

SECURITIES AND EXCHANGE COMMISSION

(Release No. 35-28008; 70-10245)

KeySpan Corporation, et al.

Order Authorizing Allocation Methodologies of Service Companies

July 28, 2005

KeySpan Corporation (“KeySpan”), a registered holding company under the Public Utility Holding Company Act of 1935 (“Act”), and its direct subsidiaries, KeySpan Corporate Services LLC (“KCS”), KeySpan Utility Services LLC (“KUS”) and KeySpan Engineering & Survey, Inc. (“KENG”), each of Brooklyn, New York (together, “Applicants”) have filed a declaration (“Declaration”) under section 13 of the Act and rules 54, 87, 88, 90, 91, 93 and 94. KCS, KUS and KENG (collectively, “Service Companies”) provide various services to KeySpan and its subsidiaries, as described below. The Commission issued a notice of the Declaration on May 24, 2005 (Holding Company Act Release No. 35-27973). No request for a hearing was received.

A. Background and Authority Requested

KeySpan registered as a holding company under the Act on November 8, 2000, as a result of KeySpan’s acquisition of Eastern Enterprises (now known as KeySpan New England, LLC) and its indirect acquisition of EnergyNorth Inc. which were authorized by the Commission in orders issued on November 7, 2000 (Holding Company Act Release Nos. 27269 and 27271), as modified by order issued on December 1, 2000 (Holding Company Act Release No. 27287).¹

¹ KeySpan directly or indirectly owns seven public-utility companies in the northeastern United States. The Brooklyn Union Gas Company, d/b/a KeySpan Energy Delivery New York, distributes natural gas at retail to residential, commercial and industrial customers in the New York City Boroughs of Brooklyn, Staten Island and Queens; KeySpan Gas East Corporation, d/b/a KeySpan Energy Delivery Long Island, distributes natural gas at retail to customers in New

In addition, on November 8, 2000, the Commission issued an order (Holding Company Act Release No. 27272), as modified by the order issued on December 1, 2000 (Holding Company Act Release No. 27286) (collectively, “Service Company Order”), that, among other things, reserved jurisdiction over the allocation methodologies proposed in the service agreements of the Service Companies and over the use of KCS and KUS as separate service companies. In the Declaration, Applicants request that the Commission: (1) approve the proposed allocation methodologies of each of the Service Companies; and (2) continue to reserve jurisdiction over the use of KCS and KUS as separate service companies, pending approval by the New York Public Service Commission, upon KeySpan’s petition, to eliminate the need to utilize KUS as a separate service company.

B. Services Provided by Each Service Company

KCS provides the following services to all KeySpan system companies: accounting, tax, auditing, treasury and finance services, risk management, financial planning, investor relations and shareholder services, information technology, communications and computer services, legal and regulatory, corporate secretary functions, human resources, environmental services, strategic planning and corporate performance, customer services and communications and

York State located in the counties of Nassau and Suffolk on Long Island and the Rockaway Peninsula in Queens County; KeySpan Generation LLC owns and operates electric generation capacity located on Long Island that is sold at wholesale to the Long Island Power Authority; Boston Gas Company, d/b/a KeySpan Energy Delivery New England, distributes natural gas to customers located in Boston and other cities and towns in eastern and central Massachusetts; Essex Gas Company, d/b/a KeySpan Energy Delivery New England, distributes natural gas to customers in eastern Massachusetts; Colonial Gas Company, d/b/a KeySpan Energy Delivery New England, distributes natural gas to customers located in northeastern Massachusetts and on Cape Cod; and EnergyNorth Natural Gas, Inc., d/b/a KeySpan Energy Delivery New England, distributes natural gas to customers located in southern and central New Hampshire and the City of Berlin located in northern New Hampshire. KeySpan, through its subsidiaries, also engages in energy related non-utility activities.

customer strategy, materials management and purchasing, facilities management, fleet management, security, corporate affairs, and executive and administrative services. KCS provides the following services to all KeySpan system companies except for the Brooklyn Union Gas Company and KeySpan Gas East Corporation (collectively, “New York Utilities”): gas supply services, management and administrative functions relating to gas operations, operations support services relating to gas operations, field services relating to gas operations, transmission and delivery system planning services, and gas marketing and sales services.

KUS provides the following services to the New York Utilities, over which the New York Public Service Commission (“NYPSC”) has jurisdiction: gas and electric transmission and distribution systems planning, research and development, fuel management, marketing and sales services, meter operations, and executive and administrative services.² KUS also provides certain sales call center services to the New York Utilities as well as to Boston Gas Company, Essex Gas Company, Colonial Gas Company and EnergyNorth Natural Gas, Inc. (each company does business as KeySpan Energy Delivery New England) (collectively, “New England Utilities”). The sales call center avoids duplication of resources and call system technologies. The sales call center handles call responses for lead inquiries in responses to advertising and mailings; calls to find out the availability of gas; calls for additional information on gas products; calls for technical questions and inquiries; calls to request appointments with sales representatives and/or plumbers; and calls to order meter sets from customers, plumbers and builders.

² KUS also provides these services to KeySpan Generation LLC, KeySpan Electric Services LLC, and KeySpan Energy Trading Services LLC. These companies either provide services to the Long Island Power Authority or are not subject to the jurisdiction of the NYPSC.

KENG provides to KCS and certain other KeySpan subsidiaries general engineering services and executive and administrative services.³

C. Allocation Methodologies Used by the Service Companies

Applicants state that the Service Companies allocate all their costs to associated utility and non-utility companies through a tiered approach. All costs are allocated and billed at cost in accordance with section 13 and rules 90 and 91 of the Act. Costs are first billed directly whenever practicable, including instances when more than one associate company is receiving the same goods or service at the same time. Amounts that cannot be directly assigned will be allocated to client companies by means of equitable allocation formulae, which to the extent possible will be based on cost-causation relationships. All other allocations will be broad based. In some instances, each of the Service Companies' cost centers that perform work for other service company cost centers may use a surrogate allocation method that mimics the allocations of the receiver cost center. Each formula will have an appropriate basis, such as meters and square footage.

Allocation percentages will be calculated on historical data where appropriate and updated annually.⁴ The method of assignment or allocation of costs shall be reviewed annually

³ According to the Applicants, KeySpan is compelled to utilize KENG due to Title VIII, Article 145 of the New York Education Law which generally restricts a public service corporation from providing any engineering or survey services to third parties, including affiliates. Nevertheless, the New York Education Law does provide certain "grandfather" exemptions that allow these services to be provided by business corporations that have been lawfully practicing engineering or land surveying and were organized and existing under the laws of the State of New York on April 15, 1935 and have existed continuously thereafter. KENG satisfies the requirements of the "grandfathering" provisions. Accordingly, KeySpan utilizes KENG as a separate service company to allow for the centralized provision of engineering and surveying services.

⁴ Due to the unique nature of KeySpan's relationship with the Long Island Power Authority ("LIPA"), the revenues and assets managed on its behalf will be included in the basis, with the

or more frequently if appropriate. If the use of a basis of allocation would result in an inequity because of a change in operation or organization, then the Service Companies may adjust the basis to effect an equitable distribution.

Applicants state that the cost of service will be determined in accordance with the Act and will include all costs of doing business incurred by the Service Companies, including a reasonable return on capital which will reflect a capitalization of the Service Companies of no more than ten percent equity, and all associated taxes.

Applicants state that each Service Company will maintain an accounting system for accumulating all costs on a project, activity or other appropriate basis. Expenses for the department will include salaries and wages of employees, materials, and supplies and all other expenses attributable to the department. Labor costs will be loaded for fringe benefits and payroll taxes. Time records of hours worked by all Service Company employees, including all officers of the company (*i.e.*, Chief Executive Officer, President and Vice Presidents) will be kept by project and activity.

Each client company will take agreed upon services and such additional, general, or special services as the client company may request and which the particular Service Company concludes it is able to perform. No amendment, alteration or rescission of an activity or project shall release a client company from liability for all costs already incurred by, or contracted for,

appropriate client company's data, in order to determine appropriate allocations. KeySpan Electric Services LLC provides to LIPA all operation, maintenance and construction services and significant administrative services relating to the Long Island electric transmission and distribution system, supplies LIPA with generating capacity, energy conversion and ancillary services, and manages all aspects of the fuel supply for KeySpan's generating facilities, as well as all aspects of the capacity and energy owned by or under contract to LIPA. KeySpan Electric Services LLC also purchases energy, capacity and ancillary services in the open market on LIPA's behalf.

the applicable Service Company pursuant to the project or activity regardless of whether the services associated with the costs have been completed.

Applicants state that each of the Service Companies' accounting and cost allocation methods and procedures have been structured so as to comply with the "Uniform System of Accounts for Mutual Service Companies" established by the Commission for holding company systems. Moreover, each of the Service Companies will file the annual report required by the Commission pursuant to rule 94 under the Act.

Applicants represent that no change in the organization of a Service Company, the type and character of the companies to be serviced, the methods of allocating cost to associate companies or the scope or character of the services to be rendered subject to section 13 of the Act, or any rule, regulation, or order under that section, shall be made until the Service Company shall first have given the Commission notice of the proposed change not less than 60 days prior to the proposed effectiveness. If, upon the receipt of a notice, the Commission shall notify the Service Company within the 60 day period that a question exists as to whether the proposed change is consistent with the provisions of section 13 of the Act, or of any rule, regulation, or order under that section, then the proposed change shall not become effective unless and until the Service Company shall have filed with the Commission an appropriate declaration regarding the proposed change and the Commission shall have permitted the declaration to become effective.

D. Reservation of Jurisdiction Over the Use of KCS and KUS as Separate Service Companies Pending Dissolution of KUS

Applicants state that in 1998, as a condition of the NYPSC's approval of the formation of KeySpan as a utility holding company, the NYPSC required KeySpan to form KCS and KUS in order to provide the services noted above. Applicants now request that the Commission continue to reserve jurisdiction over the use of KCS and KUS as separate service companies pending and

subject to approval by the NYPSC, upon KeySpan's petition, to eliminate the need to utilize KUS as a separate service company. KeySpan proposes to petition the NYPSC to allow Applicants to eliminate the need to utilize KUS as a separate service company. The petition will generally request authorization to utilize KCS as the single service company that would provide to the entire KeySpan system both corporate administrative services as well as gas marketing, gas supply, gas and electric distribution planning, meter repair operations, and all other services currently being provided by KUS and KCS. Key Span proposes to file this NYPSC petition on or before December 31, 2005 and anticipates that the NYPSC will act on this petition on or before December 31, 2006.

E. Conclusion

The proposed transactions are subject to rule 54, which provides that in determining whether to approve an application which does not relate to any "exempt wholesale generator" ("EWG") or "foreign utility company" ("FUCO"), the Commission shall not consider the effect of capitalization or earnings of any EWG or FUCO which is a subsidiary of a registered holding company if the requirements of rule 53(a), (b) and (c) are satisfied. KeySpan states that it meets the requirements of rule 53(a) and (b), except for subsection 53(a)(1). Rule 53(a)(1) limits the aggregate investment in EWGs and FUCOs to 50% of a system's consolidated retained earnings. However, KeySpan in an order dated December 18, 2003 (Holding Company Act Release No. 27776) ("Rule 53(c) Order") the Commission authorized KeySpan to invest up to \$3 billion in EWGs and FUCOs, finding that it would not have the adverse effects set forth in rule 53(c).⁵ KeySpan states that since the date of the Rule 53(c) Order, its consolidated capitalization ratio

⁵ As of March 31, 2005 KeySpan's "aggregate investment," as defined in rule 53(a)(1), in EWGs and FUCOs was approximately \$1.12 billion.

and its retained earnings have improved, and its capitalization and earnings attributable to its investment in EWGs and FUCOs has not had an adverse impact on its financial integrity.

Applicants state that no state or federal commission, other than the Commission, has jurisdiction over the proposed transactions. Applicants state that the estimated fees, commissions and expenses in connection with the proposed request are approximately \$10,000 which are comprised of legal fees.

Due notice of the filing of the Declaration has been given in the manner prescribed by rule 23 under the Act, and no hearing has been requested of, or ordered by, the Commission. Based on the facts in the record, the Commission finds that the applicable standards of the Act are satisfied and that no adverse findings are necessary.

IT IS ORDERED, under the applicable provisions of the Act and the rules under the Act, that, except as to matters as to which jurisdiction has been reserved, the Declaration is granted and permitted to become effective immediately, subject to the terms and conditions prescribed in rule 24 under the Act.

IT IS FURTHER ORDERED, that within 60 days of the issuance of this Order, in accordance with rule 24 under the Act, the Applicants will file with the Commission a report setting forth how they have applied the allocation methodologies authorized in this Order.

IT IS FURTHER ORDERED, that jurisdiction is reserved, pending completion of the record, over the use of KCS and KUS as separate service companies pending dissolution of KUS.

For the Commission, by the Division of Investment Management, under delegated authority.

Margaret H. McFarland
Deputy Secretary