.3 Certificate of Assumed Name Designating LIPA as the assumed name of LILCO dated June, 1998.*

4.1 Financing Agreement Note dated as of May 28, 1998.**

10.1 Management Services Agreement dated as of June 26, 1997 between LILCO and the Authority.*

10.2 Power Supply Agreement dated as of June 26, 1997 between LILCO and the Authority.*

10.3 Energy Management Agreement dated as of June 26, 1997 between LILCO and the Authority.*

10.4 Generation Purchase Rights Agreement dated June 26, 1997 between LILCO and the Authority with counterpart executed by MarketSpan Generation LLC as of May 28, 1998.*

10.5 Guaranty Agreement dated May 28, 1998 by MarketSpan Corporation (F/K/A BL Holding Crop.); agreed to and accepted by the Authority.*

10.6 Liabilities Undertaking and Indemnification Agreement dated as of June 26, 1997 by LILCO and MarketSpan Electric Services LLC, MarketSpan Generation LLC, MarketSpan Trading Services LLC, MarketSpan Utility Services LLC, MarketSpan Gas Corporation (d/b/a Brooklyn Union), MarketSpan Corporate Services and MarketSpan Finance Corporation.*

10.7 Liabilities Undertaking and Indemnification Agreement dated as of June 26, 1997 by the Authority and LILCO.*

10.8 Energy Management Agreement - Assignment and Assumption Agreement dated as of May 28, 1998 by and between LILCO, MarketSpan Trading Services LLC and MarketSpan Corporation (F/K/A BL Holding Corp.); acknowledged and agreed to by the Authority and LIPA Acquisition Corp.*

10.9 Management Services Agreement - Assignment and Assumption Agreement dated as of May 28, 1998 by and between LILCO, MarketSpan Electric Services LLC and MarketSpan Corporation (F/K/A BL Holding Corp.); acknowledged and agreed to by the Authority and LIPA Acquisition Corp.*

10.10 Power Supply Agreement - Assignment and Assumption Agreement dated as of May 28, 1998 by and between LILCO, MarketSpan Generation LLC and MarketSpan Corporation (F/K/A BL Holding Corp.); acknowledged and agreed to by the Authority and LIPA Acquisition Corp.*

10.11 Generation Purchase Rights Agreement - Assignment and Assumption Agreement dated as of May 28, 1998 by and between LILCO, MarketSpan Corporation (F/KA BL Holding Corp.); acknowledged and agreed to by the Authority and LIPA Acquisition Corp.*

10.12 Operating Agreements - Assignment and Assumption Agreement dated as of May 28, 1998 by and among the Authority, LIPA Acquisition Corp. and MarketSpan Corporation (F/K/A BL Holding Corp.).*

10.13 Collections Allocation and Segregation Agreement dated as of May 28, 1998 by and among the Authority, LIPA Acquisition Corp. and MarketSpan Corporation (F/K/A BL Holding Corp.) and MarketSpan Trading Services LLC.*

10.14 7.3% Promissory Note in favor of LILCO in the principal amount of $397,000,000.*

10.15 8.20% Promissory Note in favor of LILCO in the principal amount of $270,000,000.*

10.16 Amended and Restated $28,375,000 Pollution Control Revenue Bonds (LILCO Projects) Series A Promissory Note in favor of LILCO.

10.19 Amended and Restated $19,100,000 Pollution Control Revenue Bonds (LILCO Projects) Series B Promissory Note in favor of LILCO.

10.21 Amended and Restated Adjustable Rate Pollution Control Revenue Bonds (LILCO Projects) 1985 Series A Promissory Note in favor of LILCO.

10.22 Amended and Restated Adjustable Rate Pollution Control Revenue Bonds (LILCO Projects) 1985 Series B Promissory Notes in favor of LILCO.

10.24 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1989 Series B Promissory Note in favor of LILCO.

10.25 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1990 Series A Promissory Note in favor of LILCO.

10.26 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1991 Series A Promissory Note in favor of LILCO.

10.28 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1992 Series B Promissory Note in favor of LILCO.

10.30 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1992 Series D Promissory Note in favor of LILCO.

10.32 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1993 Series B Promissory Note in favor of LILCO.

10.33 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1994 Series A Promissory Note in favor of LILCO.

10.34 Amended and Restated Electric Facilities Revenue Bonds (LILCO Projects) 1995 Series A Promissory Note in favor of LILCO.

10.35 Dealer Manager Agreement between Salomon Smith Barney, Inc. and Long Island Lighting Company d/b/a LIPA dated as of October 12, 1998.**

10.36 Financing Agreement dated as of May 1, 1998 between the Long Island Power Authority and LIPA Acquisition Corp.**

10.37 Indemnification Agreement dated May 28, 1998 by and between LIPA Acquisition Corp. and each of the officers and directors of the Registrant.

16.1 Letter dated June 23, 1998 from Ernst & Young LLP to the Securities and Exchange Commission.***

27. Financial Data Schedule.

(b) Reports on Form 8-K

A report on Form 8-K was filed on December 22, 1998 in connection with LIPA's change in fiscal year from March 31 to December 31.

* Previously filed with the Securities and Exchange Commission as an exhibit to LIPA's Form 10-Q for the period ended June 30, 1998.

** Previously filed with the Securities and Exchange Commission as an exhibit to LIPA's Form 10-Q for the period ended September 30, 1998

*** Previously filed with the Securities and Exchange Commission as an exhibit to LIPA's Form 8-K filed on June 23, 1998

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Uniondale, State of New York, on March 31, 1999.

LONG ISLAND LIGHTING COMPANY d/b/a LIPA

By: /s/ Richard M. Kessel

Richard M. Kessel
Chairman of the Board, President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Richard M. Kessel Richard M. Kessel (Principal Executive Officer)	Chairman of the Board, President and Chief Executive Officer	March 31, 1999
/s/ David P. Warren David P. Warren	Chief Financial Officer (Principal Financial Officer)	March 31, 1999
/s/ Edward P. Murphy, Jr. Edward P. Murphy, Jr.	Vice President and Controller (Principal Accounting Officer)	March 31, 1999
/s/ Patrick Foye Patrick Foye	Director	March 31, 1999
Michael Affrunti	Director	March , 1999
/s/ Harvey Auerbach Harvey Auerbach	Director	March 31, 1999
Thomas A. Doherty	Director	March , 1999
/s/ Michael L. Faltischek Michael L. Faltischek	Director	March 31, 1999
/s/ Harriet A. Gilliam Harriet A. Gilliam	Director	March 31, 1999
/s/Rupert H. Hopkins Rupert H. Hopkins	Director	March 31, 1999
/s/ Joseph F. Janoski Joseph F. Janoski	Director	March 31, 1999
/s/ Nancy N. Miklos Nancy N. Miklos	Director	March 31, 1999
Vincent Polimeni	Director	March , 1999
Jonathan Sinnreich	Director	March , 1999

REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE

To the Board of Directors of Long Island Lighting Company d/b/a LIPA

Our audit of the financial statements referred to in our report dated March 5, 1999 appearing on page 35 of this 1998 Annual Report on Form 10-K also included an audit of the financial statement schedule listed on page 86 of this Form 10-K. In our opinion, for the nine months ended December 31, 1998, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related financial statements.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

Melville, New York
March 5, 1999

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

(Thousands of Dollars)

	Column A	Column B	Column C	Column D	Column E
		Additions			
Description	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts-describe	Deductions - describe	Balance at end of period
Nine months ended December 31, 1998					
Deducted from asset accounts:					
Allowance for doubtful accounts	$23,483	$11,663	—	$ 9,227(1) $ 5,708(2)	$20,211
Year ended March 31, 1998					
Deducted from asset accounts:					
Allowance for doubtful accounts	$23,675	$23,239	—	$23,431(1)	$23,483
Three Months Ended March 31, 1997					
Deducted from asset accounts:					
Allowance for doubtful accounts	$25,000	$ 4,821	—	$ 6,146(1)	$23,675
Year ended December 31, 1996					
Deducted from asset accounts:					
Allowance for doubtful accounts	$24,676	$23,119	—	$22,795(1)	$25,000

(1) Uncollectible accounts written off, net of recoveries.
(2) Transferred with sale of gas operations.