ENERGY EAST CORP
Form 10-Q
November 01, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended

**September 30, 2007**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

| Commission file number | Exact name of Registrant as specified in its charter, State of incorporation, Address and Telephone number | IRS Employer Identification No. |
|---|---|---|
| 1-14766 | Energy East Corporation | |

(Incorporated in New York)
52 Farm View Drive
New Gloucester, Maine 04260-5116
(207) 688-6300
**www.energyeast.com**

14-1798693

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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer __X__ Accelerated filer ____ Non-accelerated filer ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ____ No __X__

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

The number of shares of common stock (Par value $.01 per share) outstanding as of October 31, 2007, was 158,278,536.

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## Glossary

Abbreviations for the Energy East companies mentioned in this report:

**Berkshire Gas** The Berkshire Gas Company is a regulated utility primarily engaged in the distribution of natural gas in western Massachusetts. Berkshire Gas is a wholly-owned subsidiary of Berkshire Energy Resources.

**CMP** Central Maine Power Company is a regulated utility primarily engaged in transmitting and distributing electricity generated by others to retail customers in Maine. CMP is a wholly-owned subsidiary of CMP Group, Inc.

**CNG** Connecticut Natural Gas Corporation is a regulated utility primarily engaged in the retail distribution of natural gas in Connecticut. CNG is a wholly-owned subsidiary of CTG Resources, Inc.

**Energetix** Energetix, Inc. markets electric and natural gas services in upstate New York.

**Energy East, the company, we, our** or **us** Energy East Corporation is the parent company of RGS Energy Group, Inc., Connecticut Energy

**MNG** Maine Natural Gas Corporation is a small natural gas delivery company in the state of Maine.

**NYSEG** New York State Electric & Gas Corporation is a regulated utility primarily engaged in purchasing and delivering electricity and natural gas in the central, eastern and western parts of the state of New York. NYSEG is a wholly-owned subsidiary of RGS Energy Group, Inc.

**RG&E** Rochester Gas and Electric Corporation is a regulated utility primarily engaged in generating, purchasing and delivering electricity and purchasing and delivering natural gas in an area centered around the city of Rochester, New York. RG&E is a wholly-owned subsidiary of RGS Energy Group, Inc.

**SCG** The Southern Connecticut Gas Company is a regulated utility primarily engaged in the retail distribution of natural gas in Connecticut. SCG is

Corporation, CMP Group, Inc., CTG Resources, Inc., Berkshire Energy Resources, The Energy Network, Inc. and Energy East Enterprises, Inc.

a wholly-owned subsidiary of Connecticut Energy Corporation.

Abbreviations or acronyms frequently used in this report:

**ALJ** Administrative Law Judge

**AMI** advanced metering infrastructure

**ARP 2000** Alternative Rate Plan 2000

**ASGA** Asset Sale Gain Account

**DIG Issue G26** Derivatives Implementation Group (DIG) Issue No. G26, "Cash Flow Hedges: Hedging Interest Cash Flows on Variable-Rate Assets and Liabilities That Are Not Based on a Benchmark Interest Rate"

**DPUC** Connecticut Department of Public Utility Control

**Dth** dekatherm

**EITF 06-10** Emerging Issues Task Force Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements"

**EPA** Environmental Protection Agency

**EPS** earnings per share

**ESCO** energy service company

**FASB** Financial Accounting Standards Board

**FERC** Federal Energy Regulatory Commission

**FIN 46(R)** FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51*

**Merger Agreement** The Agreement and Plan of Merger dated as of June 25, 2007, among Iberdrola, S.A., Green Acquisition Capital, Inc., a direct, wholly-owned subsidiary of Iberdrola, and Energy East

**MPUC** Maine Public Utilities Commission

**MW, MWh** megawatt, megawatt-hour

**NBC** nonbypassable wires charge

**NUG** nonutility generator

**NYISO** New York Independent System Operator

**NYPSC** New York State Public Service Commission

**NYSDEC** New York State Department of Environmental Conservation

**OPEB** other postemployment benefits

**PCB** polychlorinated biphenyl

**ROE** return on equity

**RTO** Regional Transmission Organization

**Russell Station** A coal-fired electric generation facility in Greece, New York

**SAR** stock appreciation right

**SEC** United States Securities and Exchange Commission

**Statement 109** Statement of Financial Accounting

**FIN 48** FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*

**FSP FIN 39-1** FASB Staff Position No. FIN 39-1, "Amendment of FASB Interpretation No. 39"

**ISO-NE** ISO New England Inc.

**MD&A** Management's Discussion and Analysis of Financial Condition and Results of Operations

**Merger** The proposed transaction whereby Energy East will merge with Green Acquisition Capital, Inc., a direct, wholly-owned subsidiary of Iberdrola, S.A. and we would become a subsidiary of Iberdrola as provided for in the Merger Agreement

Standards No. 109, A*ccounting for Income Taxes*

**Statement 157** Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*

**Statement 159** Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115*

**VEBA** Voluntary employees' beneficiary association authorized by Internal Revenue Code Section 501(c)(9)

Forward-looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements in certain circumstances. This Form 10-Q contains certain forward-looking statements that are based upon management's current expectations and information that is currently available. Whenever used in this report, the words "estimate," "expect," "believe," "anticipate," or similar expressions are intended to identify such forward-looking statements.

In addition to the assumptions and other factors referred to specifically in connection with such statements, factors that involve risks and uncertainties that could cause actual results to differ materially from those contemplated in any forward-looking statements are discussed in our Form 10-K for the fiscal year ended December 31, 2006, Item 1A - Risk Factors and Item 7 - MD&A - Market Risk, and also include, among others:

- the occurrence of any event, change or other circumstances that could give rise to the termination of the proposed Merger Agreement,
- the outcome of any legal or regulatory proceedings that have been instituted against us or others following the announcement of the Merger Agreement,
- our ability to obtain stockholder approval of the Merger,
- the failure of the Merger to close for any reason, including the failure to obtain regulatory approvals required for the Merger,
- the regulatory process relating to the Merger, which could delay the Merger or result in the imposition of conditions that could have a material adverse effect on the company,
- our ability to compete in the rapidly changing and competitive electric and/or natural gas utility markets,
- regulatory uncertainty and volatile energy supply prices,
- implementation of the Energy Policy Act of 2005,
- increased state and FERC regulation,
- the operation of the NYISO and retroactive NYISO billing adjustments,
- the operation of ISO-NE as an RTO and CMP's continued participation in ISO-NE,
- our continued ability to recover NUG and other costs,
- changes in fuel supply or cost and the success of strategies to satisfy power requirements,
- our ability to expand our products and services including our energy infrastructure in the Northeast,
- the effect of commodity costs on customer usage and uncollectible expense,
- our ability to maintain enterprise-wide integration synergies,

- market risk from changes in value of financial or commodity instruments, derivative or nonderivative, caused by fluctuations in interest rates or commodity prices,
- the ability of third parties to continue to supply electricity and natural gas,
- our ability to obtain adequate and timely rate relief and/or the extension of current rate plans,
- the possible discontinuation or further modification of fixed-price supply programs in New York,
- nuclear decommissioning or environmental incidents,
- legal or administrative proceedings,
- changes in the cost or availability of capital,
- economic growth or contraction in the areas in which we do business,
- extreme weather-related events such as floods, hurricanes, ice storms or snow storms,
- weather variations affecting customer energy usage,
- changes in authoritative accounting guidance,
- acts of terrorism,
- the effect of volatility in the equity and fixed income markets on the cost of pension and other postretirement benefits,
- the inability of our internal control framework to provide absolute assurance that all incidents of fraud or error will be detected and prevented, and
- other considerations that may be disclosed from time to time in our publicly disseminated documents and filings.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

## PART I - FINANCIAL INFORMATION

Item 1.

**Financial Statements**

Energy East Corporation
Condensed Consolidated Statements of Income - (Unaudited)

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands, except per share amounts) | | | | |
| Operating Revenues | | | | |
| Utility | $906,594 | $969,093 | $3,447,664 | $3,512,196 |
| Other | 124,091 | 121,261 | 385,784 | 386,594 |
| **Total Operating Revenues** | 1,030,685 | 1,090,354 | 3,833,448 | 3,898,790 |
| Operating Expenses | | | | |
| Electricity purchased and fuel used in generation | | | | |
| Utility | 381,141 | 401,603 | 1,117,826 | 1,133,153 |
| Other | 98,809 | 95,060 | 272,827 | 268,686 |
| Natural gas purchased | | | | |
| Utility | 81,849 | 97,469 | 794,587 | 779,902 |
| Other | 7,721 | 7,709 | 62,216 | 61,043 |

| | | | | |
|---|---|---|---|---|
| Other operating expenses | 228,837 | 202,677 | 621,120 | 590,015 |
| Maintenance | 36,623 | 57,509 | 131,193 | 153,723 |
| Depreciation and amortization | 69,290 | 69,921 | 206,361 | 209,385 |
| Other taxes | 57,228 | 58,495 | 191,728 | 190,625 |
| **Total Operating Expenses** | 961,498 | 990,443 | 3,397,858 | 3,386,532 |
| Operating Income | 69,187 | 99,911 | 435,590 | 512,258 |
| Other (Income) | (10,023) | (9,873) | (29,729) | (27,183) |
| Other Deductions | 3,225 | 12,332 | 7,879 | 20,480 |
| Interest Charges, Net | 68,651 | 76,818 | 204,906 | 230,681 |
| Preferred Stock Dividends of Subsidiaries | 282 | 283 | 846 | 847 |
| Income Before Income Taxes | 7,052 | 20,351 | 251,688 | 287,433 |
| Income Tax (Benefit) Expense | (17,990) | (661) | 73,861 | 104,896 |
| Net Income | $25,042 | $21,012 | $177,827 | $182,537 |
| Earnings per Share, basic and diluted | $.16 | $.14 | $1.15 | $1.24 |
| Dividends Declared per Share | $.30 | $.29 | $.90 | $.87 |
| Average Common Shares Outstanding, basic | 157,221 | 146,903 | 153,986 | 146,946 |
| Average Common Shares Outstanding, diluted | 158,279 | 147,702 | 154,972 | 147,686 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

Energy East Corporation
Condensed Consolidated Balance Sheets - (Unaudited)

| | Sept. 30, 2007 | Dec. 31, 2006 |
|---|---|---|
| (Thousands) | | |
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | $115,516 | $93,373 |
| Investments available for sale | 222,100 | 20,000 |
| Accounts receivable and unbilled revenues, net | 735,913 | 914,657 |
| Fuel and natural gas in storage, at average cost | 307,925 | 277,766 |
| Materials and supplies, at average cost | 30,190 | 33,273 |
| Deferred income taxes | 69,170 | 93,187 |
| Derivative assets | 9,690 | 1,327 |
| Prepayments and other current assets | 183,544 | 193,226 |
| **Total Current Assets** | 1,674,048 | 1,626,809 |
| Utility Plant, at Original Cost | | |

| | | |
|---|---|---|
| Electric | 5,723,203 | 5,557,858 |
| Natural gas | 2,705,182 | 2,654,426 |
| Common | 570,652 | 550,440 |
| | 8,999,037 | 8,762,724 |
| Less accumulated depreciation | 3,057,039 | 2,935,798 |
| **Net Utility Plant in Service** | 5,941,998 | 5,826,926 |
| Construction work in progress | 140,007 | 121,097 |
| **Total Utility Plant** | 6,082,005 | 5,948,023 |
| Other Property and Investments | 179,790 | 183,315 |
| Regulatory and Other Assets | | |
| Regulatory assets | | |
| Nuclear plant obligations | 204,836 | 263,659 |
| Unfunded future income taxes | 326,730 | 256,683 |
| Deferred income taxes | 20,594 | - |
| Environmental remediation costs | 178,001 | 128,925 |
| Unamortized loss on debt reacquisitions | 50,971 | 52,724 |
| Nonutility generator termination agreements | 68,415 | 79,241 |
| Natural gas hedges | 20,918 | 47,372 |
| Pension and other postretirement benefits | 325,871 | 351,011 |
| Other | 332,648 | 356,299 |
| Total regulatory assets | 1,528,984 | 1,535,914 |
| Other assets | | |
| Goodwill | 1,526,048 | 1,526,048 |
| Prepaid pension benefits | 635,606 | 577,356 |
| Derivative assets | 28,904 | 46,375 |
| Deferred income taxes | 19,362 | - |
| Other | 108,167 | 118,561 |
| Total other assets | 2,318,087 | 2,268,340 |
| Total Regulatory and Other Assets | 3,847,071 | 3,804,254 |
| Total Assets | $11,782,914 | $11,562,401 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

Energy East Corporation
Condensed Consolidated Balance Sheets - (Unaudited)

| | Sept. 30, 2007 | Dec. 31, 2006 |
|---|---|---|

| (Thousands) | | |
|---|---|---|
| Liabilities | | |
| Current Liabilities | | |
| Current portion of long-term debt | $198,890 | $260,768 |
| Notes payable | 136,240 | 109,363 |
| Accounts payable and accrued liabilities | 377,085 | 470,325 |
| Interest accrued | 57,554 | 57,243 |
| Taxes accrued | 69,872 | 44,009 |
| Unfunded future income taxes | 6,667 | 19,664 |
| Derivative liabilities | 31,664 | 71,678 |
| Customer refunds | 17,000 | 70,770 |
| Other | 208,881 | 209,839 |
| **Total Current Liabilities** | 1,103,853 | 1,313,659 |
| Regulatory and Other Liabilities | | |
| Regulatory liabilities | | |
| Accrued removal obligation | 884,541 | 843,273 |
| Deferred income taxes | - | 105,528 |
| Gain on sale of generation assets | 94,719 | 127,674 |
| Pension benefits | 117,895 | 127,330 |
| Other | 155,339 | 93,268 |
| Total regulatory liabilities | 1,252,494 | 1,297,073 |
| Other liabilities | | |
| Deferred income taxes | 1,336,081 | 1,105,117 |
| Nuclear plant obligations | 188,286 | 202,963 |
| Pension and other postretirement benefits | 521,435 | 530,838 |
| Environmental remediation costs | 193,375 | 168,949 |
| Derivative liabilities | 13,578 | 21,871 |
| Other | 275,667 | 306,283 |
| Total other liabilities | 2,528,422 | 2,336,021 |
| **Total Regulatory and Other Liabilities** | 3,780,916 | 3,633,094 |
| Long-term debt | 3,689,747 | 3,726,709 |
| **Total Liabilities** | 8,574,516 | 8,673,462 |
| Commitments and Contingencies | | |
| Preferred Stock of Subsidiaries | | |
| Redeemable solely at the option of subsidiaries | 24,587 | 24,592 |
| Common Stock Equity | | |

| | | |
|---|---|---|
| Common stock | 1,584 | 1,480 |
| Capital in excess of par value | 1,751,632 | 1,505,795 |
| Retained earnings | 1,423,156 | 1,382,461 |
| Accumulated other comprehensive income (loss) | 9,889 | (23,779) |
| Treasury stock, at cost | (2,450) | (1,610) |
| Total Common Stock Equity | 3,183,811 | 2,864,347 |
| Total Liabilities and Stockholders' Equity | $11,782,914 | $11,562,401 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

Energy East Corporation
Condensed Consolidated Statements of Cash Flows - (Unaudited)

| Nine months ended September 30, | 2007 | 2006 |
|---|---|---|
| (Thousands) | | |
| Operating Activities | | |
| Net income | $177,827 | $182,537 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 290,853 | 309,663 |
| Income taxes and investment tax credits deferred, net | 52,412 | 20,881 |
| Pension income | (35,516) | (22,553) |
| Changes in current operating assets and liabilities | | |
| Accounts receivable and unbilled revenues, net | 106,825 | 241,423 |
| Inventory | (26,714) | (18,446) |
| Prepayments and other current assets | 11,084 | (106,813) |
| Accounts payable and accrued liabilities | (84,117) | (238,194) |
| Interest accrued | 311 | 10,146 |
| Taxes accrued | 9,564 | (16,662) |
| Customer refunds | (10,056) | (15,486) |
| Other current liabilities | (15,535) | (34,592) |
| Pension contributions | (3,000) | (400) |
| Other assets | (3,308) | (13,395) |
| Other liabilities | (12,460) | (37,569) |
| **Net Cash Provided by Operating Activities** | 458,170 | 260,540 |
| Investing Activities | | |
| Utility plant additions | (291,899) | (266,678) |
| Other property additions | (526) | (1,468) |
| Other property sold | 20 | - |

| | | |
|---|---|---|
| Maturities of current investments available for sale | 766,475 | 1,005,365 |
| Purchases of current investments available for sale | (968,575) | (855,340) |
| Investments | 3,094 | 20,203 |
| **Net Cash (Used in) Investing Activities** | (491,411) | (97,918) |
| Financing Activities | | |
| Issuance of common stock | 236,196 | - |
| Repurchase of common stock | (8,339) | (6,107) |
| Redemption of preferred stock of subsidiary, including premium | (6) | (39) |
| Issuance of first mortgage bonds | 99,890 | - |
| Long-term note issuances | 40,000 | 552,148 |
| Long-term note repayments | (209,883) | (649,648) |
| Notes payable three months or less, net | 27,136 | 48,683 |
| Notes payable issuances | 1,649 | 78,560 |
| Notes payable repayments | (1,907) | (71,260) |
| Dividends paid on common stock | (129,352) | (127,878) |
| **Net Cash Provided by (Used in) Financing Activities** | 55,384 | (175,541) |
| Net Increase in Cash and Cash Equivalents | 22,143 | (12,919) |
| Cash and Cash Equivalents, Beginning of Period | 93,373 | 120,009 |
| Cash and Cash Equivalents, End of Period | $115,516 | $107,090 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

Energy East Corporation
Condensed Consolidated Statements of Retained Earnings - (Unaudited)

| Nine months ended September 30, | 2007 | 2006 |
|---|---|---|
| (Thousands) | | |
| Balance, Beginning of Period | $1,382,461 | $1,294,580 |
| Adjustment for the cumulative effect of applying the provisions of FIN 48 as of January 1, 2007 | 1,291 | - |
| Add net income | 177,827 | 182,537 |
| | 1,561,579 | 1,477,117 |
| Deduct dividends on common stock | 138,423 | 127,878 |
| Balance, End of Period | $1,423,156 | $1,349,239 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

Energy East Corporation
Condensed Consolidated Statements of Comprehensive Income - (Unaudited)

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Net income | $25,042 | $21,012 | $177,827 | $182,537 |
| Other comprehensive income, net of tax | | | | |
| Net unrealized (losses) gains on investments, net of income tax (expense) for the three months of $(120) in 2007 and $(653) in 2006 and for the nine months of $(292) in 2007 and $(629) in 2006 | 181 | 986 | 446 | 949 |
| Minimum pension liability adjustment net of income tax benefit of $552 for the three months and $1,214 for the nine months in 2006 | - | (841) | - | (1,838) |
| Amortization of pension costs for nonqualified plans, net of income tax (expense) of $(1,133) for the three months and $(2,535) for the nine months in 2007 | 1,802 | - | 3,870 | - |
| Net unrealized (losses) on derivatives qualified as hedges, net of income tax benefit for the three months of $13,288 in 2007 and $34,077 in 2006 and for the nine months of $12,402 in 2007 and $105,888 in 2006 | (20,423) | (50,718) | (19,303) | (164,194) |
| Reclassification adjustment for derivative losses (gains) included in net income, net of income tax (benefit) expense for the three months of $(443) in 2007 and $9,057 in 2006 and for the nine months of $(24,253) in 2007 and $(7,296) in 2006 | 654 | (13,656) | 36,564 | 11,117 |
| Net unrecognized gains on settled cash flow treasury hedges, net of income tax (expense) of $(3,018) for the three months and $(8,890) for the nine months in 2007 | 4,357 | - | 12,091 | - |
| Total other comprehensive (loss) income | (13,429) | (64,229) | 33,668 | (153,966) |
| Comprehensive Income (Loss) | $11,613 | $(43,217) | $211,495 | $28,571 |

The

notes on pages 6 through 13 are an integral part of our condensed consolidated financial statements.

## Notes to Condensed Consolidated Financial Statements

### Note 1. Unaudited Condensed Consolidated Financial Statements

In management's opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary for a fair statement of the interim periods presented. All such adjustments are of a normal, recurring nature. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Our financial statements consolidate our majority-owned subsidiaries after eliminating all intercompany transactions.

On June 25, 2007, we entered into an Agreement and Plan of Merger with Iberdrola, S.A., and Green Acquisition Capital, Inc. pursuant to which we will become a wholly-owned subsidiary of Iberdrola upon receipt of required regulatory approvals, shareholder approval and satisfaction of other closing conditions.

The accompanying unaudited financial statements should be read in conjunction with the financial statements and notes contained in our report on Form 10-K filed for the fiscal year ended December 31, 2006. Due to the seasonal nature of our operations, financial results for interim periods are not necessarily indicative of trends for a 12-month period.

Reclassifications

**:** Certain amounts have been reclassified in the unaudited financial statements to conform to the 2007 presentation. Effective January 1, 2007, we recognize book overdrafts where no credit is required to be extended by a bank as an operating activity rather than as a financing activity. As a result, our net cash provided by operating activities and net cash used in financing activities increased $20 million for the nine months ended September 30, 2006. Effective April 1, 2007, we began recording the unrecognized gains and losses on settled treasury hedges in other comprehensive income rather than as other assets or long-term debt. As a result, our other comprehensive income increased $10 million for the nine months ended September 30, 2007.

Note 2. Other (Income) and Other Deductions

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Interest and dividend income | $(5,276) | $(5,714) | $(14,337) | $(13,606) |
| Allowance for funds used during construction | (1,229) | (630) | (3,684) | (1,503) |
| Earnings from equity investments | (677) | (963) | (2,421) | (2,463) |
| Gains from energy risk contracts | (864) | (691) | (2,339) | (2,310) |
| Miscellaneous | (1,977) | (1,875) | (6,948) | (7,301) |
| Total other (income) | $(10,023) | $(9,873) | $(29,729) | $(27,183) |
| Losses on energy risk contracts | $600 | $1,254 | $4,087 | $6,258 |
| Recognition of expense from retirement of debt and trust preferred securities | - | 11,248 | - | 11,248 |
| Donations, civic and political | 572 | 665 | 1,517 | 2,374 |
| Miscellaneous | 2,053 | (835) | 2,275 | 600 |
| Total other deductions | $3,225 | $12,332 | $7,879 | $20,480 |

Note 3. Basic and Diluted Earnings per Share

We determine basic EPS by dividing net income by the weighted-average number of shares of common stock outstanding during the period. The weighted-average common shares outstanding for diluted EPS include the incremental effect of restricted stock and stock options issued and exclude stock options issued in tandem with SARs. Historically, we have issued stock options in tandem with SARs and substantially all stock option plan participants have exercised the SARs instead of the stock options. The numerator we use in calculating both basic and diluted EPS for each period is our reported net income.

The reconciliation of basic and dilutive average common shares for each period follows:

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Basic average common shares outstanding | 157,221 | 146,903 | 153,986 | 146,946 |
| Restricted stock awards | 1,058 | 799 | 986 | 740 |
| Potentially dilutive common shares | 273 | 137 | 184 | 141 |
| Options issued with SARs | (273) | (137) | (184) | (141) |
| Diluted average common shares outstanding | 158,279 | 147,702 | 154,972 | 147,686 |

We exclude from the determination of EPS options that have an exercise price that is greater than the average market price of the common shares during the period. Shares excluded from the EPS calculation for the periods ended September 30 were: for the three months - 1.2 million in 2007 and 1.5 million in 2006, and for the nine months - 1.8 million in 2007 and 1.2 million in 2006.

Note 4. Income Taxes

Income taxes were $20.9 million less for the quarter ended September 30, 2007 and $8.9 million less for the quarter ended September 30, 2006 than they would have been at the statutory rate of 39.9%.

Income taxes were $26.8 million less for the nine months ended September 30, 2007 and $10.1 million less for the nine months ended September 30, 2006 than they would have been at the statutory rate of 39.9%.

Differences between the statutory rate and the effective rate for the periods ended September 30, 2007 and 2006 are primarily due to:

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Tax expense at statutory rate | $2,924 | $8,228 | $100,698 | $114,952 |
| Prior year tax return adjustments | (6,214) | (2,061) | (6,214) | (2,061) |
| Flow-through items | | | | |
| Depreciation | (4,762) | (354) | (2,531) | 5,652 |
| Removal costs | (1,676) | (2,370) | (4,376) | (4,933) |
| Medicare Subsidy | (1,419) | (1,460) | (4,257) | (4,378) |
| Unitary/Combined state benefits | (5,921) | (647) | (7,911) | (1,792) |
| Other | (922) | (1,997) | (1,548) | (2,544) |

| | | | | |
|---|---|---|---|---|
| Difference from Statutory | (20,914) | (8,889) | (26,837) | (10,056) |
| Total Income Taxes | $(17,990) | $(661) | $73,861 | $104,896 |

The 2007 prior year tax return adjustments primarily result from statutorily allowed acceleration of certain tax deductions that were incorporated for the first time in the filing of our 2006 federal income tax return. Because some of those items are flowed-through to ratepayers in certain regulatory jurisdictions an effective tax rate benefit results. The primary drivers of the 2006 prior year tax return adjustments related to retirements of assets offset by the flow-through effect related to book versus tax depreciation. The 2007 increase in the Unitary/Combined state benefits is primarily due to revising the 2007 estimated effective tax rate to incorporate the effects of the accelerated deductions mentioned above as well as the effect of NYSEG's $60 million VEBA contribution.

FIN 48

: In July 2006 the FASB released FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with Statement 109 by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or to be taken in a tax return. The evaluation of a tax position is a two-step process. The first step is for an entity to determine if it is more likely than not that a tax position will be sustained upon examination. The second step involves measuring the amount of tax benefit to be recognized in the financial statements based on the largest amount of benefit that meets the prescribed recognition threshold. The difference between the amounts based on that position and the position taken in a tax return is generally recorded as a liability.

FIN 48 also provides guidance for the presentation of reserves in the balance sheet and the proper measurement of deferred tax assets and liabilities using the FIN 48 standard. That guidance requires classifying as current reserves that are expected to be addressed in the next 12-month period. It also requires that the tax basis of assets and liabilities reflect the presumed FIN 48 outcome versus the actual filing position in determining the proper level of accumulated deferred income taxes in accordance with Statement 109.

We adopted FIN 48 effective January 1, 2007. The total amount of gross unrecognized tax benefits at the date of adoption was $26.6 million and included income taxes of $21.2 million, interest of $5.2 million and a penalty of $0.2 million. The total amount of gross unrecognized tax benefits as of September 30, 2007 is $23.7 million and includes income taxes of $17.4 million, interest of $6.1 million and a penalty of $0.2 million. Including interest and penalty, $12.8 million of the gross unrecognized tax benefits would affect the effective tax rate, if recognized. The decrease of $3.8 million in the gross income tax amount is due to a redetermination of reserves related to 2006 based on the filing of various 2006 income tax returns. The adoption of FIN 48 did not have a material effect on our results of operation, financial position or cash flows. The cumulative effect of adoption was an increase to retained earnings of $1.3 million. In addition, we reclassified $2.3 million of accumulated deferred income tax liabilities.

We have been audited through 2000 for New York state income taxes, through 2001 for federal income taxes and through 2002 for Maine income taxes. The statute of limitations in Connecticut has expired for all years through 2003. Our New York state returns for 2001 through 2004, federal returns for 2002 through 2005 and Maine returns for 2003 and 2004 are currently under review. We anticipate that the reviews will be completed within the next 12 months. Approximately $13.1 million of the gross income tax reserves relate to the years currently under audit, with the majority relating to combined state reporting issues. We cannot estimate the ultimate outcome of the reviews.

We continue to classify all interest and penalties related to uncertain tax positions as income tax expense.

New York State Income Tax Legislation

: On April 9, 2007, New York state enacted its 2007-2008 budget, which included amendments to the New York state income tax. Those amendments include a reduction in the corporate net income tax rate to 7.1% from 7.5%, and the adoption of a single sales factor for apportioning taxable income to New York state. Both amendments are effective January 1, 2007.

We have determined that these amendments did not have a material effect on our results of operations, financial position or cash flows.

Also included in the 2007-2008 New York state budget was a provision whereby certain corporations would be required to file unitary income tax returns. This provision is effective January 1, 2007. On June 25, 2007 New York state issued a Technical Service Bulletin providing further guidance as to what meets the unitary income tax filing criteria.

While we continue to monitor this issue, we have currently determined that we do not meet the unitary income tax filing criteria based on our review of the legislation, the June 25, 2007 Technical Service Bulletin and other public statements made by New York State Department of Taxation and Finance representatives.

Note 5. Variable Interest Entities

A variable interest entity is an entity that is not controllable through voting interests and/or in which the equity investor does not bear the residual economic risks and rewards. FIN 46(R) requires a business enterprise to consolidate a variable interest entity if the enterprise has a variable interest that will absorb a majority of the entity's expected losses.

We have power purchase contracts with various NUGs. However, we were not involved in the formation of and do not have ownership interests in any NUGs. We have evaluated all of our power purchase contracts with NUGs with respect to FIN 46(R) and determined that most of the purchase contracts are not variable interests for one of the following reasons: the contract is based on a fixed price or a market price and there is no other involvement with the NUG, the contract is short-term in duration, the contract is for a minor portion of the NUG's capacity or the NUG is a governmental organization or an individual. We are not able to determine if we have variable interests with respect to power purchase contracts with six remaining NUGs because we are unable to obtain the information necessary to: (1) determine if any of those NUGs is a variable interest entity, (2) determine if an operating utility is a NUG's primary beneficiary or (3) perform the accounting required to consolidate any of those NUGs. We routinely request necessary information from the six NUGs, and will continue to do so, but none of these NUGs has yet provided the requested information. We did not consolidate any NUGs as of September 30, 2007, or December 31, 2006.

We continue to purchase electricity from the six NUGs at above-market prices. We are not exposed to any loss as a result of our involvement with the NUGs because we are allowed to recover through rates the cost of our purchases. Also, we are under no obligation to a NUG if it decides not to operate for any reason. The combined contractual capacity for the six NUGs is approximately 462 MWs. The combined purchases from the six NUGs totaled approximately $296 million for the nine months ended September 30, 2007, and $266 million for the nine months ended September 30, 2006.

Note 6. Commitments and Contingencies

NYISO Billing Adjustment

**:** The NYISO frequently bills market participants on a retroactive basis when it determines that billing adjustments are necessary. Such retroactive billings can cover several months or years and cannot be reasonably estimated. NYSEG and RG&E record transmission or supply revenue or expense, as appropriate, when revised amounts are available. The two companies have developed an accrual process that incorporates available information about retroactive NYISO billing adjustments as provided to all market participants. However, on an ongoing basis, they cannot fully predict either the magnitude or the direction of any final billing adjustments.

NYPSC Proceeding on NYSEG's Accounting for OPEB:

In August 2006 the NYPSC issued its decision in the NYSEG electric rate case. Among other things, the NYPSC instructed the ALJ to open a separate proceeding regarding the NYPSC staff's position that NYSEG should have retained $57 million of interest in its OPEB reserve and used it to reduce rate base rather than to reduce OPEB expenses. In July 2007 NYSEG, the NYPSC staff and various intervenors filed a joint proposal with the NYPSC resolving all outstanding issues in this matter. On September 20, 2007, the NYPSC approved the joint proposal. The joint proposal provides that NYSEG will refund to customers $17 million from its existing ASGA account and establish an external VEBA trust fund for already-reserved OPEB costs, which are currently deducted from rate base, of approximately $112 million. NYSEG contributed $60 million to the VEBA on October 4, 2007, and will contribute an additional $52 million in January 2008. The joint proposal also requires pretax charges to earnings for regulatory purposes of $8 million in 2007, $5 million in 2008, and $4 million in 2009. The charges in 2008 and 2009 are expected to be offset by earnings on the VEBA.

Merger-related Lawsuit

**:** On July 6, 2007, a purported class action complaint was filed in the Supreme Court of the State of New York for Kings County against the company and its directors. The complaint alleges that, among other things, the consideration for the proposed acquisition by Iberdrola is unfair and inadequate because it does not provide the company's stockholders with a sufficient premium for the company's common stock and the defendants have breached their fiduciary duty. The complaint seeks to enjoin the merger in addition to an unspecified amount of damages. On September 26, 2007, the plaintiff and Energy East and its directors agreed, subject to confirmatory discovery and court approval, to settle the lawsuit. The settlement is based on Energy East's agreement to include certain additional disclosures in its proxy statement. As a result of the settlement, plaintiff will not seek to enjoin the transaction. The settlement, if completed and approved by the court, will result in dismissal with prejudice of the lawsuit. The settlement also will result in a release of claims that have been or could have been asserted relating to the Merger, the Merger Agreement, or any disclosures relating to the Merger by the plaintiff and the purported class of Energy East shareholders. In connection with such settlement, the plaintiff's counsel will apply to the court for attorneys' fees and expenses not to exceed in the aggregate $340,000, which Energy East has agreed to pay, if awarded by the court, provided the court approves the settlement and dismisses the lawsuit with prejudice. Energy East and its directors continue to deny all of the substantive allegations in the complaint.

Note 7. Environmental Liability

In June 2007, based on an updated study, we increased our estimate of the costs related to the investigation and remediation of certain of RG&E's existing sites where gas was manufactured in the past. The liability to investigate and perform remediation, as necessary, for those inactive gas manufacturing sites increased $25 million as of June 30, 2007. There was no effect on net income as a result of the increase in estimate because the costs will be recovered in rates, through insurance settlements or from other third parties. RG&E seeks to collect past and future environmental response costs through current litigation.

## Note 8. New Accounting Standards

### Statement 157

**:** In September 2006 the FASB issued Statement 157. Changes from current practice that will result from the application of Statement 157 relate to the definition of fair value, the methods used to measure fair value, and expanded disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements in which the FASB previously concluded that fair value is the relevant measurement attribute, but does not require any new fair value measurements. Statement 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier application encouraged. The provisions are to be applied prospectively, with certain exceptions. A cumulative-effect adjustment to retained earnings is required for application to certain financial instruments. We plan to adopt Statement 157 effective January 1, 2008, and are currently assessing the effects that the adoption would have on our results of operation, financial position and/or cash flows.

### Statement 159

**:** In February 2007 the FASB issued Statement 159, which will allow an entity to measure eligible financial instruments and certain other items at fair value as of specified election dates on an instrument-by-instrument basis (the fair value option). The fair value option is irrevocable unless a new election date occurs. The fair value option will significantly expand an entity's ability to select the measurement attribute for certain key assets and liabilities, and allow it to mitigate potential mismatches that arise under the current mixed measurement attribute model. Statement 159 will be effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, with early adoption permitted when specified conditions are met. We plan to adopt Statement 159 as of January 1, 2008, and are currently assessing the effects that the adoption would have on our results of operation, financial position and/or cash flows.

### DIG Issue G26

**:** In December 2006 the FASB cleared DIG Issue G26, which provides guidance concerning a cash flow hedge of a variable-rate financial asset or liability for which the interest rate risk is not based solely on an index, such as an interest rate that is reset through an auction process. According to DIG Issue G26, an entity may designate the risk being hedged as the risk of overall changes in the hedged cash flows related to a variable-rate financial asset or liability. However, it may not designate the risk being hedged as the interest rate risk (the risk of changes in cash flows attributable to changes in the designated benchmark interest rate) unless the cash flows of the hedged transaction are explicitly based on that same benchmark interest rate. The implementation guidance of DIG Issue G26 became effective on April 1, 2007. As a result of applying DIG Issue G26, we dedesignated the hedging relationships as of April 1, 2007, for two of NYSEG's cash flow hedges. A $3.3 million pretax loss on those derivatives for the period prior to April 1, 2007, will remain in accumulated other comprehensive income and be reclassified into earnings in the same periods that the hedged forecasted transactions have an effect on earnings.

### EITF 06-10

**:** The FASB ratified the consensus in EITF 06-10 in late March 2007. EITF 06-10 requires an employer to recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement (in which the employee, versus the employer, owns and controls the insurance policy) in accordance with either FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions* (Statement 106) or APB Opinion No. 12, *Omnibus Opinion - 1967* (Opinion 12). An entity would recognize a liability in accordance with Statement 106 if, in substance, a postretirement benefit plan exists or, in accordance with Opinion 12, if the arrangement is, in substance, an individual deferred compensation contract. EITF 06-10 also requires an employer to recognize and measure an

asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years, with earlier application permitted. Entities should recognize the effects of applying the consensus through either (1) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (2) a change in accounting principle through retrospective application to all prior periods. We plan to apply the consensus in EITF 06-10 as of January 1, 2008 as a change in accounting principle through a cumulative-effect adjustment to retained earnings. We are currently assessing the effects that the application of EITF 06-10 would have on our results of operation, financial position and/or cash flows, but expect that the effects will not be material.

FSP FIN 39-1

: The FASB issued FSP FIN 39-1 in late April 2007. FSP FIN 39-1 permits a reporting entity that is party to a master netting arrangement to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments that have been offset under the same master netting arrangement in accordance with paragraph 10 of FASB Interpretation No. 39, *Offsetting of Certain Amounts Related to Certain Contracts* (Interpretation 39). FSP FIN 39-1 also amends Interpretation 39 to replace the terms *conditional contracts* and *exchange contracts* with the term *derivative instruments* as defined in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, with early application permitted. The effects of applying FSP FIN 39-1 are to be recognized as a change in accounting principle through retrospective application for all financial statements presented unless it is impracticable to do so. Upon adoption of FSP FIN 39-1, a reporting entity would be allowed to change its accounting policy to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. We plan to adopt FSP FIN 39-1 as of January 1, 2008, and are currently assessing the effects that the adoption would have on our results of operation, financial position and/or cash flows.

Note 9. Accounts Receivable

Our accounts receivable include unbilled revenues of $141 million at September 30, 2007, and $221 million at December 31, 2006, and are shown net of an allowance for doubtful accounts of $60 million at September 30, 2007, and $59 million at December 31, 2006.

Note 10. Retirement Benefits

We have funded noncontributory defined benefit pension plans that cover substantially all of our employees. The plans provide defined benefits based on years of service and final average salary. We also have other postretirement health care benefit plans covering substantially all of our employees. The health care plans are contributory with participants' contributions adjusted annually.

Components of net periodic benefit (income) cost

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| Three months ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Service cost | $8,779 | $9,360 | $1,438 | $1,463 |
| Interest cost | 32,463 | 31,800 | 7,423 | 7,330 |
| Expected return on plan assets | (58,216) | (55,423) | (711) | (423) |
| Amortization of prior service cost | 1,154 | 1,184 | (1,858) | (1,876) |
| Recognized net loss | 3,982 | 5,562 | 1,382 | 1,696 |
| Amortization of transition obligation | - | - | 1,700 | 1,700 |
| Net periodic benefit (income) cost | $(11,838) | $(7,517) | $9,374 | $9,890 |

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| Nine months ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Service cost | $26,335 | $28,082 | $4,315 | $4,389 |
| Interest cost | 97,388 | 95,398 | 22,268 | 21,990 |
| Expected return on plan assets | (174,646) | (166,270) | (2,134) | (1,270) |
| Amortization of prior service cost | 3,461 | 3,552 | (5,575) | (5,628) |
| Recognized net actuarial loss | 11,946 | 16,685 | 4,148 | 5,088 |
| Amortization of transition obligation | - | - | 5,100 | 5,100 |
| Net periodic benefit (income) cost | $(35,516) | $(22,553) | $28,122 | $29,669 |

Under the terms of the joint proposal entered into by NYSEG to resolve issues related to its OPEB costs, NYSEG has established a VEBA, contributed $60 million to the VEBA on October 4, 2007, and expects to contribute an additional $52 million in January 2008. In addition, Energy East contributed $3 million to its pension plans in September 2007.

Note 11. Segment Information

Our electric delivery segment consists of our regulated transmission, distribution and generation operations in New York and Maine, and our natural gas delivery segment consists of our regulated transportation, storage and distribution operations in New York, Connecticut, Maine and Massachusetts. We measure segment profitability based on net income. Other includes primarily our energy marketing companies, and interest income, intersegment eliminations and our other nonutility businesses.

Selected information for our business segments includes:

| | Operating Revenues | | Net Income | |
|---|---|---|---|---|
| Three months ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Electric Delivery | $736,902 | $782,437 | $41,471 | $44,649 |
| Natural Gas Delivery | 169,692 | 186,656 | (18,198) | (18,706) |
| Other | 124,091 | 121,261 | 1,769 | (4,931) |

| | | | | |
|---|---|---|---|---|
| Total | $1,030,685 | $1,090,354 | $25,042 | $21,012 |

-

| | Operating Revenues | | | Net Income |
|---|---|---|---|---|
| Nine months ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Electric Delivery | $2,186,186 | $2,285,436 | $117,626 | $139,112 |
| Natural Gas Delivery | 1,261,478 | 1,226,760 | 56,786 | 43,116 |
| Other | 385,784 | 386,594 | 3,415 | 309 |
| Total | $3,833,448 | $3,898,790 | $177,827 | $182,537 |

Item 2.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

For a discussion of our Agreement and Plan of Merger with Iberdrola whereby we will become a wholly-owned subsidiary of Iberdrola upon completion of the Merger, see Recent Developments.

Energy East's primary operations, our electric and natural gas utility operations, are subject to rate regulation established predominantly by state utility commissions. The approved regulatory treatment on various matters significantly affects our results of operations, financial position and cash flows. We have long-term rate plans for NYSEG's natural gas segment, RG&E, CMP and Berkshire Gas that currently allow for recovery of certain costs, including stranded costs, and provide stable rates for customers and revenue predictability. Where long-term rate plans are not in effect, we monitor the adequacy of rate levels and file for new rates when necessary. NYSEG's five-year electric rate plan expired December 31, 2006, and new rates went into effect on January 1, 2007. SCG received approval for new rates that became effective January 1, 2006, and CNG recently received approval for new rates that became effective April 1, 2007.

Continuing uncertainty in the evolution of the utility industry, particularly the electric utility industry, has resulted in several federal and state regulatory proceedings that could significantly affect our operations and the rates that our customers pay for energy. Those proceedings, which are discussed below, could affect the nature of the electric and natural gas utility industries in New York and New England.

We expect to make significant capital investments to enhance the safety and reliability of our distribution systems and to meet the growing energy needs of our customers in an environmentally responsive manner. Capital spending is expected to exceed $3 billion through 2011, including $496 million in 2007. Major spending programs include the installation of advanced metering infrastructure (AMI) in New York and Maine requiring an investment of approximately $360 million; in excess of $500 million of transmission investments, predominantly in Maine; a high efficiency transformer replacement program; and a "green" fleet initiative. The majority of our planned transmission investments will be pursuant to a regional reliability planning process and should qualify for the FERC's transmission investment ROE incentive adders for New England transmission owners. We have also proposed that RG&E build a new 300 MW natural gas fired power plant at the Russell Station. The proposed plant would meet projected load requirements in the Rochester, New York area and would cost approximately $300 million. We estimate that over one-half of our capital spending program will be funded with internally generated funds and the remainder through the issuance of a combination of debt and equity securities.

This MD&A for the quarter and nine months ended September 30, 2007 should be read in conjunction with our MD&A, financial statements and related notes contained in our report on Form 10-K for the fiscal year ended December 31, 2006. Due to the seasonal nature of our operations, financial results for interim periods are not necessarily indicative of trends for a 12-month period.

Strategy

We have maintained a consistent energy delivery and services strategy over the past several years, focusing on the safe, secure and reliable transmission and distribution of electricity and natural gas. Our operating companies have become increasingly efficient through realization of merger-enabled synergies. Our current strategic focus is on addressing many of the precepts of the Energy Policy Act of 2005 including: (1) investing in transmission to increase reliability, meet new load growth and connect new, renewable generation to the grid; (2) investing in AMI to promote customer conservation and peak load management; (3) investing in our distribution infrastructure to make it more efficient by reducing losses; and (4) investing in new regulated generation that is environmentally friendly and, where possible, sustainable.

Our individual operating company rate plans are a critical component of our success. While specific provisions may vary among our public utility subsidiaries, our overall strategy includes creating stable rate environments that allow our subsidiaries to earn a fair return while minimizing price increases and sharing achieved savings with customers, subject to conditions contained in the Merger Agreement.

Recent Developments

On June 25, 2007, we announced that we had entered into the Merger Agreement with Iberdrola, S.A. a corporation organized under the Laws of the Kingdom of Spain, and Green Acquisition Capital, Inc., a New York corporation that is a wholly-owned subsidiary of Iberdrola.

The Merger Agreement provides for a business combination whereby we and our subsidiaries would become wholly-owned subsidiaries of Iberdrola and each outstanding share of common stock of Energy East (other than shares of Energy East common stock owned by us as treasury stock or by one of our subsidiaries or by Iberdrola or a subsidiary of Iberdrola) will be converted into the right to receive $28.50 per share in cash, without interest.

Iberdrola is one of the world's largest energy companies with more than 26,000 employees. Iberdrola is a leading owner and operator of renewable energy facilities, having an installed capacity of over 7,000 MW of wind generation (the largest wind portfolio in the world) and almost 10,000 MW of hydro generation. In the United States, Iberdrola owns and operates the largest wind facility on the East Coast - Maple Ridge, in upstate New York - and has over 20,000 MW of renewable generation under development in the United States.

Consummation of the Merger is subject to various customary closing conditions, including the requisite approval by our shareholders, the absence of injunctions or restraints imposed by governmental entities, the receipt of required regulatory approvals and the absence of any material adverse change to us. We and our directors have received a class action complaint on behalf of our shareholders, alleging in substance that the Merger Consideration is unfair and inadequate. We have settled with the plaintiffs, subject to court approval. (See Part II, Item 1, Legal Proceedings.)

We expect the Merger to be completed in the first half of 2008 following receipt of the required approvals, including approvals from the FERC and the public utilities commissions in Connecticut, Maine, New Hampshire and New York. Requests for the necessary approvals were made on August 1, 2007, with the four state public utilities commissions and the FERC. Until closing, we and our subsidiaries will continue to operate as a separate company.

Electric Delivery Business Developments

Our electric delivery business consists primarily of our regulated electricity transmission, distribution and generation operations in upstate New York and Maine.

NYSEG's Supply Service Filing

: On August 29, 2007, the NYPSC approved a proposal for revisions to NYSEG's commodity supply service in a joint proposal submitted by NYSEG, NYPSC staff and other interested parties. Provisions of the Supply Service Plan joint proposal as adopted include:

- Continuation of supply service options for customers including taking service from an ESCO, taking service from NYSEG under a Fixed Price Option (FPO) and taking service from NYSEG under various variable price options, depending on the size of the customer.
- Customers would choose their supply service option annually in November and December for the upcoming year.
- The variable rate options will continue to be the default service for customers that do not choose to take service from an ESCO or from NYSEG under the FPO.
- The commodity component of the FPO will be calculated and set annually as under the current commodity program; however, the cost allowance used to set the supply rate will increase. The cost allowance is the margin over projected market prices.
- Customers would be able to switch from the FPO to ESCO service at any time during the year, not just during the enrollment period.
- NYSEG will retain the first $10 million (pretax) of earnings, with sharing above that amount at 85% to ratepayers and 15% to shareholders.
- NYSEG will absorb any losses that are experienced under the FPO.

The provisions of the Supply Service Plan will become effective on January 1, 2008 and remain in place for a three-year term, unless modified as part of an electric delivery rate case prior to that time.

In approving the Supply Service Plan, the NYPSC also established a new proceeding to develop revenue decoupling mechanisms for both the electric and natural gas segments of the business.

NYPSC Proceeding on NYSEG's Accounting for OPEB

: In August 2006 the NYPSC issued its decision in the NYSEG electric rate case. Among other things, the NYPSC instructed the ALJ to open a separate proceeding regarding the NYPSC staff's position that NYSEG should have retained $57 million of interest in its OPEB reserve and used it to reduce rate base rather than to reduce OPEB expenses. In July 2007 NYSEG, the NYPSC staff and various intervenors filed a joint proposal with the NYPSC resolving all outstanding issues in this matter. On September 20, 2007, the NYPSC approved the joint proposal. The joint proposal provides that NYSEG will refund to customers $17 million from its existing ASGA account and establish an external VEBA trust fund for already-reserved OPEB costs, which are currently deducted from rate base, of approximately $112 million. NYSEG contributed $60 million to the VEBA on October 4, 2007, and will contribute an additional $52 million in January 2008. The joint proposal also requires pretax charges to earnings for regulatory purposes of $8 million in 2007, $5 million in 2008 and $4 million in 2009. The charges in 2008 and 2009 are expected to be offset by earnings on the VEBA.

Advanced Metering Infrastructure

: In response to an August 2006 NYPSC order, NYSEG and RG&E filed a plan to install AMI (smart meters) for all of their electric and natural gas customers. Smart meters would provide customers with detailed consumption data, enabling them to better control their energy usage. Smart meters would also eliminate the need for routine manual meter readings and estimated bills, improve the companies' response to service interruptions, improve the gas balancing and settlement process, reduce greenhouse gas emissions, and create opportunity for a wide range of time-differentiated rates, load management and load aggregation programs that are expected to reduce peak loads and thereby defer the need for additional electric generation sources. In May 2007 NYSEG and RG&E filed a supplemental plan that includes updated cost estimates for NYPSC review and approval. The plan calls for a total capital investment of approximately $268 million between 2008 and 2010. Approval for rate treatment has been requested to go into effect January 1, 2008; The company is awaiting NYPSC action on this matter, which is expected by the first quarter of 2008.

Niagara Power Project Relicensing

: The NYPA's FERC license with respect to the Niagara Power Project expired on August 31, 2007. In order to continue to operate the Niagara Power Project, the NYPA filed a relicensing application in August 2005. NYSEG and RG&E had been allocated an aggregate of 360 MWs of Niagara Power Project power based on contracts with the NYPA that expired on August 31, 2007. NYSEG and RG&E also received an allocation of 148 MWs from the St. Lawrence Project pursuant to those same contracts. On March 15, 2007, FERC issued to the NYPA a new license pursuant to an Order on Offer of Settlement and Issuing New License (the "Order"). In the Order, FERC rejected NYSEG's and RG&E's arguments for a continued allocation, stating that its policy is not to direct a specific allocation absent statutory directive, but to leave those matters to private contract or state regulation. The annual value of the allocations to us is approximately $67 million for the Niagara Power Project and $51 million for the St. Lawrence Project, and the loss of the allocations would increase our residential customer rates. At its meeting on July 31, 2007, the NYPA's board of trustees approved a resolution calling for the extension of NYSEG's and RG&E's contracts with the NYPA through June 30, 2008, subject to early termination by the NYPA on at least 30 days' prior written notice. The NYPA executed the contract extensions with NYSEG and RG&E in late August 2007. Under the contract extensions, the allocations to the two companies were slightly reduced from a total of 508 MWs to a total of 451 MWs, which significantly reduces the potential effect on residential customer rates during the time of the contract extensions.

Threatened Litigation for Russell Station

: In October 1999 RG&E received a letter from the New York State Attorney General's office alleging that RG&E may have constructed and operated major modifications to its Beebee and Russell generating stations without obtaining the required prevention of significant deterioration or new source review permits. The letter requested that RG&E provide the Attorney General's office with a large number of documents relating to this allegation. In January 2000 RG&E received a subpoena from the NYSDEC ordering production of similar documents. RG&E supplied documents and complied with the subpoena.

The NYSDEC served RG&E with a notice of violation in May 2000 alleging that between 1983 and 1987 RG&E completed five projects at Russell Station and two projects at Beebee Station, which is currently shut down, without obtaining the appropriate permits. RG&E believes it has complied with the applicable rules and there is no basis for the Attorney General's and the NYSDEC's allegations. Beginning in July 2000 the NYSDEC, the Attorney General and RG&E had a number of discussions with respect to the resolution of the notice of violation. In October 2006 the Attorney General's office and the NYSDEC notified RG&E of their intention to file a complaint in federal court for violations involving Russell Station unless a settlement can be reached.

If the Attorney General and the NYSDEC were to commence a Clean Air Act lawsuit against RG&E, they would need to demonstrate that, among other things, the challenged modifications to Russell Station caused an "increase" in emissions from the station. The issue of what constitutes the appropriate test for an emissions increase was before the United States Supreme Court in Environmental Defense v. Duke Energy Corporation, Docket No. 05-848. In April 2007 the US Supreme Court ruled that the lower courts, in an attempt to reconcile perceived inconsistencies in the EPA's regulation of stationary sources of air pollution, impermissibly invalidated certain of those regulations. The court did not reach a decision concerning whether Duke had in fact violated those regulations. The case was remanded so that issue, as well as other defenses asserted by Duke, can be adjudicated. The effect of this decision on discussions between RG&E, the Attorney General and NYSDEC is unknown. RG&E, the NYSDEC and the Attorney General continue to discuss this matter and no suit has been filed to date. RG&E is not able to predict the outcome of this matter.

CMP July 1, 2007 Price Change

: CMP's delivery prices decreased by a total of $7 million effective July 1, 2007, as a result of the annual update to CMP's transmission revenue requirement, a change in its stranded cost reconciliation adjustment and its final annual ARP 2000 distribution price change. This decrease results primarily from lower transmission congestion costs and a transmission refund requirement previously reserved by CMP. In July each year, CMP updates its transmission revenue requirement and reflects the resulting price change in rates pursuant to its tariff on file with the FERC. CMP's transmission revenue requirement decreased by $7 million. On June 12, 2007, the MPUC approved a settlement implementing an annual stranded cost reconciliation in which CMP will reduce its stranded cost rates by $4 million. These decreases are partially offset by increases under ARP 2000. CMP submitted to the MPUC its annual price change filing pursuant to the terms of its current ARP 2000 on March 15, 2007, and on June 21, 2007, the MPUC approved a settlement which provided for a $4 million distribution rate increase.

CMP Alternative Rate Plan

: On May 1, 2007, CMP submitted a filing to the MPUC proposing a new alternative rate plan for a seven-year term beginning January 1, 2008 (referred to as ARP 2008). CMP's current ARP 2000 ends on December 31, 2007. CMP's proposal retains the basic structure of ARP 2000, including annual price changes based on a specified inflation index less a predetermined productivity offset, service quality indicators and associated penalties for failure to achieve the performance targets, and explicit provisions for the recovery of certain exogenous or mandated costs. The filing proposes to maintain the existing rates at the termination of ARP 2000 as the initial rates for ARP 2008. The first price change under the new rate plan would occur on July 1, 2008. The proposal includes fixed productivity offset values of 0.25% for the initial two years of the rate plan and 0.50% for the remaining five years. It utilizes reserve accounting mechanisms to address recovery of costs associated with major storm restoration and environmental clean-up costs for manufactured gas sites and PCB-contaminated facilities. CMP's ARP 2008 proposal also incorporates incremental investment and operating expenses for new initiatives including: (1) an AMI project to deploy advanced meters and communications to all of CMP's customers at an estimated cost of $90 million; (2) proposed enhancements in distribution vegetation management, inspection practices and distribution betterment projects designed to improve distribution reliability; and (3) accelerated deployment of more efficient distribution transformers. CMP expects a decision on its filing from the MPUC by the second quarter of 2008, but cannot predict the outcome of this proceeding.

April 2007 Storms

: CMP experienced two significant winter storms in April that resulted in extensive outages for its customers and significant damage to its distribution facilities. CMP incurred approximately $11 million in incremental costs to restore electric service to its customers after the storms. CMP estimates that it is entitled to recover approximately $5 million of those costs under ARP 2000 and has deferred that amount as a regulatory asset. CMP plans to request recovery of the $5 million either in its current ARP 2008 proceeding or in some other rate proceeding before the MPUC.

Stranded Cost Reset

: On October 1, 2007, CMP submitted a filing to the MPUC proposing to revise CMP's stranded cost revenue requirement and rates. CMP estimates that its annual stranded cost rates will decrease by approximately $58 million effective March 1, 2008, primarily due to expiring contracts with NUGs and the termination of Maine Yankee nuclear decommissioning collections. CMP proposes to establish stranded cost rates for a three-year period commencing March 1, 2008, with a continuation of current mechanisms for annual reconciliation of actual stranded cost expense and rate recovery. CMP cannot predict the outcome of this proceeding.

Natural Gas Delivery Business Developments

Our natural gas delivery business consists of our regulated natural gas transportation, storage and distribution operations in New York, Connecticut, Massachusetts and Maine.

Natural Gas Supply Agreements

: Our natural gas companies - NYSEG, RG&E, SCG, CNG, Berkshire Gas and MNG - have each entered into a new three-year strategic alliance with Coral Energy Resources, beginning on April 1, 2007, that optimizes transportation and storage services.

CNG Regulatory Proceeding

: In September 2006 CNG submitted a general rate filing, requesting a net rate increase of $28.2 million, or 7.9%, in base delivery revenues effective April 1, 2007, based on an 11.0% ROE. In December 2006 CNG and The Office of Consumer Counsel in the State of Connecticut filed with the DPUC a proposed settlement agreement. On March 14, 2007, the DPUC approved the settlement with minor modifications. The approval included a rate increase of $14.4 million, based on an allowed ROE of 10.1% and a non-firm margin of $12.6 million. The agreement allows CNG to proceed with its proposed automated meter reading project and defer the net costs until its next rate case. CNG also agreed to freeze its base distribution rates for 24 months. The new rates became effective April 1, 2007.

*Advanced Metering Infrastructure*: See Electric Delivery Business Developments.

New Accounting Standards

See Item 1, Note 8 to our condensed consolidated financial statements for explanations about the following new accounting standards recently released by the FASB:

- Statement 157 issued in September 2006,
- Statement 159 issued in February 2007,
- DIG Issue G26 cleared in December 2006 and posted to the FASB website in January 2007,
- EITF 06-10 ratified in March 2007, and
- FSP FIN 39-1 posted in April 2007.

(a) Liquidity and Capital Resources

Operating Activities

: Significant operating activities that affected cash flows during the nine months ended September 30, 2007, included the following:

- A decrease in accounts payable that decreased cash $84 million, primarily due to payments for natural gas and electricity purchases,
- A decrease in receivables that increased cash $107 million, and
- An increase in fuel inventories that decreased cash $27 million.

In addition, RG&E paid a cash refund to customers of $10 million, which represented the last scheduled refund pursuant to its 2004 electric rate agreement. NYSEG refunded $77 million as a credit to customer bills, which was required as part of its August 2006 rate order. This noncash transaction is not included in the Statement of Cash Flows.

Investing Activities

: Utility capital spending for the nine months ended September 30, 2007 was $292 million. We project utility capital spending of $496 million for 2007, the majority of which we expect to pay for with internally generated funds. Capital spending will be primarily for the extension of energy delivery service, necessary improvements to existing facilities, compliance with environmental requirements and governmental mandates, and the RG&E transmission project.

Current investments available for sale, which consist of auction rate securities, increased $202 million during the nine months, primarily as a result of funds available from our spring 2007 issuance of common stock.

Financing Activities

: The financing activities discussed below include those activities necessary for the company and its principal subsidiaries to maintain adequate liquidity and credit quality and ensure access to capital markets.

On March 27, 2007, we sold nine million shares of common stock at $24.25 per share. As provided for in an underwriting agreement, we sold an additional one million shares of common stock at $24.25 per share on April 2, 2007, pursuant to an over-allotment provision. After deducting underwriting fees and other costs, the aggregate net proceeds were $235 million. The proceeds will be used to fund the repurchase of debt and for general corporate purposes, including our construction program. The sale increased our common equity ratio to 44%.

During the six months ended June 30, 2007, we issued 406,073 shares of our common stock at an average price of $24.87 through our Investor Services Program. As a result of the Merger Agreement, effective June 30, 2007, shares purchased through the Investor Services Program are now purchased in the open market.

We repurchased 350,000 shares of our common stock in January 2007, primarily for grants of restricted stock. We awarded 296,145 shares of our common stock, issued out of treasury stock, to certain employees through our Restricted Stock Plan, at a grant date fair value of $24.76 per share of common stock. On July 1, 2007, we issued 47,826 shares at a grant date fair value of $26.09 per share of common stock.

In July 2007 RG&E issued and sold $100 million of First Mortgage 6.47% Bonds, due 2032, Series WW, to fund a portion of the amount necessary to redeem $125 million of its First Mortgage 6.65% Bonds, due 2032, Series UU, which were redeemed on July 23, 2007.

On July 18, 2007, RG&E filed a Form 15 with the SEC, and on July 24, 2007, the New York Stock Exchange filed a Form 25 with respect to RG&E's redeemed Series UU bonds, which terminated RG&E's status as a registrant under the Securities Exchange Act of 1934 (Exchange Act). RG&E will no longer file Exchange Act reports including Forms 10-K, 10-Q and 8-K, and proxy statements or information statements

. We do not expect that the termination of RG&E's Exchange Act registration will materially affect RG&E's access to or cost of capital.

In September 2007 CMP issued $40 million of Series F medium-term notes at 6.40%, due in 2037, of which $15 million was used to refinance maturing debt Series F medium-term notes at 4.25%, due in 2007, and the remainder will be used for general corporate purposes.

In October 2007 SCG issued $40 million of medium-term notes at 6.38%, due in 2037, to refinance maturing debt of Series II medium-term notes at 7.60% due in 2007.

In October 2007 CNG issued $20 million of medium-term notes at 6.66%, due in 2037, of which $19 million was to refinance maturing debt of Series B medium-term notes at 6.62% - 6.69% due in 2007 and the remainder for general corporate purposes.

In July 2007, NYSEG filed a petition with the NYPSC for new long-term financing authority. A hearing with the NYPSC is scheduled for November 7, 2007. NYSEG plans to issue $200 million to refinance $150 million of maturing debt and to finance the VEBA funding mandated under its recent OPEB accounting settlement with the NYPSC. In addition, in October 2007, RG&E filed a petition with the NYPSC for a new long-term financing authority. RG&E expects the NYPSC will grant its requested relief at a hearing in early 2008.

(b) Results of Operations

Earnings per Share

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands, except per share amounts) | | | | |
| Net Income | $25,042 | $21,012 | $177,827 | $182,537 |
| Earnings per Share, basic and diluted | $.16 | $.14 | $1.15 | $1.24 |
| Dividends Declared per Share | $.30 | $.29 | $.90 | $.87 |
| Average Common Shares Outstanding, basic | 157,221 | 146,903 | 153,986 | 146,946 |
| Average Common Shares Outstanding, diluted | 158,279 | 147,702 | 154,972 | 147,686 |

Three Months

Earnings per basic share for the quarter ended September 30, 2007 increased 2 cents compared to the quarter ended September 30, 2006, primarily because of:

- Lower interest expenses that increased earnings 3 cents per share due to lower carrying costs on regulatory liabilities, savings from debt refinancings completed in 2006 and the issuance of common stock in the spring of 2007,

- Lower income tax expense that increased earnings 8 cents per share, primarily due to adjustments reflecting the actual 2006 tax expense as filed and revisions to tax expense for 2007, and
- An increase of 4 cents for the recognition in July 2006 of unamortized expenses related to the retirement of our 8 1/4% debt securities and associated trust preferred securities.

Those increases were offset by:

- Lower electric margins largely due to the August 2006 NYSEG electric rate order that reduced earnings 10 cents per share, and
- Higher operating and maintenance costs, which reduced earnings 2 cents per share.

Nine Months

Earnings per share, basic for the nine months ended September 30, 2007, decreased 9 cents per share compared to the nine months ended September 30, 2006, primarily because of:

- Lower electric margins largely due to the August 2006 NYSEG rate order which, excluding delivery volume increases, reduced earnings per share 42 cents ,
- Higher operating and maintenance costs, which reduced earnings per share 3 cents, and
- The effect of a higher number of common shares outstanding, which reduced earnings per share 6 cents.

Those decreases were partially offset by:

- Higher electricity and natural gas delivery volumes, which resulted in a 9 cents per share increase in electric margins and an increase of 8 cents per share in natural gas margins,
- Lower interest costs, which increased earnings 10 cents per share, for the reasons described above.
- Lower income taxes which increased earnings 11 cents per share primarily due to adjustments reflecting the actual 2006 tax expense as filed and revisions to tax expense for 2007, and
- An increase of 4 cents for the recognition in July 2006 of unamortized expenses related to the retirement of our 8 1/4% debt securities and associated trust preferred securities.

Energy Deliveries

Comparisons of energy deliveries and electricity commodity sales for the three months and nine months ended September 30, 2007 and 2006 are shown below.

| | Electricity Deliveries (MWh) | | | Natural Gas Deliveries (Dth) | | |
|---|---|---|---|---|---|---|
| Three months ended September 30, | 2007 | 2006 | Change | 2007 | 2006 | Change |
| (Thousands) | | | | | | |
| Residential | 3,113 | 3,147 | (1%) | 4,633 | 5,081 | (9%) |
| Commercial | 2,689 | 2,631 | 2% | 1,584 | 2,474 | (36%) |
| Industrial | 1,909 | 1,895 | 1% | 474 | 530 | (11%) |
| Other | 570 | 537 | 6% | 2,744 | 2,952 | (7%) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Transportation of customer-owned natural gas | N/A | N/A | N/A | 13,764 | 14,280 | (4%) |
| Total Retail | 8,281 | 8,210 | 1% | 23,199 | 25,317 | (8%) |
| Wholesale | 1,665 | 2,152 | (23%) | 276 | - | - |
| Total Deliveries | 9,946 | 10,362 | (4%) | 23,475 | 25,317 | (7%) |
| Electricity commodity sales (1) | 3,417 | 3,503 | (3%) | N/A | N/A | N/A |

(1)

Included in total deliveries

| | Electricity Deliveries (MWh) | | | Natural Gas Deliveries (Dth) | | |
|---|---|---|---|---|---|---|
| Nine months ended September 30, | 2007 | 2006 | Change | 2007 | 2006 | Change |
| (Thousands) | | | | | | |
| Residential | 9,323 | 9,056 | 3% | 54,814 | 50,052 | 10% |
| Commercial | 7,620 | 7,304 | 4% | 18,233 | 17,460 | 4% |
| Industrial | 5,448 | 5,416 | 1% | 2,549 | 2,575 | (1%) |
| Other | 1,712 | 1,661 | 3% | 9,837 | 9,442 | 4% |
| Transportation of customer-owned natural gas | N/A | N/A | N/A | 57,135 | 57,010 | - |
| Total Retail | 24,103 | 23,437 | 3% | 142,568 | 136,539 | 4% |
| Wholesale | 5,385 | 7,139 | (25%) | 894 | 91 | 882% |
| Total Deliveries | 29,488 | 30,576 | (4%) | 143,462 | 136,630 | 5% |
| Electricity commodity sales (1) | 10,106 | 10,146 | - | N/A | N/A | N/A |

(1)

Included in total deliveries

Several factors influence the change in volume of energy deliveries, with the primary factor being weather. Temperatures during the nine months ended September 30, 2007, were significantly colder than in 2006. The effects of warmer or colder weather are especially significant to the demand for natural gas. We estimate that for the nine months ended September 30, 2007, approximately one-half of the 4% increase in retail natural gas deliveries was due to colder weather. Comparative weather data is shown in the following table.

Weather Conditions

| | Three Months | | | Nine Months | | |
|---|---|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | Normal | 2007 | 2006 | Normal |

| | | | | | | |
|---|---|---|---|---|---|---|
| New York | | | | | | |
| Heating degree days | 141 | 184 | 227 | 4,398 | 4,019 | 4,594 |
| (Warmer) colder than prior year | (23%) | | | 9% | | |
| (Warmer) than normal | (38%) | | | (4%) | | |
| Cooling degree days | 422 | 424 | 366 | 621 | 562 | 489 |
| (Cooler) warmer than prior year | (1%) | | | 11% | | |
| Warmer than normal | 15% | | | 27% | | |
| New England | | | | | | |
| Heating degree days | 99 | 119 | 128 | 4,103 | 3,661 | 4,138 |
| (Warmer) colder than prior year | (17%) | | | 12% | | |
| (Warmer) colder than normal | (23%) | | | 1% | | |
| Cooling degree days | 319 | 340 | 322 | 407 | 444 | 388 |
| (Cooler) than prior year | (6%) | | | (8%) | | |
| (Cooler) warmer than normal | (1%) | | | 5% | | |

Operating Results for the Electric Delivery Business

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Operating Revenues | | | | |
| Retail | $592,143 | $591,768 | $1,709,379 | $1,666,341 |
| Wholesale | 107,735 | 133,689 | 339,786 | 428,567 |
| Other | 37,024 | 56,980 | 137,021 | 190,528 |
| Total Operating Revenues | $736,902 | $782,437 | $2,186,186 | $2,285,436 |
| Operating Expenses | | | | |
| Electricity purchased and fuel used in generation | $381,141 | $401,603 | $1,117,826 | $1,133,153 |
| Other operating and maintenance expenses | 183,647 | 179,760 | 526,713 | 517,503 |
| Depreciation and amortization | 45,118 | 46,308 | 134,230 | 139,009 |
| Other taxes | 38,131 | 38,976 | 113,380 | 115,058 |
| Total Operating Expenses | $648,037 | $666,647 | $1,892,149 | $1,904,723 |
| Operating Income | $88,865 | $115,790 | $294,037 | $380,713 |

Three Months

Operating Revenues

: The $46 million decrease in operating revenues for the third quarter of 2007 was primarily the result of:

- A decrease of $9 million resulting from NYSEG's delivery rate decrease pursuant to its August 2006 rate order,

- A decrease of $19 million resulting from lower accruals for the NBC, which will be passed on to customers through lower transition charges,
- A decrease of $26 million in wholesale revenues, reflecting a 23% decline in wholesale volume, and
- A decrease of $4 million resulting from a 3% decrease in sales under supply service programs in New York.

Those decreases were partially offset by:

- An increase of $12 million in average delivery prices, primarily resulting from higher transition charges. Transition charges allow our electric utility companies to recover actual generation and purchased power costs and have no net effect on earnings.

Operating Expenses

: The $19 million decrease in operating expenses for the third quarter of 2007 was primarily the result of:

- A decrease of $20 million for lower purchased power costs, including $4 million because of a major NUG contract that expired,
- A decrease of $3 million in bad debt expense, and
- A decrease of $8 million in storm related costs.

Those decreases were partially offset by:

- An increase of $3 million in OPEB expenses attributable to the discontinuance of credits from the internal reserve as a result of NYSEG's August 2006 rate order,
- An increase of $4 million related to NYSEG's OPEB joint proposal (see Electric Delivery Business Developments, NYPSC Proceeding on NYSEG's Accounting for OPEB), and
- An increase of $5 million consisting of small increases in several categories.

Nine Months

Operating Revenues

: The $99 million decrease in operating revenues for the nine months ended September 30, 2007 was primarily the result of:

- A decrease of $18 million resulting from higher accruals for earnings sharing, which is included in other revenues. Those higher accruals reflect $14 million of adjustments recorded in 2006 resulting from the finalization of NYSEG's and RG&E's annual compliance filings for 2005,
- A decrease of $27 million resulting from NYSEG's delivery rate decrease pursuant to its August 2006 rate order,
- A decrease of $89 million in wholesale revenues, reflecting a 25% decline in wholesale volume,
- A decrease of $28 million resulting from lower accruals for the NBC, which will be passed on to customers through lower transition charges,
- A decrease of $3 million resulting from lower prices for electricity sales under supply service programs in New York, and
- A decrease of $8 million in other revenues.

Those decreases were partially offset by:

- An increase of $51 million in average delivery prices, primarily resulting from higher transition charges. Transition charges allow our electric utility companies to recover actual generation and purchased power costs and have no net effect on earnings. The increase in transition charges was partially offset by the NBC accrual discussed above, and
- An increase of $24 million resulting from a 3% increase in retail deliveries. Approximately one-third of the increase was due to colder winter temperatures in 2007.

Operating Expenses

: The $13 million decrease in operating expenses for the nine months ended September 30, 2007 was primarily the result of:

- A decrease of $15 million for lower purchased power costs, including $6 million because of a major NUG contract that expired,
- A decrease of $5 million in depreciation expense primarily due to lower depreciation rates adopted in NYSEG's August 2006 rate order, and
- A decrease of $10 million in storm related costs.

Those decreases were partially offset by:

- An increase of $9 in OPEB expenses attributable to the discontinuance of credits from the internal reserve as a result of NYSEG's August 2006 rate order.
- An increase of $4 million related to the OPEB joint proposal settlement (see Electric Delivery Business Developments, NYPSC Proceeding on NYSEG's Accounting for OPEB), and
- An increase of $4 million consisting of small increases in several categories.

Operating Results for the Natural Gas Delivery Business

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Operating Revenues | | | | |
| Retail | $158,617 | $177,108 | $1,247,279 | $1,211,388 |
| Wholesale | 2,019 | 1 | 7,954 | 30 |
| Other | 9,056 | 9,547 | 6,245 | 15,342 |
| Total Operating Revenues | $169,692 | $186,656 | $1,261,478 | $1,226,760 |
| Operating Expenses | | | | |
| Natural gas purchased | $81,849 | $97,469 | $794,587 | $779,902 |
| Other operating and maintenance expenses | 66,483 | 66,748 | 182,910 | 190,830 |
| Depreciation and amortization | 21,345 | 21,511 | 64,870 | 64,229 |
| Other taxes | 17,721 | 18,356 | 73,787 | 71,018 |
| Total Operating Expenses | $187,398 | $204,084 | $1,116,154 | $1,105,979 |
| Operating Income | $(17,706) | $(17,428) | $145,324 | $120,781 |

Three Months

Operating Revenues

: The $17 million decrease in operating revenues for the third quarter of 2007 was primarily the result of:

- A decrease of $23 million resulting from an 8% decrease in retail deliveries, and
- A decrease of $4 million resulting from CNG's interruptible margin sharing mechanism.

Those decreases were partially offset by:

- An increase of $3 million resulting from higher base rates for CNG,
- An increase of $4 million from higher wholesale and transportation revenues, and
- An increase of $4 million in other revenues.

Operating Expenses

: The $17 million decrease in operating expenses for the third quarter of 2007 was primarily the result of:

- A decrease of $21 million in natural gas purchases due to lower delivery volumes.

That decrease was partially offset by:

- An increase of $3 million primarily due to higher prices for purchased natural gas that were passed on to customers.

Nine Months

Operating Revenues

: The $35 million increase in operating revenues for the nine months ended September 30, 2007 was primarily the result of:

- An increase of $71 million resulting from a 4% increase in retail deliveries. About one-half of the increase was due to colder winter weather in 2007,
- An increase of $18 million resulting from higher wholesale and transportation revenues, and
- An increase of $8 million resulting from higher base rates for CNG.

Those increases were partially offset by:

- A decrease of $51 million resulting from lower market prices for natural gas that were passed on to customers,
- A decrease of $7 million from CNG's interruptible margin sharing mechanism, and
- A decrease of $4 million in other revenue.

-

Operating Expenses

: The $10 million increase in operating expenses for the nine months ended September 30, 2007, was primarily the result of:

- An increase of $55 million in natural gas purchases due to higher delivery volumes,

- An increase of $3 million in gross receipts taxes resulting from higher revenues, and
- An increase of $6 million in natural gas purchases resulting from an increase in wholesale sales.

Those increases were partially offset by:

- A decrease of $46 million in natural gas purchases resulting from lower market prices that were passed on to customers, and
- A decrease of $8 million in operating expenses primarily due to lower bad debt expenses.

Operating Results for the Energy Marketing Business

The primary business included in our Other segment is our energy marketing business composed of Energetix, Inc. and NYSEG Solutions, Inc., which market electricity and natural gas to customers throughout New York state. They have approximately 162,000 electricity customers and 52,000 natural gas customers in the service territories of RG&E, NYSEG and several other New York state utilities.

| | Three Months | | Nine Months | |
|---|---|---|---|---|
| Periods ended September 30, | 2007 | 2006 | 2007 | 2006 |
| (Thousands) | | | | |
| Electricity sales (MWh) | 1,218 | 1,160 | 3,385 | 3,445 |
| Natural gas sales (Dth) | 484 | 565 | 5,445 | 5,131 |
| Operating Revenues | | | | |
| Electric | $107,180 | $100,789 | $287,828 | $282,689 |
| Natural gas | 4,997 | 5,009 | 58,870 | 60,884 |
| Total Operating Revenues | $112,177 | $105,798 | $346,698 | $343,573 |
| Operating Expenses | | | | |
| Electricity purchased | $101,604 | $96,538 | $273,377 | $270,148 |
| Natural gas purchased | 5,519 | 5,965 | 57,239 | 56,520 |
| Other operating expenses | 4,673 | 2,808 | 11,362 | 8,334 |
| Total Operating Expenses | $111,796 | $105,311 | $341,978 | $335,002 |
| Operating Income | $381 | $487 | $4,720 | $8,571 |

Three Months

Operating Revenues

: The $6 million increase in operating revenues for the third quarter of 2007 was primarily the result of:

- An increase of $5 million due higher retail electricity sales resulting from an increase in customers,
- An increase of $1 million in electric revenue resulting from higher average rates, and
- An increase of $1 million in natural gas revenues resulting from higher average natural gas rates.

Those increases were partially offset by:

- A decrease of $1 million in natural gas revenue resulting from lower sales.

Operating Expenses

: The $7 million increase in operating expense for the third quarter of 2007 was primarily the result of:

- An increase of $5 million in purchased electricity due to higher electric volumes resulting from an increase in customers,
- An increase of $2 million in other operating expenses due to additional sales and marketing expenses as well as increased billing costs, and
- An increase of $1 million in natural gas purchased due to higher natural gas prices.

Those increases were partially offset by:

- A decrease of $1 million in purchased natural gas due to lower sales.

Nine Months

Operating Revenues

: The $3 million increase in operating revenues for the nine months ended September 30, 2007, was primarily the result of:

- An increase of $10 million due to higher retail electric revenues from variable rate customers resulting from higher market prices for electricity, and
- An increase of $4 million due to an increase in natural gas sales.

Those increases were partially offset by:

- A decrease of $5 million due to lower electric sales resulting from the loss of some large customers to other suppliers, and
- A decrease of $6 million due to lower natural gas prices.

Operating Expenses

: The $7 million increase in operating expenses for the nine months ended September 30, 2007, was primarily the result of:

- An increase of $8 million in purchased electricity resulting from higher market prices,
- An increase of $4 million in purchased natural gas due to higher natural gas sales, and
- An increase of $3 million in other operating expenses due to additional sales and marketing expenses as well as increased billing costs.

Those increases were offset by:

- A decrease of $5 million in purchased electricity due to lower electric sales, and
- A decrease of $3 million in natural gas purchases due to lower natural gas prices.

Item 3.

**Quantitative and Qualitative Disclosures About Market Risk**

(See our report on Form 10-K for the fiscal year ended December 31, 2006, Item 7A - Quantitative and Qualitative Disclosures About Market Risk.)

NYSEG's and RG&E's exposure to fluctuations in the market price of electricity is limited to the load required to serve those customers who select the fixed rate option, which effectively combines delivery and supply service at a fixed price. NYSEG uses electricity contracts, both physical and financial, to manage fluctuations in the cost of electricity required to serve customers who select the fixed rate option. We include the cost or benefit of those contracts in the amount expensed for electricity purchased when the related electricity is sold. Owned electric generation and long-term supply contracts reduce NYSEG's exposure, and significantly reduce RG&E's exposure, to market fluctuations for procurement of their fixed rate option electricity supply.

As of October 1, 2007, the expected load for NYSEG's fixed rate option customers is fully hedged for October through December 2007. A fluctuation of $1.00 per MWh in the average price of electricity would change NYSEG's earnings less than $150,000 for October through December 2007. RG&E expects to meet its fixed price load obligations for 2007 with owned generation or long-term supply contracts. The percentage of NYSEG's and RG&E's hedged load is based on load forecasts, which include certain assumptions such as historical weather patterns. Actual results could differ as a result of changes in the load compared to the load forecasts.

All of our natural gas utilities have purchased gas adjustment clauses that allow them to recover through rates any changes in the market price of purchased natural gas, substantially eliminating their exposure to natural gas price risk. NYSEG and RG&E use natural gas futures and forwards to manage fluctuations in natural gas commodity prices in order to provide price stability to customers. The cost or benefit of natural gas futures and forwards is included in the commodity cost that is passed on to customers when the related sales commitments are fulfilled. We record changes in the fair value of natural gas hedge contracts as regulatory assets or regulatory liabilities.

Energetix and NYSEG Solutions, Inc. offer retail electric and natural gas service to customers in New York state and actively hedge the load required to serve customers that have chosen them as their commodity supplier. As of October 15, 2007, the energy marketing subsidiaries' expected fixed price loads were fully hedged for November through December 2007. A fluctuation of $1.00 per MWh in the average price of electricity would change their earnings less than $22,000 for November through December 2007. The percentage of hedged load for the energy marketing subsidiaries is based on load forecasts, which include certain assumptions such as historical weather patterns. Actual results could differ as a result of changes in the load compared to the load forecasts.

NYSEG, RG&E, Energetix and NYSEG Solutions face risks related to counterparty performance on hedging contracts due to counterparty credit default. We have developed a matrix of unsecured credit thresholds that are dependent on a counterparty's or the counterparty guarantor's applicable credit rating (normally Moody's or S&P). When our exposure to risk for a counterparty exceeds the unsecured credit threshold, the counterparty is required to post additional collateral or we will no longer transact with the counterparty until the exposure drops below the unsecured credit threshold.

We use interest rate swap agreements to manage the risk of increases in variable interest rates and to maintain desired fixed-to-floating rate ratios. We record amounts paid and received under those agreements as adjustments to the interest expense of the specific debt issues. As required by DIG Issue G26 (see Part I, Item 1, Note 8. New Accounting Standards) we dedesignated the hedging relationships as of April 1, 2007, for NYSEG's two cash flow hedges related to its auction rate notes. We are investigating our options concerning the future management of interest rate risk for those instruments.

Item 4.

**Controls and Procedures**

Our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. "Disclosure controls and procedures" are controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms, is recorded, processed, summarized and reported, and is accumulated and communicated to the company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective.

We maintain a system of internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Our system of internal control over financial reporting contains self-monitoring mechanisms and actions are taken to correct deficiencies as they are identified. There was no change in our internal control over financial reporting that occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

Item 1

. **Legal Proceedings**
(See Part I, Item 2, MD&A, Threatened Litigation for Russell Station.)

Merger-related Lawsuit:

On July 6, 2007, a purported class action complaint was filed in the Supreme Court of the State of New York for Kings County against the company and its directors. The complaint alleges that, among other things, the consideration for the proposed acquisition by Iberdrola is unfair and inadequate because it does not provide the company's stockholders with a sufficient premium for the company's common stock and the defendants have breached their fiduciary duty. The complaint seeks to enjoin the merger in addition to an unspecified amount of damages. On September 26, 2007, the plaintiff and Energy East and its directors agreed, subject to confirmatory discovery and court approval, to settle the lawsuit. The settlement is based on Energy East's agreement to include certain additional disclosures in its proxy statement. As a result of the settlement, plaintiff will not seek to enjoin the transaction. The settlement, if completed and approved by the court, will result in dismissal with prejudice of the lawsuit. The settlement also will result in a release of claims that have been or could have been asserted relating to the Merger, the Merger Agreement, or any disclosures relating to the Merger by the plaintiff and the purported class of Energy East shareholders. In connection with such settlement, the plaintiff's counsel will apply to the court for attorneys' fees and expenses not to exceed in the aggregate $340,000, which Energy East has agreed to pay, if awarded by the court, provided the court approves the settlement and dismisses the lawsuit with prejudice. Energy East and its directors continue to deny all of the substantive allegations in the complaint.

Item 1A. Risk Factors

The information presented below updates, and should be read in conjunction with, the risk factor information disclosed in our annual report on Form 10-K. (See report of Form 10-K for Energy East for the fiscal year ended

December 31, 2006, Part I, Item 1A. Risk Factors.)

There can be no assurance that Iberdrola's acquisition of the company will be completed:

Consummation of the proposed merger is subject to satisfaction of various closing conditions, including obtaining approvals or consents from a number of United States federal and state public utility, antitrust and other regulatory authorities described in the Merger Agreement. We cannot predict whether such authorizations will be obtained on satisfactory terms or the timing of required regulatory approvals. If the Merger is not completed and the Merger Agreement is terminated, the market price of our common stock may decline to the extent that the then-current market price of those shares reflects an assumption as to the completion of the Merger. Under certain circumstances, we could be obligated to pay Iberdrola a termination fee of $45 million. While the Merger is pending, we have agreed to operate our businesses in the ordinary course and certain significant business actions or changes from our ordinary course will require the consent of Iberdrola.

Item 2.

**Unregistered Sales of Equity Securities and Use of Proceeds**

(c) Issuer Purchases of Equity Securities

| Period | (a) Total number of shares purchased [1] | (b) Average price paid per share | (c) Total number of shares purchased as part of publicly announced plans or programs | (d) Maximum number of shares that may yet be purchased under the plans or programs |
|---|---|---|---|---|
| Month #1 (July 1, 2007 to July 31, 2007) | 5,929[1] | $26.16 | - | - |
| Month #2 (August 1, 2007 to August 31, 2007) | 4,526[1] | $25.97 | - | - |
| Month #3 (September 1, 2007 to September 30, 2007) | 4,889[1] | $26.87 | - | - |
| Total | 15,344 | $26.33 | - | - |

(1)

Represents shares of the company's common stock (Par Value $.01) purchased in open-market transactions on behalf of the company's Employees' Stock Purchase Plan.

Item 6.

**Exhibits**

See

Exhibit Index.

Signature

Pursuant to the requirements 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.

ENERGY EAST CORPORATION
(Registrant)

Date: November 1, 2007

By /s/Robert D. Kump
Robert D. Kump
Senior Vice President and Chief Financial Officer
(Principal Accounting Officer)

EXHIBIT INDEX

The following exhibits are delivered with this report:

| Exhibit No. | Description of Exhibit |
|---|---|
| (A)10-33 | Amended and Restated Employment Agreement dated as of June 25, 2007, by and among the Company, Energy East Management Corporation and W.W. von Schack. |
| 31-1 | Certification under Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31-2 | Certification under Section 302 of the Sarbanes-Oxley Act of 2002. |
| *32 | Certifications under Section 906 of the Sarbanes-Oxley Act of 2002. |

(A) Management contract or compensatory plan or arrangement.
* Furnished pursuant to Regulation S-K Item 601(b)(32).