

SECURITIES AND EXCHANGE COMMISSION

(Release No. 35-28049; 70-9957)

KeySpan Corporation, et al.

Supplemental Order Authorizing Expansion of Captive Insurance Company Activities

October 21, 2005

KeySpan Corporation (“KeySpan”), a registered holding company under the Public Utility Holding Company Act of 1935, as amended (“Act”) and its wholly owned captive insurance company subsidiary, KeySpan Insurance Company (“KIC”), both in Brooklyn, New York (collectively, “Applicants”), have filed a post-effective amendment (“Application”) with the Securities and Exchange Commission (“Commission”) under sections 6(a), 7, 9(a), 10, 12(b) and 13(b) of the Act and rules 45, 54, 90 and 91 under the Act. The Commission issued a notice of the proposed transaction on August 26, 2005 (HCAR No. 28020).

By order dated April 24, 2003, HCAR No. 27669 (“First Captive Order”), the Commission authorized KeySpan to organize a subsidiary to engage in activities associated with a captive insurance company. In accordance with the First Captive Order, KeySpan formed KIC, which is authorized to provide certain insurance services to KeySpan and its subsidiaries (“KeySpan System” and/or “System Companies”). By order dated February 3, 2004, HCAR No. 27795 (“Second Captive Order”), the Commission authorized KeySpan to expand the authority granted to the Applicants under the First Captive Order in order to allow KIC to provide additional insurance services covering property, boiler and machinery “all-risk” insurance services. KeySpan and KIC now seek an expansion of the authorization granted to KeySpan under the First Captive

Order and the Second Captive Order (collectively referred to herein as the “Captive Orders”).

Under the Captive Orders, KIC is authorized to provide several major types of coverage to the KeySpan System, including automobile liability, workers’ compensation, general liability, property, and boiler and machinery “all-risk” insurance. In addition, KIC is authorized to provide general liability and workers’ compensation insurance to its principal contractors under an Owner’s Controlled Insurance Program (“OCIP”). The contractors provide scheduled gas main construction and maintenance to the KeySpan System. Except for the general liability and workers’ compensation insurance provided to the principal contractor under OCIP, KIC will not extend or provide to any non-affiliated company any insurance services, unless otherwise expressly authorized by the Commission.

KIC assumes the risk of the more predictable loss layer from the commercial insurers for automobile and general liability losses, workers’ compensation, property, boiler and machinery “all-risk” insurance. Commercial insurance will continue to be purchased for “unpredictable” losses above the predictable loss layers from various commercial insurance companies, as was done under the program prior to the formation of KIC. To the extent that KIC procures insurance at a lower cost than that which could be obtained through traditional insurers, the savings in the premiums flow through ratably to the KeySpan System companies through the operation of the allocation methodology used to establish premiums.

Applicants now propose that KIC would offer the following additional insurance services to the KeySpan System:

- **Excess Liability** – A reduction of costs could be realized by all system companies, in an amount equal to the percentage of coverage taken on by KIC, if KIC were to take a position in the upper layers of the Excess General Liability insurance purchased from the commercial market. Specifically, the KIC would take a specific percentage of the Company's \$265 million excess of \$35 million excess liability program, not to exceed 25%. Applicants assert that this limitation of 25% would serve to mitigate any potentially adverse event while saving the System Companies a potential 20% when compared to current market pricing.
- **Service/Maintenance Contracts Insurance** – KIC could be used to underwrite the risks posed to the service companies through warranty contracts. Currently the home energy service companies are being asked by state regulatory agencies to evidence financial backing of these contracts which does not exist at this time. Applicants assert that a savings of approximately 20% could be realized by using KIC versus utilizing the commercial insurance market.
- **Subsidiary Deductible Buy-Down Options** – KIC can be used to offer separate deductibles to operating entities according to their individual appetite for risk. Applicants assert that this would assist the operating entities, especially the smaller ones, in maintaining fiscal responsibility and would place their deductibles more in-line with their business operational risk.
- **Weather Insurance** – KeySpan currently uses the commercial market to hedge against adverse weather fluctuations in New England. Savings on the profit and administration paid to insurance companies would benefit the System Companies. Applicants state that System Companies would save approximately 15% by using KIC.

- Certified Terrorism Coverage – If the Terrorism Risk Insurance Act of 2002 (“TRIA”) is extended beyond December 31, 2005, KIC can offer this line of coverage because of its status as a licensed insurance company in the State of Vermont. This would save approximately 10 - 15% in current costs paid to the commercial market. In the event of a certified terrorism loss, KIC would have access to TRIA and would be able to recoup the loss associated with the event, subject to applicable deductible and co-insurance provisions.
- Joint Venture Opportunities – KIC can be a vehicle for insuring predictable risks associated with joint ventures, partnerships or other business combinations.

KeySpan currently insures excess liability, weather insurance, and certified terrorism coverage through the traditional commercial insurance market. It has various deductibles ranging from \$1 million to \$3 million. It purchases limits up to \$2.5 billion from the commercial insurance market. KeySpan does not presently purchase service/maintenance contracts insurance, subsidiary deductible buy-down options, or joint venture opportunities insurance from the commercial insurance market but intends to provide coverage in these areas ranging from \$5 million to \$15 million through KIC.

Applicants state that KIC can be used as a vehicle to lower costs to the KeySpan System companies by acting as a buffer layer between current commercial market deductibles and planned increases in such deductibles. KeySpan could engage the commercial market at higher deductibles than currently possible because KIC would insure the increased risk associated with higher deductibles. Increasing the commercial market deductibles would allow the KeySpan System to reduce commercial market premiums. The premium charged by KIC for this buffer layer would be calculated based

on expected losses, utilizing the same method as used by commercial insurance companies. Applicants state that, the premium charged by KIC would not include an additional charge for profit or administration and would therefore provide further savings to the KeySpan System companies.

Applicants state that, to the extent that KIC can provide insurance at a lower cost than that which could be obtained through traditional insurers, the savings would continue to flow through ratably to the KeySpan System companies through the allocation methodology used to establish premiums, as described above. Moreover, there would be no additional staffing requirements for KeySpan System companies. KIC would not be operated to generate profits beyond what is necessary to maintain adequate reserves.

KeySpan states that it currently meets all of the conditions of rule 53(a) except for clause (1). At June 30, 2005 KeySpan's "aggregate investment," as defined in rule 53(a)(1), in EWGs and FUCOs was approximately \$1.12 billion. However, the Commission authorized KeySpan to invest in EWGs and FUCOs in an aggregate amount of up to \$3 billion by order dated December 18, 2003 (HCAR No. 27776, ("Rule 53(c) Order"). In addition, KeySpan states that it has complied, and will continue to comply, with the record-keeping requirements of rule 53(a)(2), the limitation under rule 53(a)(3) of affiliate utility company personnel rendering services to KeySpan's EWGs or FUCOs, and the requirements of rule 53(a)(4) concerning the submission of copies of certain filings under the Act to retail rate regulatory commissions. None of the circumstances described in rule 53(b) has occurred.

With respect to capitalization, Applicants state that there has been no material adverse impact on KeySpan's consolidated capitalization resulting from KeySpan's investments in EWGs and FUCOs. The action requested in the instant filing would not, by itself, or even considered in conjunction with the effect of the capitalization and earnings of KeySpan's EWGs and FUCOs, have a material adverse effect on the financial integrity of the KeySpan system, or an adverse impact on KeySpan's public utility subsidiaries, their customers, or the ability of State commissions to protect such public-utility customers. The rule 53(c) Order was predicated, in part, upon an assessment of KeySpan's overall financial condition which took into account, among other factors, KeySpan's consolidated capitalization ratio and its retained earnings, both of which have improved since the date of the rule 53(c) Order.

KeySpan's investments in EWGs and FUCOs have increased from approximately \$657 million as of December 31, 2000 to approximately \$1.12 billion as of June 30, 2005. Nevertheless, KeySpan's EWG and FUCO investments, in the aggregate, have been profitable for all quarterly periods from December 31, 2000 through June 30, 2005. As of September 30, 2003, the most recent period for which financial statement information was evaluated in the rule 53(c) Order, KeySpan's consolidated capitalization consisted of 38.67% common equity and 61.33% debt (including long and short-term debt and preferred stock). As of June 30, 2005, KeySpan's consolidated capitalization consisted of 51.63% equity and 48.37% debt (including long and short-term debt and preferred stock). These ratios comply with the requirement in KeySpan's present financing order dated December 6, 2002 (HCAR No. 27612) that KeySpan's common equity will be at least 30% of its capitalization. In addition, KeySpan's average

consolidated retained earnings increased from approximately \$480 million as of December 31, 2000 to approximately \$890 million as of June 30, 2005. Accordingly, throughout all applicable periods, the capitalization and earnings attributable to KeySpan's investments in EWGs and FUCOs has not had an adverse impact on KeySpan's financial integrity.

In addition, KeySpan will file a certificate of notification on a semi-annual basis describing the following:

- 1) a summary for the reporting period of each KeySpan System company's premium payments to KIC pursuant to the allocation methodology used to establish premiums organized by line of insurance coverage provided by KIC;
- 2) for the first three years of KIC's operations, a statement of actual savings achieved by the KeySpan System as a result of KIC's operations during the period; and
- 3) a copy of KIC's income statement and balance sheet, including any notes thereto.

Applicants state that the fees, commissions and expenses incurred or to be incurred in connection with this Application are estimated not to exceed \$10,000. In addition, Applicants state that no state or federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of this Application, as amended, has been given in the manner prescribed in rule 23 under the Act, and no hearing has been requested of, or ordered by, the Commission. On the basis of the facts in the record, it is found that the applicable standards of the Act and rules under the Act are satisfied, and that no adverse findings are necessary.

IT IS ORDERED, under the applicable provisions of the Act and rules under the Act, that the Application of KeySpan Corporation, et al. (70-9957), as amended, be granted and permitted to become effective immediately, subject to the terms and conditions prescribed in rule 24 under the Act.

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

Jonathan G. Katz
Secretary