New York State Electric & Gas Corporation

Financial Statements

For the Years Ended December 31, 2010 and 2009

New York State Electric & Gas Corporation

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Report of Independent Auditors

To the Stockholder and Board of Directors
of New York State Electric & Gas Corporation:

In our opinion, the accompanying balance sheets and the related statements of income, of cash flows, and of changes in common stock equity present fairly, in all material respects, the financial position of New York State Electric & Gas Corporation (the "Company") at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 28, 2011

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New York State Electric & Gas Corporation
Statements of Income

Year Ended December 31,	2010	2009
(Thousands)		
Operating Revenues		
Electric	**$1,344,951**	$1,217,171
Natural gas	**372,235**	433,781
Total Operating Revenues	**1,717,186**	1,650,952
Operating Expenses		
Electricity purchased	**614,074**	589,771
Natural gas purchased	**187,097**	252,352
Other operating expenses	**293,541**	334,368
Maintenance	**166,536**	96,861
Depreciation and amortization	**113,295**	109,028
Other taxes	**121,020**	118,659
Total Operating Expenses	**1,495,563**	1,501,039
Operating Income	**221,623**	149,913
Other (Income)	**(12,936)**	(15,424)
Other Deductions	**845**	1,254
Interest Charges, Net	**71,058**	78,369
Income Before Income Taxes	**162,656**	85,714
Income Taxes	**62,171**	30,400
Net Income	**100,485**	55,314
Preferred Stock Dividends	**396**	396
Earnings Available for Common Stock	**$100,089**	$54,918

The accompanying notes are an integral part of our financial statements.

New York State Electric & Gas Corporation
Statements of Comprehensive Income

Year Ended December 31,	2010	2009
(Thousands)		
Net Income	**$100,485**	$55,314
Other Comprehensive Income, Net of Tax	**1,053**	4,393
Comprehensive Income	**$101,538**	$59,707

The accompanying notes are an integral part of our financial statements.

New York State Electric & Gas Corporation
Balance Sheets

December 31,	2010	2009
(Thousands)		
Assets		
Current Assets		
Cash and cash equivalents	**$6,244**	$42,555
Accounts receivable and unbilled revenues, net	**281,077**	290,394
Affiliated accounts receivable	**4,291**	2,521
Fuel and natural gas in storage, at average cost	**34,605**	41,641
Materials and supplies, at average cost	**11,541**	8,784
Deferred income taxes	**41,032**	18,084
Derivative assets	**1,504**	203
Broker margin accounts	**10,965**	7,166
Prepayments and other current assets	**51,513**	44,725
Total Current Assets	**442,772**	456,073
Utility Plant, at Original Cost		
Electric	**3,115,112**	2,990,907
Natural gas	**750,033**	731,105
Common	**298,911**	299,687
	4,164,056	4,021,699
Less accumulated depreciation	**1,679,189**	1,596,345
Net Utility Plant in Service	**2,484,867**	2,425,354
Construction work in progress	**128,801**	57,061
Total Utility Plant	**2,613,668**	2,482,415
Assets Held For Sale	**32,730**	33,455
Other Property and Investments	**18,288**	21,366
Regulatory and Other Assets		
Regulatory assets		
Environmental remediation costs	**156,841**	172,465
Unfunded future income taxes	**104,978**	59,646
Unamortized loss on debt reacquisitions	**30,816**	34,719
Natural gas hedges	**5,357**	4,178
Pension and other postretirement benefits	**579,544**	566,070
Other	**127,087**	136,041
Total regulatory assets	**1,004,623**	973,119
Other assets		
Prepaid pension benefits	**87,336**	144,362
Other	**20,263**	31,129
Total other assets	**107,599**	175,491
Total Regulatory and Other Assets	**1,112,222**	1,148,610
Total Assets	**$4,219,680**	$4,141,919

The accompanying notes are an integral part of our financial statements.

New York State Electric & Gas Corporation
Balance Sheets

December 31,	2010	2009
(Thousands)		
Liabilities		
Current Liabilities		
Current portion of long-term debt	**$288**	$187,768
Notes payable	**24,400**	-
Accounts payable and accrued liabilities	**103,966**	46,278
Accounts payable to affiliates	**19,497**	27,576
Accounts payable, natural gas purchased	**14,984**	18,163
Accounts payable, electricity purchased	**58,535**	55,896
Interest accrued	**7,236**	7,639
Taxes accrued	**6,366**	5,431
Derivative liabilities	**5,375**	4,048
Environmental remediation costs	**32,536**	26,707
Energy efficiency programs	**21,480**	13,766
Customer deposits	**38,789**	40,855
Other	**35,721**	23,901
Total Current Liabilities	**369,173**	458,028
Regulatory and Other Liabilities		
Regulatory liabilities		
Deferred income taxes	**188,834**	166,337
Accrued removal obligations	**420,738**	409,292
Positive benefit adjustments	**111,018**	177,920
Other	**109,334**	60,753
Total regulatory liabilities	**829,924**	814,302
Other liabilities		
Deferred income taxes	**610,244**	559,795
Other postretirement benefits	**143,488**	158,528
Asset retirement obligation	**16,590**	16,716
Environmental remediation costs	**95,174**	102,456
Other	**63,098**	76,733
Total other liabilities	**928,594**	914,228
Total Regulatory and Other Liabilities	**1,758,518**	1,728,530
Long-term debt	**1,014,568**	904,082
Total Liabilities	**3,142,259**	3,090,640
Commitments and Contingencies		
Preferred Stock		
Redeemable solely at the option of NYSEG	**10,159**	10,159
Common Stock Equity		
Common stock ($6.66 2/3 par value, 90,000 shares authorized and 64,508 shares outstanding at December 31, 2010 and 2009)	**430,057**	430,057
Capital in excess of par value	**268,364**	268,364
Retained earnings	**375,882**	350,793
Accumulated other comprehensive loss	**(7,041)**	(8,094)
Total Common Stock Equity	**1,067,262**	1,041,120
Total Liabilities and Equity	**$4,219,680**	$4,141,919

The accompanying notes are an integral part of our financial statements.

New York State Electric & Gas Corporation
Statements of Cash Flows

Year Ended December 31,	2010	2009
(Thousands)		
Operating Activities		
Net income	**$100,485**	$55,314
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**113,339**	118,957
Amortization of regulatory and other assets and liabilities	**7,490**	4,168
Deferred income taxes and investment tax credits, net	**28,937**	99,116
Storm cost related to joint proposal	**57,453**	-
Positive benefit adjustments (income) including carrying costs	**(66,902)**	10,281
Pension expense (income)	**29,672**	(14,929)
Changes in current operating assets and liabilities		
Accounts receivable and unbilled revenues, net	**9,104**	2,723
Inventories	**4,279**	27,089
Broker margin accounts	**(3,799)**	36,398
Prepayments and other current assets	**200**	(9,855)
Accounts payable and accrued liabilities	**30,410**	(26,522)
Interest accrued	**(403)**	29
Taxes accrued	**(10,727)**	15,763
Other current liabilities	**10,574**	15,472
Changes in other assets		
Nonbypassable wires charge	**9,081**	2,323
Environmental reserves	**14,171**	(23,807)
Other	**5,868**	(26,626)
Changes in other liabilities		
Reserve on regulatory assets	**(30,000)**	30,000
Asset sale gain account charges	**2,729**	(23,829)
Other	**(6,897)**	5,107
Net Cash Provided by Operating Activities	**305,064**	297,172
Investing Activities		
Utility plant additions	**(217,302)**	(119,376)
Investments, net	**4,241**	1,192
Net Cash Used in Investing Activities	**(213,061)**	(118,184)
Financing Activities		
Long-term note repayments	**(77,318)**	(9,565)
Notes payable three months or less, net	**24,400**	(117,000)
Notes payable affiliates	**-**	(19,000)
Dividends paid on common and preferred stocks	**(75,396)**	(396)
Net Cash Used in Financing Activities	**(128,314)**	(145,961)
Net (Decrease) Increase in Cash and Cash Equivalents	**(36,311)**	33,027
Cash and Cash Equivalents, Beginning of Year	**42,555**	9,528
Cash and Cash Equivalents, End of Year	**$6,244**	$42,555

The accompanying notes are an integral part of our financial statements.

New York State Electric & Gas Corporation
Statements of Changes in Common Stock Equity

(Thousands)	Common Stock Outstanding $6.66 2/3 Par Value Shares	Amount	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2009	64,508	$430,057	$268,364	$295,875	$(12,487)	$981,809
Net income				55,314		55,314
Other comprehensive income, net of tax					4,393	4,393
Comprehensive income						59,707
Cash dividends declared						
Preferred stock (at serial rates)						
Redeemable - optional				(396)		(396)
Balance, December 31, 2009	64,508	430,057	268,364	350,793	(8,094)	1,041,120
Net income				100,485		100,485
Other comprehensive income, net of tax					1,053	1,053
Comprehensive income						101,538
Cash dividends declared						
Common stock				(75,000)		(75,000)
Preferred stock (at serial rates)						
Redeemable - optional				(396)		(396)
Balance, December 31, 2010	64,508	$430,057	$268,364	$375,882	$(7,041)	$1,067,262

The accompanying notes are an integral part of our financial statements.

Notes to Financial Statements

New York State Electric & Gas Corporation

Note 1. Significant Accounting Policies

Background: New York State Electric & Gas Corporation (NYSEG, the company, we, our, us) conducts regulated electricity transmission and distribution operations and regulated natural gas transportation, storage and distribution operations in upstate New York. It also generates electricity, primarily from its several hydroelectric stations. NYSEG serves approximately 877,000 electricity and 261,000 natural gas customers in its service territory of approximately 20,000 square miles, which is located in the central, eastern and western parts of the state of New York and has a population of approximately 2.5 million. The larger cities in which NYSEG serves electricity and natural gas customers are Binghamton, Elmira, Auburn, Geneva, Ithaca and Lockport. We operate under the authority of the New York State Public Service Commission (NYPSC) and are also subject to regulation by the Federal Energy Regulatory Commission (FERC).

NYSEG is a subsidiary of Iberdrola USA, Inc. (Iberdrola USA), which is a wholly-owned subsidiary of Iberdrola, S.A. (Iberdrola), a corporation organized under the laws of the Kingdom of Spain. On December 1, 2009, Iberdrola USA changed its legal and operating name to Iberdrola USA, Inc., from Energy East Corporation.

We have evaluated events or transactions that occurred after December 31, 2010, for inclusion in these financial statements through March 28, 2011, which is the date these financial statements were available to be issued.

As part of an effort to reduce costs and increase efficiency, we undertook various measures to reduce workforce levels in 2010. We reduced workforce levels by 37 employees through an involuntary separation at a cost of approximately $1 million, which we paid in cash and charged to other operating expenses. We also offered voluntary early retirement programs (VERPs) to qualifying nonunion and union employees. The 319 employees who accepted the VERPs will receive forms of enhanced pension benefits. In 2010 we recorded costs totaling approximately $21 million for the VERPs, which will be paid from our pension plans. We also modified the Kirkwood call center workforce salary structure and size, incurring a cost of approximately $4 million, which was paid in cash and charged to other operating expenses. As part of the New York rate order (see Note 11), we were allowed to defer and recover those costs in rates.

***Accounts receivable*:** Accounts receivable at December 31 include unbilled revenues of $82 million for 2010 and $84 million for 2009, and are shown net of an allowance for doubtful accounts at December 31 of $14 million for 2010 and $11 million for 2009. Accounts receivable do not bear interest, although late fees may be assessed. Bad debt expense was $16 million in 2010 and $17 million in 2009.

Unbilled revenues represent estimates of receivables for energy provided but not yet billed. The estimates are determined based on various assumptions, such as current month energy load requirements, billing rates by customer classification and delivery loss factors. Changes in those assumptions could significantly affect the estimates of unbilled revenues.

The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable, determined based on experience for each service region and operating segment. Each month we review our allowance for doubtful accounts and past due accounts over 90 days and/or above a specified amount, and review all other balances on a pooled basis by age and type of receivable. When we believe that a receivable will not be recovered, we charge off the account balance against the allowance. Changes in assumptions

about input factors and customer receivables, which are inherently uncertain and susceptible to change from period to period, could significantly affect the allowance for doubtful accounts estimates. During 2010 we recorded an increase in the allowance for doubtful accounts of $4 million because we no longer consider customer security deposits when we determine the amount of our allowance for doubtful accounts.

***Asset retirement obligations*:** We record the fair value of the liability for an asset retirement obligation (ARO) and/or a conditional ARO in the period in which it is incurred and capitalize the cost by increasing the carrying amount of the related long-lived asset. We adjust the liability to its present value periodically over time, and depreciate the capitalized cost over the useful life of the related asset. Upon settlement we will either settle the obligation at its recorded amount or incur a gain or a loss. We defer any timing differences between rate recovery and depreciation expense as either a regulatory asset or a regulatory liability.

The term conditional ARO refers to an entity's legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. If an entity has sufficient information to reasonably estimate the fair value of the liability for a conditional ARO, it must recognize that liability at the time the liability is incurred.

Our ARO at December 31, including our conditional ARO was $17 million for 2010 and 2009. The ARO consists primarily of obligations related to removal or retirement of: asbestos, PCB-contaminated equipment, gas pipeline and cast iron gas mains. The long-lived assets associated with our AROs are generation property, gas storage property, distribution property and other property.

We have AROs for which we have not recognized a liability because the fair value cannot be reasonably estimated due to indeterminate settlement dates, including: the removal of hydroelectric dams due to structural inadequacy; the removal of property upon termination of an easement, right-of-way or franchise; and costs for abandonment of certain types of gas mains.

Accrued removal obligations: We meet the requirements concerning accounting for regulated operations, and recognize a regulatory liability, for financial reporting purposes only, for the difference between removal costs collected in rates and actual costs incurred. We classify those amounts as accrued removal obligations.

Broker margin accounts: We maintain accounts with clearing firms that require initial margin deposits upon the establishment of new positions, primarily related to natural gas and electricity derivatives, as well as maintenance margin deposits in the event of unfavorable movements in market valuation for those positions. The amount reflecting those activities is shown as broker margin accounts on our balance sheets.

Notes to Financial Statements

New York State Electric & Gas Corporation

***Statements of cash flows*:** We consider all highly liquid investments with a maturity date of three months or less when acquired to be cash equivalents and those investments are included in cash and cash equivalents.

Supplemental Disclosure of Cash Flows Information	2010	2009
(Thousands)		
Cash paid (received) during the year ended December 31:		
Interest, net of amounts capitalized	**$52,309**	$53,559
Income taxes, net of cash paid	**$44,558**	$(83,869)

Interest capitalized was $1 million in 2010 and $0.7 million in 2009. We have decreased utility plant additions by $19 million for amounts payable as of December 31, 2010.

***Depreciation and amortization*:** We determine depreciation expense using the straight-line method, based on the average service lives of groups of depreciable property, which include estimated cost of removal. The weighted-average service lives of certain classifications of property are: transmission property – 62 years, distribution property - 54 years, gas production and storage property – 23 years, generation property – 59 years and other property – 40 years. Our depreciation accruals were equivalent to 2.7% of average depreciable property for 2010 and 2009.

We charge repairs and minor replacements to operating expense, and capitalize renewals and betterments, including certain indirect costs. We charge the original cost of utility plant retired or otherwise disposed of to accumulated depreciation.

Government grants: Authoritative accounting principles generally accepted in the United States of America do not address accounting for government grants. For that reason, we account for government grants related to depreciable assets in accordance with the prescribed FERC accounting for contributions in aid of construction, that is, the grant amount is credited to the cost of the related property, plant and equipment. In accounting for government grants related to operating and maintenance costs, we recognize amounts receivable as compensation for expenses already incurred in profit or loss in the period in which it becomes receivable. (See Note 6.)

New accounting standards adopted: We have adopted new accounting standards issued by the Financial Accounting Standards Board (FASB) as explained below.

Fair value measurements: The FASB has issued a number of new standards related to fair value measurements. In April 2009 the FASB issued two new standards related to fair value measurements, which we began applying effective April 1, 2009:

- One of the new standards provides guidance for determining fair value when the volume and level of activity for an asset or liability have significantly decreased and for identifying transactions that are not orderly. It provides additional guidance to entities for estimating fair value in accordance with existing requirements when the volume and level of activity for an asset or a liability has significantly decreased. Even in those circumstances, and without considering the valuation technique(s) used, the intention of fair value measurement does not change. The new standard also provides guidance for identifying circumstances that indicate a transaction is not orderly. In addition, it amends the disclosures in connection with fair value measurements to require disclosure in interim and annual periods about the inputs and valuation techniques used to measure fair value as well as a discussion of any changes

in them during the period; and to require disclosures concerning debt and equity securities according to major security types.

- The other new standard provides amended guidance concerning the recognition and presentation of other-than-temporary impairments. It amends the guidance in U.S. generally accepted accounting principles for other-than-temporary impairment of debt securities (but not equity securities) to make it more operational and to improve the financial statement presentation and disclosure of other-than-temporary impairments on debt and equity securities.

In August 2009 the FASB issued an accounting standards update to provide amended guidance concerning the fair value measurement of liabilities. The key provisions of the amendments include clarification about valuation techniques that are to be used in circumstances in which a quoted price in an active market for the identical liability is not available and that a reporting entity is not to include a separate input or adjustments to other inputs to reflect the existence of a restriction that prevents the transfer of a liability. The amended guidance is effective for an entity's first reporting period (including interim periods) beginning after issuance of the update. We initially began applying the guidance effective October 1, 2009.

In January 2010 the FASB issued amendments to improve disclosures about fair value measurements. New disclosures that are or will be required include: 1) details of transfers in and out of Level 1 and Level 2 of the fair value measurement hierarchy, and 2) gross presentation of roll forward activity within Level 3 – separate presentation of information about purchases, sales, issuances and settlements. Entities will also have to provide fair value measurement disclosures for each class of assets and liabilities, as well as disclosures about inputs and valuation techniques for both recurring and nonrecurring Level 2 and Level 3 fair value measurements. The amendments are effective for interim and annual reporting periods beginning after December 15, 2009, except that the disclosures about Level 3 roll forward activity are effective for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years.

Our adoption of the new standards related to fair value measurements had no effect on our financial position, results of operation or cash flows. Our adoption of the amendments concerning Level 3 roll forward activity effective for fiscal years beginning on or after January 1, 2011, and interim periods within those fiscal years, will not affect our results of operation, financial position or cash flows.

Variable interest entities: In June 2009 the FASB issued amendments to its revised interpretation concerning consolidation of variable interest entities (VIEs). The amendments clarify, but do not significantly change, the criteria for determining whether an entity meets the definition of a VIE, and change existing consolidation guidance so that qualifying special purpose entities are no longer exempt from consolidation. The amendments require an enterprise to perform ongoing assessments as to whether an entity is a VIE and whether the enterprise is the primary beneficiary of a VIE. Previously such assessments were required only when specified events occurred. The amended standard will alter how an enterprise determines when an entity that is not sufficiently capitalized or not controlled through voting should be consolidated. An enterprise will also be required to perform a qualitative analysis to determine whether it should provide consolidated reporting of an entity based upon the entity's purpose and design and the enterprise's ability to direct the entity's actions. The amended standard also requires enhanced disclosures to provide more transparent information about an enterprise's involvement in a VIE, and any significant changes in its risk exposure due to that involvement.

The amendments are effective at the start of a company's first fiscal year beginning after November 15, 2009, including interim periods. Our adoption of the amendments effective January 1, 2010, did not affect our results of operation, financial position or cash flows.

Other (Income) and Other Deductions:

Year Ended December 31, **(Thousands)**	**2010**	**2009**
Interest and dividend income	**$(521)**	$(868)
Carrying cost on regulatory assets	**(10,224)**	(12,360)
Allowance for funds used during construction	**(2,116)**	(1,007)
Miscellaneous	**(75)**	(1,189)
Total other (income)	**$(12,936)**	$(15,424)
Civic donations	**$259**	$420
Accrued penalties	**-**	78
Miscellaneous	**586**	756
Total other deductions	**$845**	$1,254

***Reclassifications*:** Certain amounts have been reclassified in our financial statements to conform to the 2010 presentation. The reclassifications primarily affect the balance sheet in connection with the presentation of assets held for sale.

***Regulatory assets and regulatory liabilities*:** We currently meet the requirements concerning accounting for regulated operations for our electric and natural gas operations in New York; however, we cannot predict what effect the competitive market or future actions of regulatory entities would have on our ability to continue to do so. If we were to no longer meet the requirements concerning accounting for regulated operations for all or a separable part of our operations, we may have to record certain regulatory assets and regulatory liabilities as an expense or as revenue, or include them in accumulated other comprehensive income.

Pursuant to the requirements concerning accounting for regulated operations we capitalize, as regulatory assets, incurred and accrued costs that are probable of recovery in future electric and natural gas rates. Substantially all regulatory assets for which funds have been expended are either included in rate base or are accruing carrying costs. As a result of the New York rate decision (see Note 11), the majority of our regulatory assets and liabilities are now included in rate base. As a result, carrying costs will decline significantly from 2010 levels. We also record, as regulatory liabilities, obligations to refund previously collected revenue or to spend revenue collected from customers on future costs.

Unfunded future income taxes and deferred income taxes are amortized as the related temporary differences reverse. Unamortized loss on debt reacquisitions is amortized over the lives of the related debt issues. Nuclear plant obligations, gain on sale of generation assets, other regulatory assets and other regulatory liabilities are amortized over various periods in accordance with our current rate plans. Amortization of total regulatory assets net of amortization of total regulatory liabilities was $1 million in 2010 and $3 million in 2009.

In 2009 we recorded reserves totaling $30 million on existing regulatory assets to reflect management's assessment of risk and increased uncertainty about the ultimate recovery for certain issues that had not been resolved with our regulator. (See Note 6.) The resulting charge increased other operating expenses for the period. Those issues were resolved as part of the 2010 rate decision. (See Note 11.)

New York State Electric & Gas Corporation

Other regulatory assets and other regulatory liabilities consisted of:

December 31, (Thousands)	2010	2009
Asset retirement obligations	**$14,868**	$15,299
Deferred pension costs	**47,913**	52,299
Deferred storm costs	**33,200**	69,649
Nonbypassable wires charge	**2,530**	11,611
Cost to achieve efficiency initiatives	**23,610**	-
Other	**4,966**	17,183
Reserve on regulatory assets	**-**	(30,000)
Total other regulatory assets	**$127,087**	$136,041
Economic development	**$18,204**	$8,278
Deferred natural gas costs	**6,051**	13,281
Asset retirement obligations	**3,001**	3,001
Taxes on depreciation expense	**13,459**	11,552
Asset sale gain account	**38,993**	17,470
Nonbypassable wires charge	**13,182**	-
Other	**16,444**	7,171
Total other regulatory liabilities	**$109,334**	$60,753

Related party transactions: Iberdrola USA Management Corporation provides various administrative and management services to Iberdrola USA's operating utilities, including NYSEG, pursuant to service agreements. The cost for those services is allocated in accordance with methodologies set forth in the service agreements. The cost allocation methodologies vary depending on the type of service provided. Management believes such allocations are reasonable. The cost for services provided to NYSEG by Iberdrola USA and its subsidiaries were approximately $54 million for 2010 and $59 million for 2009 and cost for services provided by NYSEG to Iberdrola USA and its subsidiaries were approximately $11 million for 2010 and $9 million for 2009.

***Revenue recognition*:** We recognize revenues upon delivery of energy and energy-related products and services to our customers.

We enter into power purchase and sales transactions with the New York Independent System Operator (NYISO). When we sell electricity from owned generation to the NYISO, and subsequently repurchase electricity from the NYISO to serve our customers, we record the transactions on a net basis in our statement of income. We net our purchase and sale transactions with the NYISO on an hourly basis.

In addition, we accrue revenue pursuant to the various regulatory provisions to record regulatory assets for revenues that will be collected in the future.

***Taxes*:** We compute our income tax provision on a separate return method. The determination and allocation of our income tax provision and its components are outlined and agreed to in our tax sharing agreements with Iberdrola USA.

Deferred income taxes reflect the effect of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and the amount recognized for tax purposes. We amortize investment tax credits over the estimated lives of the related assets.

Notes to Financial Statements

New York State Electric & Gas Corporation

We account for sales tax collected from customers and remitted to taxing authorities on a net basis.

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

Use of estimates and assumptions: The preparation of our financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but not limited to: (1) allowance for doubtful accounts and unbilled revenues; (2) asset impairments; (3) depreciable lives of assets; (4) income tax valuation allowances; (5) uncertain tax positions; (6) reserves for professional, workers' compensation, and comprehensive general insurance liability risks; (7) contingency and litigation reserves; and (8) earnings sharing mechanism (ESM), nonbypassable wires charges and environmental remediation liability. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations, as considered necessary. Actual results could differ from those estimates.

Note 2. Income Taxes

Year Ended December 31,	**2010**	**2009**
(Thousands)		
Current		
Federal	**$22,865**	$(55,575)
State	**10,369**	(13,140)
Current taxes charged to expense	**33,234**	(68,715)
Deferred		
Federal	**34,186**	85,373
State	**(4,544)**	14,449
Deferred taxes charged to expense	**29,642**	99,822
Investment tax credit adjustments	**(705)**	(707)
Total	**$62,171**	$30,400

The significant increase in current income tax expense in 2010, and corresponding decrease in deferred income tax expense as compared to 2009 is driven primarily by the increase in pretax book income offset by tax depreciation.

Notes to Financial Statements

New York State Electric & Gas Corporation

Our tax expense differed from the expense at the statutory rate of 35% due to the following:

Year Ended December 31, (Thousands)	2010	2009
Tax expense at statutory rate	**$56,930**	$30,000
Depreciation and amortization not normalized	**7,645**	3,162
Investment tax credit amortization	**(705)**	(707)
Removal costs	**(4,248)**	(2,381)
Medicare subsidy	**(939)**	(2,725)
Tax return and audit adjustments	**101**	1,828
State taxes, net of federal benefit	**3,786**	851
Other, net	**(399)**	372
Total	**$62,171**	$30,400

Income taxes were $5.2 million more in 2010 than they would have been at the federal statutory rate of 35% and $0.4 million more in 2009. The 2010 effective tax rate was more than the statutory rate primarily due to depreciation and amortization not normalized, offset by tax benefits, including removal costs and Medicare subsidy. The 2009 effective tax rate was more than the statutory rate primarily due to depreciation and amortization not normalized and the flow-through effect of the tax deduction related to retirements on the 2008 return filed in 2009 offset by tax benefits, including removal costs and Medicare subsidy. The variance in State taxes, net in 2010 as compared to 2009 is driven primarily by the increase in pretax income.

Our deferred tax assets and liabilities consisted of:

December 31, (Thousands)	2010	2009
Current Deferred Income Tax Assets	**$41,032**	$18,084
Noncurrent Deferred Income Tax Liabilities (Assets)		
Property related	**$569,245**	$536,560
Unfunded future income taxes	**37,988**	26,425
Accumulated deferred investment tax credits	**18,460**	19,165
Pension	**194,857**	205,657
Other postretirement benefits	**(30,537)**	(34,042)
Positive benefits adjustments merger order	**(43,980)**	(70,483)
Other	**53,045**	42,850
Total Noncurrent Deferred Income Tax Liabilities	**799,078**	726,132
Less amounts classified as regulatory liabilities		
Deferred income taxes	**188,834**	166,337
Noncurrent Deferred Income Tax Liabilities	**$610,244**	$559,795
Deferred tax assets	**$115,549**	$122,609
Deferred tax liabilities	**873,595**	830,657
Net Accumulated Deferred Income Tax Liabilities	**$758,046**	$708,048

We have no federal or state tax credit or loss carryforwards, and no valuation allowances.

Reconciliation of Gross Income Tax Reserves (Thousands)	2010	2009
Balance as of January 1	**$22,809**	$606
Increases for tax positions related to prior years	**-**	22,203
Balance as of December 31	**$22,809**	$22,809

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The total gross unrecognized tax benefits as of December 31, 2010, were $22.8 million, including gross income tax reserves of $22.2 million and interest of $0.6 million. Including interest, $2.4 million of the gross unrecognized tax benefits would affect the effective tax rate, if recognized.

We have been audited through 2005 for federal income taxes. The statute of limitations in all state jurisdictions has expired for all years through 2006. Our federal returns for 2006 through 2009 are currently under review. We anticipate that the reviews will be completed in 2011. We cannot predict the ultimate outcome of the reviews.

As a result of the passage of The Small Business Jobs Act in September 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 in December 2010, certain capital additions qualify for 50% bonus depreciation and 100% expensing, respectively, for tax purposes. Iberdrola USA and its affiliates have elected to apply the 50% bonus and 100% expensing to the additions it has determined qualify for this accelerated tax depreciation. There is no earnings impact related to this election as the accelerated tax depreciation creates a temporary difference that requires the establishment of a deferred tax liability.

Elimination of tax deduction related to Medicare Part D Subsidy**:** The Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010 (H.R. 4872) were signed into U.S. law in late March 2010. We receive a federal subsidy because we sponsor retiree health benefit plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. The subsidy is known as the Retiree Drug Subsidy (RDS or the subsidy). The RDS payments we receive are not currently taxed. A provision in the PPACA changes the tax treatment of the RDS, requiring the amount of the subsidy received to be offset against the amount of retiree health care payments that would be eligible for a tax deduction. As a result, the subsidy received would reduce an employer's tax deduction for the costs of retiree health care. Our subsidy receipts will effectively become taxable in tax years that begin after December 31, 2012.

In accordance with U.S. GAAP concerning accounting for income taxes, a reporting entity is required to immediately recognize the effect of a change in tax law in continuing operations in the income statement in the period that includes the enactment date. We recorded the effect of the change related to the RDS in the quarter ended March 31, 2010, due to the fact that we accounted for the future tax benefit on an accrual basis. In accounting for the effect of the change for U.S. GAAP reporting, an employer that captured the tax benefit of future subsidies on an accrual basis would now be required to reduce the accumulated deferred tax asset on its balance sheet related to the accrued estimated deductible retiree health care payments to reflect the fact that the future deduction will now be reduced by the collection of the accrued subsidy.

Companies that meet the requirements concerning accounting for regulated operations offset that decrease with the establishment of a regulatory asset. As a result, we have recorded a regulatory asset for unfunded future income taxes of approximately $25 million and reduced our deferred income tax asset related to the costs of retiree health care by approximately $16 million. In addition, because the recognition of the unfunded future income tax regulatory asset is considered a temporary difference, we have recognized an associated deferred income

tax liability of approximately $9 million. There is no immediate effect on the income statement under this accounting, only our balance sheet is affected. The amortization of the $25 million regulatory asset and associated $9 million deferred tax liability commenced on September 1, 2010, in accordance with the provisions of the NYSEG rate settlement. The amortization period is 40 months.

Note 3. Long-term Debt

At December 31, 2010 and 2009, our long-term debt was:

			Amount (Thousands)	
	Interest Rates	**Maturity**	**2010**	**2009**
1985 Series A, B & D	4.00% - 4.10%	2015	**$132,000**	$132,000
1994 Series B & C	3.00%	2013	**101,000**	-
2004 Series B & C	3.245% - 5.35%	2028-2034	**70,000**	170,000
2006 Series A	3.00%	2013	**12,000**	-
Pollution control notes, fixed			**315,000**	302,000
2006 Series A	.27%	2024	-	12,000
2005 Series A	.25%	2026	**25**	1,550
2004 Series A	.25%	2027	**175**	175
2004 Series C	.70%	2034	**100,000**	-
1994 Series B,C, D1 & D2	.17% to .24%	2029	**-**	175,000
Pollution control notes, variable			**100,200**	188,725
Unsecured notes	5.50% to 6.15%	2012 to 2023	**600,000**	600,000
Obligations under capital leases			**2,083**	3,876
Unamortized premium (discount) on debt, net			**(2,427)**	(2,751)
Total long-term debt			**1,014,856**	1,091,850
Less variable rate demand notes included in current liabilities			**-**	187,000
Less capital leases included in current liabilities			**288**	768
Total Long-term Debt			**$1,014,568**	$904,082

We have no secured indebtedness. None of our debt obligations are guaranteed or secured by any of our affiliates.

In June 2010 we converted $113 million of variable-rate pollution control notes (PCNs) (1994 Series B & C and 2006 Series A) to fixed rate mandatory tender bonds due in 2013. Concurrent with that transaction we redeemed and did not remarket an additional $74 million of our variable-rate PCNs (1994 Series D1 & D2) and terminated a $190 million credit facility that had served as backstop liquidity for the variable rate PCNs prior to their conversion or redemption.

As of December 31, 2010, we had outstanding $415 million of tax-exempt PCNs, of which $202 million have coupons fixed to maturity, $113 million are notes with a mandatory redemption date in 2013 and $100 million are 7-day auction rate notes. The notes with mandatory redemption dates in 2013 have maturity dates in 2024 through 2029 and may be remarketed as tax-exempt bonds in a different interest rate mode after the mandatory redemptions.

As of December 31, 2009, we had outstanding $489 million of tax-exempt PCNs, of which $202 million had coupons fixed to maturity, $100 million were auction rate notes under a special rate period where the rate was fixed until January 2010, $187 million were weekly variable rate demand notes, and $2 million were 7-day auction rate notes.

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In August 2008 we began to place orders for our own accounts in the auctions. We bid at each auction for 100% of the outstanding securities at the greater of the one-month London Interbank Offer Rate (LIBOR) or the Securities Industry and Financial Markets index. We continued to bid on $99 million of our auction rate notes during 2010 and 2009. At December 31, 2010, we held a total of $99 million of those securities, and $97 million at December 31, 2009.

As of March 18, 2011, we were:
Paying rates averaging 0.70% on the remaining $100 million of auction rate notes for which we are not placing orders at auction.

- Paying rates averaging 0.21% on the $99 million of auction rates notes on which we are placing orders at auction, substantially all of which are being held on account and have been accounted for as a redemption of long-term debt.

At December 31, 2010, long-term debt and capital lease payments (in thousands) that will become due during the next five years is:

2011	2012	2013	2014	2015
$288	$100,302	$113,318	$334	$132,350

Note 4. Bank Loans and Other Borrowings

NYSEG is a joint borrower with the other Iberdrola USA operating utilities in a revolving credit facility providing maximum borrowings of up to $475 million in aggregate. Sublimits that total to the aggregate limit apply to each joint borrower and can be altered within the constraints imposed by maximum limits that apply to each joint borrower. NYSEG's maximum credit limit under the joint facility is $200 million and was set at $175 million on December 31, 2010 and at the maximum on March 18, 2011. The joint facility expires in 2012 and requires a fee of 10 basis points annually on the current joint facility sublimit amount.

We also have an intercompany credit facility under a demand note agreement with Iberdrola USA that provides financing of up to $250 million. Under the terms of that agreement, which expires in 2018, we pay the same rate as under Iberdrola USA's credit facility. We had no debt outstanding under the agreement at December 31, 2010. Iberdrola USA obtains funding for its own short-term needs and for the temporary needs of its subsidiaries through a separate credit facility providing maximum borrowings of up to $300 million. That credit facility expires in 2012 and requires a fee on undrawn borrowings of 6 basis points. As of December 31, 2010, Iberdrola USA had utilized $133 million of the $300 million available under its facility.

We use drawings on our credit facilities to finance working capital needs, fund letters of credit, to temporarily finance certain refundings and for other corporate purposes. We had $24 million of short-term debt outstanding under the Joint Facility at December 31, 2010and no short-term debt outstanding at December 31, 2009. The weighted average interest rate on short-term debt was 0.5% at December 31, 2010. At March 18, 2011, we had $117 million of debt outstanding under the intercompany credit facility bearing and interest rate of 0.49%.

In our joint facility we covenant not to permit, without the consent of the lender, our ratio of total indebtedness to total capitalization to exceed 0.65 to 1.00 at any time. For purposes of calculating the maximum ratio of indebtedness to total capitalization, the facility excludes from net worth the balance of Accumulated other comprehensive income (loss) as it appears on the balance sheet. The facility contains various other covenants, including a restriction on the amount of secured indebtedness NYSEG may maintain. Continued unremedied failure to

comply with those covenants for five business days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity. NYSEG's ratio of indebtedness to total capitalization pursuant to the revolving credit facility was 0.49 to 1.00 at December 31, 2010. We are not in default as of December 31, 2010.

In its revolving credit facility Iberdrola USA covenants not to permit, without the consent of the lender, its ratio of consolidated indebtedness to consolidated total capitalization to exceed 0.65 to 1.00 at any time. For purposes of calculating the maximum ratio of indebtedness to total capitalization, the facility excludes from net worth the balance of Accumulated other comprehensive income (loss) as it appears on the balance sheet. The facility contains various other covenants, including a restriction on the amount of secured indebtedness Iberdrola USA may maintain. Continued unremedied failure to comply with those covenants for 15 days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity. Iberdrola USA's ratio of consolidated indebtedness to consolidated total capitalization pursuant to the revolving credit facility was 0.48 to 1.00 at December 31, 2010. Iberdrola USA was not in default as of December 31, 2010.

We believe we have sufficient liquidity available to meet our working capital and capital spending requirements. As of March 18, 2011, we have a $190 million available under the joint facility, $133 million available under the intercompany facility and approximately $9 million of cash on hand.

Note 5. Preferred Stock Redeemable Solely at the Option of the Company

At December 31, 2010 and 2009, our serial cumulative preferred stock was:

Series	Par Value Per Share	Redemption Price Per Share	Shares Authorized and Outstanding[1]	Amount (Thousands) 2010	2009
3.75%	$100	$104.00	78,379	**$7,838**	$7,838
4.50% (1949)	100	103.75	11,800	**1,180**	1,180
4.40%	100	102.00	7,093	**709**	709
4.15% (1954)	100	102.00	4,317	**432**	432
Limited Voting Junior	1	-	1	**-**	-
Total				**$10,159**	$10,159

[1] At December 31, 2010, NYSEG had 2,353,411 shares of $100 par value preferred stock, 10,800,000 shares of $25 par value preferred stock and 1,000,000 shares of $100 par value preference stock authorized but unissued.

We had no redemptions or purchases of preferred stock during 2010 and 2009.

Note 6. Commitments and Contingencies

***Capital spending*:** We have commitments in connection with our capital spending program. We plan to invest more than $900 million in our energy delivery infrastructure during the next five years, including amounts dedicated to electric reliability. We expect that about three-fourths of our capital spending will be paid for with internally generated funds and the remainder through the issuance of debt securities. The program is subject to periodic review and revision. Our capital spending will be primarily for the extension of energy delivery service, increased transmission capacity, necessary improvements to existing facilities and compliance with environmental requirements and governmental mandates.

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A Smart Grid Investment Grant (SGIG) was awarded to and is administered through the NYISO to the New York transmission owners, which include NYSEG. The DOE awarded the grant to the NYISO, which concluded a sub-recipient agreement with us on May 5, 2010. According to the grant the DOE will reimburse us, through the NYISO, a total of approximately $5.5 million for two projects. We will spend a matching amount on the projects to bring the total value of the SGIG project to approximately $11.1 million. The SGIG consists of a project to add switched capacitors to our electric grid and another project to install phasor measurement units to the grid. The new equipment will improve the voltage stability of the New York electric grid and enhance the efficiency of power flows across New York, thereby reducing the cost and increasing the reliability of electric power for New York consumers. We expect to complete the projects by the end of July 2013.

On November 30, 2010, we executed a $29.6 million cooperative funding agreement with the DOE as part of the agency's Smart Grid Demonstration Program. As a result, we launched a comprehensive feasibility study of a compressed air energy storage (CAES) facility. Compressed air would be pumped into a depleted underground salt cavern when low-cost, off-peak electricity is available to power the compressors. The compressed air could then be released to spin a turbine and generate electricity as needed, particularly during times of high customer demand. The feasibility study, to be completed in late 2011, will evaluate the technical and economic viability of CAES technology as an integral part of promoting stable electricity transmission system operation and the continued development of renewable energy. If the study confirms that CAES is feasible and economical, we would seek approval from state and federal agencies to proceed with construction of the plant with a target in-service date of late 2014.

Merger order: The Iberdrola merger order contained a capital expenditure condition for NYSEG and RG&E of an aggregate $540 million (NYSEG $320 million, RG&E $220 million) during 2009 and 2010. In September 2009 we requested a limited waiver of the capital expenditure merger condition to allow us to spend our capital investment by 2011. The NYPSC denied the request in its order issued in April 2010. If NYSEG and RG&E were to spend less than the amount targeted in the merger order, we were obligated to provide a calculation of the revenue requirement effect resulting from the actual level of capital spending compared to the targeted amount, which could be returned to customers if ordered by the NYPSC.

NYSEG and RG&E were also afforded the opportunity to provide an assessment of other considerations, including the effects on customers associated with a lower level of capital spending, and to provide reasons why the total revenue requirement effect, as calculated, should not be returned to customers. NYSEG and RG&E made their required filing on January 31, 2011. In that filing they informed the NYPSC that their capital expenditures for 2009 and 2010 totaled $546.7 million, or $6.7 million more than the $540 million merger condition, in the aggregate. NYSEG's electric and natural gas businesses and RG&E's natural gas business invested more than their required expenditure levels, but RG&E's electric business invested less than its required expenditure level. In their filing, the companies also demonstrate that a deferral of any revenue requirement effect (in the form of a customer credit/regulatory liability) is unnecessary because: 1) in aggregate NYSEG and RG&E met the capital expenditure condition, 2) they continue to provide safe and reliable service and 3) RG&E's lower electric capital expenditures resulted in a customer benefit due to lower revenue requirements.

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Staff allegations concerning earnings sharing calculations: The New York Department of Public Service Staff (Staff) in its testimony and briefs in the merger proceeding alleged that NYSEG did not properly compute the amount due to customers under the electric ESM in NYSEG's electric rate plan that was in effect from 2002 through 2006. The Staff claimed that its preliminary analysis showed an additional $67 million, including interest, that should have been allocated to customers.

In its testimony on January 22, 2010, the NYPSC provided a detailed analysis of the issue. The Staff proposed a one-time charge of $79 million relating to our annual compliance filings including the calculation of the ESM and accounting for certain software costs. We vigorously dispute Staff's claims, but could not predict at that time how the matters would be resolved. As of December 31, 2009, we reduced our regulatory assets by $30 million with an offsetting charge to other operating expense due to the uncertainty related to this proceeding. The recent rate case settlement, which the NYPSC approved on September 16, 2010, includes a resolution of those issues as part of the overall settlement. The amount we recognized in 2009 is approximately the same as the amount included in the settlement. (See Note 11.)

Homer City: In June 2008 NYSEG received a letter from subsidiaries of Edison Mission Energy regarding a notice of violation (NOV) from the U. S. Environmental Protection Agency (EPA) claiming that certain modifications to the Homer City Electric Generation Station (Homer City) during the time it was owned by NYSEG and Pennsylvania Electric Company (Penelec) were done in violation of EPA's new source review (NSR) regulations. Homer City was sold in 1999 to Edison Mission Energy by NYSEG and Penelec. Edison Mission Energy asserts that it is entitled to indemnification for certain fines, penalties and costs arising out of the violations alleged in the NOV under the terms of the Asset Purchase Agreement for Homer City. That appears to be the same claim Edison Mission Energy made to NYSEG in October 2000. NYSEG continues to believe that the costs sought by Edison Mission Energy are not liabilities of NYSEG and therefore did not retain liability for those material claims.

In September 2008 NYSEG, Penelec and Edison Mission Energy met with the EPA for a required NOV conference. EPA indicated at the meeting that it seeks a system-wide NSR settlement covering Edison Mission Energy's entire generation fleet, including a number of plants in Illinois, and would require installation of scrubbers on Homer City Units 1 and 2 as part of the settlement. In April 2009 EPA sent Edison Mission Energy a settlement proposal that included those controls, along with specified emissions caps, operational controls, improvement projects and fines. To our knowledge, Edison Mission Energy has not yet formally responded to EPA's proposal. While the EPA's settlement proposal substantially increases the potential value of the claim, NYSEG believes it has sound contractual defenses under the Asset Purchase Agreement. NYSEG estimates that its most likely cost exposure over the next several years will be primarily for legal defense costs and, potentially, a proportionate share of fines EPA may assess against Edison Mission Energy.

In connection with this matter, on January 6, 2011, the U. S. Department of Justice filed a lawsuit on behalf of the EPA in the U.S. District Court for the Western District of Pennsylvania against current and former owners and operators of Homer City. NYSEG and Penelec are named in the suit, along with EME Homer City Generation, the current operator, and eight limited liability companies who own the plant by virtue of a sale and leaseback refinancing that occurred in 2001. NYSEG believes it has a number of sound defenses to the claims included in the lawsuit, including that the statute of limitations and equitable principles prohibit EPA from forcing NYSEG to pay for costly improvements to a plant it has not owned or operated in over 10 years. NYSEG cannot predict the nature or amounts of any potential fines or penalties.

***Nonutility generator power purchase contracts*:** We expensed approximately $13 million for NUG power in 2010 and $129 million in 2009. We estimate that our NUG power purchases will total $55 million for 2011 through 2015.

***Nuclear entitlement power purchase contracts*:** In connection with the sale of the Nine Mile Point 2 nuclear generating station in 2001, including our 18% interest, we entered into a 10-year entitlement contract under which we purchase electricity at a fixed contract price. We expensed approximately $52 million for nuclear entitlement power in 2010 and $56 million in 2009. We estimate that our nuclear entitlement power purchases will total $53 million in 2011.

Note 7. Environmental Liability

From time to time environmental laws, regulations and compliance programs may require changes in our operations and facilities and may increase the cost of electric and natural gas service.

The EPA and the New York State Department of Environmental Conservation (NYSDEC), as appropriate, have notified us that we are among the potentially responsible parties that may be liable for costs incurred to remediate certain hazardous substances at 11 waste sites. The 11 sites do not include sites where gas was manufactured in the past, which are discussed below. With respect to the 11 sites, 9 sites are included in the New York State Registry of Inactive Hazardous Waste Disposal Sites and four sites are also included on the National Priorities list.

Any liability may be joint and several for certain of those sites. We recorded an estimated liability of less than $20 thousand at December 31, 2010, related to one of the 11 sites. We have paid remediation costs related to the remaining 10 sites, and do not expect to incur any additional liability. The ultimate cost to remediate the sites may be significantly more than the accrued amount. Factors affecting the estimated remediation amount include the remedial action plan selected, the extent of site contamination and the portion attributed to us.

We have a program to investigate and perform necessary remediation at our 39 sites where gas was manufactured in the past. In 1994 and 1996 we entered into orders on consent with the NYSDEC. Those orders require us to investigate and, where necessary, remediate 36 of our 39 sites. Eight sites are included in the New York State Registry.

Our estimate for all costs related to investigation and remediation of the 39 sites ranges from $127 million to $229 million at December 31, 2010. That estimate is based on both known and potential site conditions and multiple remediation alternatives for each of the sites. The estimate could change materially based on facts and circumstances derived from site investigations, changes in required remedial action, changes in technology relating to remedial alternatives and changes to current laws and regulations.

The liability to investigate and perform remediation, as necessary, at the known inactive gas manufacturing sites was $127 million at December 31, 2010, and $129 million at December 31, 2009. We recorded a corresponding regulatory asset, net of insurance recoveries, because we expect to recover the net costs in rates.

Our environmental liability accruals have been established on an undiscounted basis. We have received insurance settlements which we accounted for as reductions to our related regulatory asset.

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Note 8. Accounting for Derivative Instruments and Hedging Activities

We are exposed to certain risks relating to our ongoing business operations. The primary risk we manage by using derivative instruments is commodity price risk. In accordance with the accounting requirements concerning derivative instruments and hedging activities, we recognize all derivative instruments as either assets or liabilities at fair value on our balance sheet.

The financial instruments we hold or issue are not for trading or speculative purposes.

Commodity price risk: Commodity price risk, due to volatility experienced in the wholesale energy markets, is a significant issue for the electric and natural gas utility industries. We manage this risk through a combination of regulatory mechanisms, such as the pass-through of the market price of electricity and natural gas to customers, and through comprehensive risk management processes. Those measures mitigate our commodity price exposure, but do not completely eliminate it. Owned electric generation and long-term supply contracts reduce our exposure to market fluctuations.

We have electricity commodity purchases and sales contracts for both capacity and energy (physical contracts) that have been designated and qualify for the normal purchases and normal sales exception in the accounting requirements concerning derivative instruments and hedging activities.

Effective January 1, 2010, we no longer offer fixed price service to our electric customers. We currently have a nonbypassable wires charge adjustment that allows us to pass through rates any changes in the market price of electricity. We use electricity contracts, both physical and financial, to manage fluctuations in electricity commodity prices in order to provide price stability to customers. We include the cost or benefit of those contracts in the amount expensed for electricity purchased when the related electricity is sold. We record changes in the fair value of electric hedge contracts to derivative assets and/or liabilities with an offset to regulatory assets and/or regulatory liabilities in accordance with the requirements concerning accounting for regulated operations. At December 31, 2010, the gain recognized in regulatory liabilities was $1.1 million for electricity derivatives. For the years ended December 31, the gain (loss) reclassified from regulatory assets into income, which is included in electricity purchased, was $5.6 million for 2010 and $(6.9) million for 2009.

We have a purchased gas adjustment clause that allows us to recover through rates any changes in the market price of purchased natural gas, substantially eliminating our exposure to natural gas price risk. We use natural gas futures and forwards to manage fluctuations in natural gas commodity prices in order to provide price stability to customers. We include the cost or benefit of natural gas futures and forwards 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 to derivative assets and/or liabilities with an offset to regulatory assets and/or regulatory liabilities in accordance with the requirements concerning accounting for regulated operations. At December 31, 2010, the loss recognized in regulatory assets was $5.4 million for natural gas hedges. For the years ended December 31, the loss reclassified from regulatory assets into income, which is included in natural gas purchased, was $8.9 million for 2010 and $34.9 million for 2009.

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Our derivative volumes by commodity type that are expected to settle each year are:

Year to settle	Electricity Contracts Financial Mwhs	Natural Gas Contracts Financial Dths	Other Fuel Contracts Financial Gals
As of December 31, 2010			
2011	2,103,125	7,320,000	795,000
2012	1,081,450	540,000	-
As of December 31, 2009			
2010	578,600	7,030,000	1,555,700
2011	-	620,000	-

The location and amounts of derivative fair values in the balance sheet are:

	Asset Derivatives		Liability Derivatives	
As of December 31,	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
(Thousands)				
Derivatives designated as hedging instruments				
2010				
Commodity contracts:				
Electricity derivatives:				
Current	Current assets	$1,431	Current liabilities	-
Long-term	Other assets	-	Other liabilities	$369
Natural gas derivatives				
Current	Current assets	-	Current liabilities	5,375
Long-term	Other assets	18	Other liabilities	-
Other contracts	Current assets	73	Current liabilities	-
Total		$1,522		$5,744
2009				
Commodity contracts:				
Electricity derivatives:				
Current	Current assets	-	Current liabilities	$107
Natural gas derivatives				
Current	Current assets	-	Current liabilities	3,941
Long-term	Other assets	-	Other liabilities	130
Other contracts	Current assets	$203	Current liabilities	-
Total		$203		$4,178

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The effect of hedging instruments on other comprehensive income (OCI) and income was:

Year Ended December 31,	Gain (Loss) Recognized in OCI on Derivatives	Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Gain (Loss) Reclassified from Accumulated OCI into Income	Location of Gain (Loss) Recognized in Income on Derivatives	Gain (Loss) Recognized in Income on Derivatives
Derivatives in Cash Flow Hedging Relationships	**Effective Portion [1]**	**Effective Portion [1]**		**Ineffective Portion and Amount Excluded from Effectiveness Testing [2]**	
(Thousands)					
2010					
Interest rate contracts	-	Interest expense	$(1,092)	Interest expense	-
Commodity contracts:					
Electricity derivatives	-	Electricity purchased	-	Other (Income)/ Other Deductions	-
Other	$81	Other operating expenses	48		-
Total	$81		$(1,044)		-
2009					
Commodity contracts:					
Electricity derivatives	$29,620	Electricity purchased	$(34,590)	Other (Income)/ Other Deductions	$104
Other	(768)	Other operating expenses	(1,808)		-
Total	$28,852		$(36,398)		$104

[1] Changes in OCI are reported in after-tax dollars.
[2] Ineffective portion of long-term power supply contracts that are designated as cash flow hedges.

The amounts in OCI related to previously settled forward starting swaps, after tax and accumulated amortization, as of December 31, 2010, is a net loss of $7.8 million as compared to a net loss of $8.9 million as of December 31, 2009.

As of December 31, 2010, the maximum length of time over which we are hedging our exposure to the variability in future cash flows for forecasted energy transactions was 22 months – through October 2012.

We 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 Standard & Poor's). 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 have various master netting arrangements in the form of multiple contracts with various single counterparties that are subject to contractual agreements that provide for the net settlement of all contracts through a single payment. Those arrangements reduce our exposure to a counterparty in the event of default on or termination of any one contract. For financial statement presentation, we do not offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim or the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangements.

Certain of our derivative instruments contain provisions that require us to maintain on our debt an investment grade credit rating from each of the major credit rating agencies. If our debt were to fall below investment grade, it would be in violation of those provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position on December 31, 2010, is $5.8 million for which we have posted collateral of $11 million in the normal course of business. If the credit-risk-related contingent features underlying those agreements were triggered on December 31, 2010, we would receive a refund of $5.2 million of collateral from our counterparties.

Note 9. Fair Value of Financial Instruments and Fair Value Measurements

The carrying amounts and estimated fair values of our financial instruments are shown in the following table.

December 31,	**2010**		**2009**	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
(Thousands)				
Pollution control notes, fixed	**$315,000**	**$310,202**	$302,000	$299,641
Pollution control notes, variable	**$100,200**	**$100,200**	$188,725	$188,725
Various long-term debt	**$600,000**	**$600,659**	$600,000	$591,172

The carrying amounts for cash and cash equivalents, accounts receivable and notes payable approximate their estimated fair values.

We value all fixed rate long-term debt, taxable or tax-exempt, by assigning a market-based yield for each security and then deriving the price from the yield. Market-based yields are determined by observing secondary market trading levels for debt of similar maturity, rating, tax and structural characteristics. We value all variable rate debt at par as it approximates fair value.

Notes to Financial Statements

New York State Electric & Gas Corporation

Assets and liabilities measured at fair value on a recurring basis

		Fair Value Measurements at December 31, Using		
Description	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
(Thousands)				
2010				
Assets				
Noncurrent investments available for sale, primarily money market funds	$11,498	$11,498	-	-
Derivatives				
Commodity contracts:				
Electricity	1,431	1,431	-	-
Natural gas	18	18	-	-
Other	73	-	-	$73
Total	$13,020	$12,947	-	$73
Liabilities				
Derivatives				
Commodity contracts:				
Electricity	$369	$369	-	-
Natural gas	5,375	5,375	-	-
Total	$5,744	$5,744	-	-
2009				
Assets				
Noncurrent investments available for sale, primarily money market funds	$15,715	$15,715	-	-
Derivatives	203	-	-	$203
Total	$15,918	$15,715	-	$203
Liabilities				
Derivatives			-	
Commodity contracts:				
Electricity	$107	-	-	$107
Natural gas	4,071	$4,071	-	-
Total	$4,178	$4,071	-	$107

We had no significant transfers to or from Level 1 and 2 during the year ended December 31, 2010. Our policy is to recognize transfers in and out as of the actual date of the event or change in circumstances that causes a transfer, if any.

Valuation techniques: We measure the fair value of our noncurrent investments available for sale using quoted market prices in active markets for identical assets and include the measurements in Level 1. The investments primarily consist of money market funds.

Notes to Financial Statements

New York State Electric & Gas Corporation

We determine the fair value of our various derivative assets and liabilities utilizing market approach valuation techniques:

- We enter into electric energy derivative contracts to hedge the forecasted purchases required to serve our electric load obligations. We hedge our electric load obligations using derivative contracts that are settled based upon Locational Based Marginal Pricing published by the NYISO. In December 2009 we began to hedge all of our electric load obligations in a NYISO location where an active market exists. The forward market prices used to value our open electric energy derivative contracts as of December 31, 2010, were readily available with no adjustment required and we include the fair values in Level 1. Prior to December 31, 2009, we entered into hedges for some NYISO locations where forward market price quotes were not actively traded and not readily available outright from market dealers. We derived forward market prices for those locations based on the historical relationship of prices in those locations to prices in locations where an active market exists. The resulting value represented the derived forward market price for each location, which we used to value the open derivative contracts. Because we adjusted the quoted market prices for our own load characteristics during 2009 we included the fair values in Level 3.
- We enter into natural gas derivative contracts to hedge the forecasted purchases required to serve our natural gas load obligations. The forward market prices used to value our open natural gas derivative contracts are exchange-based prices for the identical derivative contracts traded actively on the New York Mercantile Exchange. Because we use prices quoted in an active market, we include those fair value measurements in Level 1.

Instruments measured at fair value on a recurring basis using significant unobservable inputs

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Derivatives, Net	
Year Ended December 31,	**2010**	**2009**
(Thousands)		
Beginning balance	$96	$(14,285)
Total gains (losses) (realized/unrealized)		
Included in earnings	(48)	44,428
Included in other comprehensive income	(81)	(36,987)
Included in regulatory assets and liabilities	-	6,940
Transfers out of Level 3	106	-
Ending balance	$73	$96
Total gains for the period included in earnings attributable to the change in unrealized gains relating to instruments still held at December 31	$73	$96

The gains and losses included in earnings for the periods (above), which are reported in the various categories indicated are:

	Electricity purchased	**Other operating expense**	**Other Income**
(Thousands)			
Total gains (losses) included in earnings for year ended December 31,			
2010	-	$(48)	-
2009	$42,620	$1,718	$90

Notes to Financial Statements

New York State Electric & Gas Corporation

Note 10. Accumulated Other Comprehensive Income (Loss)

(Thousands)	Balance January 1, 2009	2009 Change	Balance December 31, 2009	2010 Change	Balance December 31, 2010
Amortization of pension cost for nonqualified plans, net of income tax benefit (expense) of $540 for 2009 and $(310) for 2010	$(2,019)	$(824)	$(2,843)	$472	$(2,371)
Unrealized gains (losses) on derivatives qualified as hedges:					
Unrealized (losses) gains during period on derivatives qualified as hedges, net of income tax benefit (expense) of $11,430 for 2009 and $(14,186) for 2010		(17,422)		21,623	
Reclassification adjustment for losses (gains) included in net income, net of income tax (benefit) expense of $(14,419) for 2009 and $14,237 for 2010		21,979		(21,702)	
Net unrecognized gains on settled cash flow treasury hedges, net of income tax (expense) of $(433) for 2009 and 2010		660		660	
Net unrealized (losses) gains on derivatives qualified as hedges	(10,468)	5,217	(5,251)	581	(4,670)
Accumulated Other Comprehensive (Loss) Income	$(12,487)	$4,393	$(8,094)	$1,053	$(7,041)

Note 11. Regulatory Proceedings

In September 2009 we filed rate cases with the NYPSC requesting approval to increase the rates we charge to deliver electricity and natural gas by a total of $233 million. The rate filings requested an allowed rate of return on equity (ROE) of 11.43% applied to an equity ratio of 48%.

On September 16, 2010, the NYPSC approved a new rate plan for NYSEG's electric and natural gas service effective August 26, 2010, through December 31, 2013. Major provisions of the plan include:

- Approximate delivery rate increases as follows (in millions of dollars):

Rate year ending August 31,	Electric	Natural Gas
2011	$16.4 (2.5%)	$9.9 (6.0%)
2012	$27.8 (4.2%)	$10.3 (5.8%)
2013	$29.3 (4.3%)	$10.5 (5.6%)

- The delivery rate increases were moderated and levelized through the use of $185 million in positive benefits adjustments (PBAs), including $20 million of carrying costs, that were required and set aside for the benefit of ratepayers when Iberdrola, S.A. acquired NYSEG in 2008. The PBAs will be utilized as follows: in September 2010 a one-time write-off of $57.4 million, which is offset by an equal write-off of deferred storm costs; amortizations during the

rate years ended August 31 of: $59.3 million in 2011, $39.0 million in 2012, $13.1 million in 2013; and $3.9 million in the four months ended December 31, 2013. The balance of $12.3 million will be utilized at a later time.

- Rates were set to allow for the recovery, over the 40 months of the rate plan, of regulatory assets of $23.4 million net of regulatory liabilities.
- The recovery in rates includes $25.6 million for the cost to achieve efficiency initiatives through workforce initiatives. (See Note 1) The rate increases were moderated with $16.8 million in annual net savings from workforce reduction and related labor cost-cutting initiatives, and were further moderated by a one percent annual productivity adjustment.
- To resolve a number of disputed items related to the annual compliance filings, including the calculation of earnings sharing accruals, we reduced our environmental reserve by $23 million and our deferred storm costs by $4 million, we will add $6 million to the Asset Sale Gain Account, we agreed to absorb $8.1 million of outstanding hedge losses, and we wrote off $1.8 million of our investment in Integrated Back Office and Work Management Systems software. In December 2009 we established a reserve of $30 million for that contingency, which was reversed as a result of the rate decision.
- The revenue requirements are based on a 10% allowed ROE applied to an equity ratio of 48 percent. Beginning in 2011, if earnings exceed the allowed return, a tiered ESM will capture a portion of the excess for the benefit of ratepayers. The ESM is subject to specified downward adjustments if we fail to meet certain reliability and customer service measures.
- Key components of the rate plan include electric reliability performance mechanisms, natural gas safety performance measures, customer service quality metrics and targets, and electric distribution vegetation management programs that establish threshold performance targets. There will be downward revenue adjustments if we fail to meet the targets.
- Low-income program budgets have been increased to approximately $12.3 million. All home energy assistance program recipients will be eligible for the program.
- New revenue decoupling mechanisms (RDMs), intended to remove company disincentives to promote increased energy efficiency were established. Under the RDMs, electric revenues are based on revenue per customer class rather than billed revenue, while natural gas revenues are based on revenue per customer. Any shortfalls (excesses) between billed revenues and allowed revenues will be accrued for future recovery (refund).

Under the merger order prescribed by the NYPSC, our customers were to receive $165 million in PBAs. Those benefits were to be used, over time, to either reduce rates or moderate requested rate increases. Conditions were also established to ensure that ratepayers receive a portion of any added benefits associated with synergy savings and efficiency gains produced by the transaction. We recorded the PBAs in September 2008, in accordance with the merger order, as a regulatory liability with an offsetting charge to income, and accrued a carrying cost at the pretax rate allowed by the NYPSC until used for the benefit of customers. Carrying costs, which are included in interest expense, were $9 million in 2010 and $10 million in 2009.

Notes to Financial Statements

New York State Electric & Gas Corporation

As part of the new rate plan, we offset the PBAs and other regulatory liabilities against certain regulatory assets. In addition, we established a regulatory asset to allow recovery of the special termination benefits, severance and other costs associated with workforce initiatives (see Note 1), and wrote off some undepreciated fixed assets and reversed a reserve established in December 2009. The effects on net income of the various adjustments to regulatory assets and regulatory liabilities are:

Description	Income Statement Line Item	Increase (Decrease) in Net Income
(Millions)		
Elimination of annual compliance filing reserve regulatory liability	Electric operating revenue	$30.0
Interim period adjustment	Electric operating revenue	0.9
	Total Electric Operating Revenue	30.9
Elimination of PBA regulatory liability	Other operating expenses	57.4
Elimination of storm costs regulatory assets	Maintenance	(62.1)
Elimination of environmental reserve regulatory asset	Other operating expenses	(23.0)
Establishment of cost to achieve efficiency regulatory asset*	Other operating expenses	26.0
Property, plant and equipment	Depreciation and amortization	(1.9)
	Total Operating Expenses	(3.6)
	Income Before Income Taxes	27.3
Income tax effect	Income Taxes	(10.8)
	Net Income	$16.5

*Relates to the recovery of special termination benefit costs (see Note 1).

Beginning on August 26, 2010, we will amortize $15.2 million per year of a theoretical excess depreciation reserve of $303.9 million. The amortization amount reflects a 20-year amortization period. Theoretical excess depreciation is the difference between actual accumulated depreciation taken to date and a theoretical reserve. The actual accumulated depreciation is the result of depreciation rates allowed in prior rate orders based on estimates of useful lives and net salvage values as determined in those cases. The theoretical reserve is the amount that would have accumulated if the depreciation rates in the new rate plan had been in place for the entire useful lives of the affected assets. Differences between the actual reserve and the theoretical reserve are normal aspects of utility ratemaking. The usual treatment is to flow any excess or deficiency back as an adjustment to depreciation expense over the remaining life of the property. However, in accordance with the new rate plan, we will moderate electric rates by recording the theoretical reserve amortization as a debit to accumulated depreciation and a credit to other revenues, and normalize the amortization from a tax perspective.

New York State Electric & Gas Corporation

Note 12. 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.

Obligations and funded status:	**Pension Benefits**		**Postretirement Benefits**	
	2010	**2009**	**2010**	**2009**
(Thousands)				
Change in benefit obligation				
Benefit obligation at January 1	**$1,270,761**	$1,215,020	**$260,795**	$242,206
Service cost	**18,049**	17,324	**2,848**	2,489
Interest cost	**72,625**	72,975	**13,870**	14,329
Plan participants' contributions	**-**	-	**5,756**	4,098
Plan amendments	**7,819**	-	**-**	-
Actuarial loss	**118,244**	38,397	**1,631**	18,713
Special termination benefits	**20,379**	-	**-**	-
Benefits paid	**(87,307)**	(72,955)	**(26,995)**	(22,822)
Federal subsidy on benefits paid	**-**	-	**1,779**	1,782
Benefit obligation at December 31	**$1,420,570**	$1,270,761	**$259,684**	$260,795
Change in plan assets				
Fair value of plan assets at January 1	**$1,415,123**	$1,242,052	**$102,176**	$81,856
Actual return on plan assets	**180,090**	246,026	**14,020**	20,320
Benefits paid	**(87,307)**	(72,955)	**-**	-
Fair value of plan assets at December 31	**$1,507,906**	$1,415,123	**$116,196**	$102,176
Funded status	**$87,336**	$144,362	**$(143,488)**	$(158,619)

Amounts recognized on the balance sheet	**Pension Benefits**		**Postretirement Benefits**	
December 31,	**2010**	**2009**	**2010**	**2009**
(Thousands)				
Noncurrent assets	**$87,336**	$144,362	**-**	-
Noncurrent liabilities	**-**	-	**$(143,488)**	$(158,619)
	$87,336	$144,362	**$(143,488)**	$(158,619)

A VERP was offered in the electric company plan during 2010, resulting in one-time charges for special termination benefits. We extended a retirement supplement, effective July 1, 2010, applicable to union employees who retire after age 59 between July 1, 2010, and June 30, 2015; the supplement was first effective July 1, 2005, and applied to retirements between July 1, 2005, and June 30, 2010.

We are allowed to defer as regulatory assets or regulatory liabilities items that would otherwise be recorded in accumulated other comprehensive income pursuant to the accounting requirements concerning defined benefit pension and other postretirement plans. Amounts recognized as regulatory assets or regulatory liabilities consist of:

	Pension Benefits		**Postretirement Benefits**	
December 31,	**2010**	**2009**	**2010**	**2009**
(Thousands)				
Net loss	**$530,923**	$508,803	**$9,289**	$20,763
Prior service cost (credit)	**$25,736**	$20,502	**$(4)**	$(4,398)
Transition obligation	-	-	**$13,600**	$20,400

New York State Electric & Gas Corporation

Our accumulated benefit obligation for all defined benefit pension plans at December 31 was $1.3 billion for 2010 and $1.2 billion for 2009.

Components of net periodic benefit cost and other amounts recognized in regulatory assets and regulatory liabilities:

	Pension Benefits		Postretirement Benefits	
Year Ended December 31,	**2010**	**2009**	**2010**	**2009**
(Thousands)				
Net periodic benefit cost				
Service cost	**$18,049**	$17,324	**$2,848**	$2,489
Interest cost	**72,625**	72,975	**13,870**	14,329
Expected return on plan assets	**(136,249)**	(138,383)	**(4,904)**	(3,929)
Special termination benefits	**20,379**	-	**-**	-
Amortization of prior service cost (benefit)	**2,585**	2,800	**(4,394)**	(6,157)
Amortization of net loss	**52,283**	30,355	**3,989**	5,356
Amortization of transition obligation	**-**	-	**6,800**	6,800
Net periodic benefit cost (income)	**$29,672**	$(14,929)	**$18,209**	$18,888
Other changes in plan assets and benefit obligations recognized in regulatory assets and regulatory liabilities				
Net loss (gain)	**$74,403**	$(69,247)	**$(7,484)**	$2,322
Amortization of net (loss)	**(52,283)**	(30,355)	**(3,989)**	(5,356)
Amortization of prior service (cost) credit	**(2,585)**	(2,800)	**4,394**	6,157
Plan amendment	**7,819**	-	**-**	-
Amortization of transition obligation	**-**	-	**(6,800)**	(6,800)
Total recognized in regulatory assets and regulatory liabilities	**$27,354**	$(102,402)	**$(13,879)**	$(3,677)
Total recognized in net periodic benefit cost and regulatory assets and regulatory liabilities	**$57,026**	$(117,331)	**$4,330**	$15,211

We include the net periodic benefit cost in other operating expenses. The net periodic benefit cost for postretirement benefits represents the amount expensed for providing health care benefits to retirees and their eligible dependents. We had no postretirement benefit costs deferred as of December 31, 2010 and 2009. We are amortizing over 20 years the transition obligation for postretirement benefits that resulted from our adoption in 1992 of the accounting requirements concerning employers' accounting for postretirement benefits other than pensions.

Amounts expected to be amortized from regulatory assets or regulatory liabilities into net periodic benefit cost for the fiscal year ended December 31, 2011	**Pension Benefits**	**Postretirement Benefits**
(Thousands)		
Estimated net loss	$70,375	$6,101
Estimated prior service cost (benefit)	$4,143	$(2)
Estimated transition obligation	-	$6,800

We expect that no pension benefit or postretirement benefit plan assets will be returned to us during the fiscal year ended December 31, 2011.

Weighted-average assumptions used to determine benefit obligations at December 31,	Pension Benefits 2010	Pension Benefits 2009	Postretirement Benefits 2010	Postretirement Benefits 2009
Discount rate	**5.00%**	5.80%	**5.00%**	5.80%
Rate of compensation increase	**4.00%**	4.00%	**N/A**	N/A

As of December 31, 2010, we decreased our discount rate from 5.80% to 5.00%. The discount rate is the rate at which the benefit obligations could presently be effectively settled. We determined the discount rate developing a yield curve derived from a portfolio of high grade noncallable bonds that closely matches the duration of the expected cash flows of our benefit obligations.

Weighted-average assumptions used to determine net periodic benefit cost for the year ended December 31,	Pension Benefits 2010	Pension Benefits 2009	Postretirement Benefits 2010	Postretirement Benefits 2009
Discount rate	**5.80%**	6.10%	**5.80%**	**6.10%**
Expected long-term return on plan assets	**8.75%**	8.75%	**-**	**-**
Expected long-term return on plan assets - nontaxable trust	**-**	-	**8.00%**	**8.00%**
Expected long-term return on plan assets - taxable trust	**-**	-	**4.80%**	**4.80%**
Rate of compensation increase	**4.00%**	4.00%	**N/A**	**N/A**

We developed our expected long-term rate of return on plan assets assumption based on a review of long-term historical returns for the major asset classes, the target asset allocations and the effect of rebalancing of plan assets discussed below. That analysis considered current capital market conditions and projected conditions. We amortize unrecognized actuarial gains and losses over 10 years from the date they are incurred.

Assumed health care cost trend rates to determine benefit obligations at December 31	2010	2009
Health care cost trend rate assumed for next year	**7.80%**	8.0%
Rate to which cost trend rate is assumed to decline (the ultimate trend rate)	**4.5%**	4.5%
Year that the rate reaches the ultimate trend rate	**2028**	2028

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

(Thousands)	1% Increase	1% Decrease
Effect on total of service and interest cost	$304	$(275)
Effect on postretirement benefit obligation	$6,774	$(6,044)

New York State Electric & Gas Corporation

***Plan assets*:** Iberdrola USA's pension benefits plan assets are held in a master trust providing for a single trustee/custodian, a uniform investment manager lineup, and an efficient, cost-effective means of allocating expenses and investment performance to each plan under the master trust. Iberdrola USA's primary investment objective is to ensure that current and future benefits obligations are adequately funded and with volatility commensurate with its tolerance for risk. Preservation of capital and achievement of sufficient total return to fund accrued and future benefits obligations are of highest concern. Iberdrola USA's primary means for achieving capital preservation is through diversification of the trust's investments while avoiding significant concentrations of risk in any one area of the securities markets. Within each asset group, further diversification is achieved through utilizing multiple asset managers and systematic allocation to various asset classes, providing broad exposure to different segments of the equity, fixed-income and alternative investment markets.

Iberdrola USA's asset allocation policy is the most important consideration in achieving its objective of superior investment returns while minimizing risk. Iberdrola USA has established a target asset allocation policy within allowable ranges for the pension benefits plan assets of 56% equity securities, 30% fixed income and 14% for all other types of investments. The target allocations within allowable ranges are further diversified into 28% large cap domestic equities, 7% medium and small cap domestic equities, 5% emerging markets, and 16% international equity securities. Fixed income investment targets and ranges are segregated into long dated corporate securities 17%, annuity contracts 5%, and 25 year zero coupon bonds 8%. All fixed income investments are in domestic securities. Other, alternative investment targets are 4% for real estate, and 10% for absolute return and strategic markets. Systematic rebalancing within the target ranges, should any asset categories drift outside their specified ranges, increases the probability that the annualized return on the investments will be enhanced, while realizing lower overall risk.

Notes to Financial Statements

New York State Electric & Gas Corporation

The fair values of Iberdrola USA consolidated pension benefits plan assets at December 31, 2010 and 2009, by asset category are shown in the following table. NYSEG's share of the total consolidated assets is approximately 70% for 2010 and 63% for 2009.

		Fair Value Measurements at December 31, Using		
Asset Category	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
(Thousands)				
2010				
Cash and cash equivalents	**$49,214**	**$734**	**$48,480**	**-**
U.S. government securities	**52,122**	**52,122**	**-**	**-**
Common stocks	**1,036,468**	**749,565**	**286,903**	**-**
Registered investment companies	**85,923**	**85,923**	**-**	**-**
Corporate bonds	**183,186**	**-**	**183,186**	**-**
Preferred stocks	**7,039**	**7,039**	**-**	**-**
Common/collective trusts	**351,408**	**-**	**76,476**	**$274,932**
Partnership/joint venture interests	**96,624**	**-**	**-**	**96,624**
Real estate investments	**45,374**	**-**	**-**	**45,374**
Other investments, principally annuity and fixed income	**243,841**	**21,817**	**31,712**	**190,312**
Total	**$2,151,199**	**$917,200**	**$626,757**	**$607,242**
2009				
Cash and cash equivalents	$38,248	$927	$37,321	-
U.S. government securities	49,619	49,619	-	-
Common stocks	1,000,311	997,495	2,816	-
Registered investment companies	119,155	119,155	-	-
Corporate bonds	364,243	-	364,243	-
Preferred stocks	6,916	6,916	-	-
Common/collective trusts	358,201	-	62,557	$295,644
Partnership/joint venture interests	93,269	-	-	93,269
Real estate investments	40,618	-	-	40,618
Other investments, principally annuity and fixed income	183,173	20,784	31,265	131,124
Total	$2,253,753	$1,194,896	$498,202	$560,655

Valuation techniques: Iberdrola USA values the pension benefits plan assets as follows:

- Cash and cash equivalents – Level 1: at cost, plus accrued interest, which approximates fair value. Level 2: proprietary cash associated with other investments, based on yields currently available on comparable securities of issuers with similar credit ratings.
- U.S. government securities, Common stocks and Registered investment companies - at the closing price reported in the active market in which the security is traded.
- Corporate bonds – based on yields currently available on comparable securities of issuers with similar credit ratings.
- Preferred stocks – at the closing price reported in the active market in which the individual investment is traded.
- Common/collective trusts and Partnership/joint ventures – using the Net Asset Value (NAV) provided by the administrator of the fund. The NAV is based on the value of the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding. The NAV is classified as Level 2 if the plan has the ability to redeem the investment with the investee at NAV per share at the measurement date. Redemption

restrictions or adjustments to NAV based on unobservable inputs result in the fair value measurement being classified as Level 3 if those inputs are significant to the overall fair value measurement.

- Real estate investments – based on a discounted cash flow approach that includes the projected future rental receipts, expenses and residual values because the highest and best use of the real estate from a market participant view is as rental property.
- Other investments, principally annuity and fixed income - Level 1: at the closing price reported in the active market in which the individual investment is traded. Level 2: based on yields currently available on comparable securities of issuers with similar credit ratings. Level 3: when quoted prices are not available for identical or similar instruments, under a discounted cash flows approach that maximizes observable inputs such as current yields of similar instruments but includes adjustments for certain risks that may not be observable such as credit and liquidity risks.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
(Thousands)	**Corporate Bonds**	**Common/ Collective Trusts**	**Partner-ship/ Joint Venture Interests**	**Real Estate Invest-ments**	**Other Invest-ments**	**Total**
Balance, December 31, 2008	$112	$432,918	$106,819	$58,687	$156,149	$754,685
Actual return on plan assets:						
Relating to assets still held at the reporting date	-	2,557	2,565	-	-	5,122
Relating to assets sold during the year	-	112,364	3,869	(19,345)	-	96,888
Purchases, sales and settlements	(112)	(252,195)	(19,984)	1,276	(25,025)	(296,040)
Transfers into and/or out of Level 3	-	-	-	-	-	-
Balance, December 31, 2009	-	295,644	93,269	40,618	131,124	560,655
Actual return on plan assets:						
Relating to assets still held at the reporting date	-	4,678	-	-	110	4,788
Relating to assets sold during the year	-	41,218	3,207	4,163	510	49,098
Purchases, sales and settlements	-	(66,608)	148	593	58,568	(7,299)
Transfers into and/or out of Level 3	-	-	-	-	-	-
Balance, December 31, 2010	-	$274,932	$96,624	$45,374	$190,312	$607,242

Iberdrola USA's postretirement benefits plan assets are held with two trustees in multiple voluntary employees' beneficiary association (VEBA) and 401(h) arrangements and are invested among and within various asset classes in order to achieve sufficient diversification in accordance with its risk tolerance. This is achieved for the postretirement benefits plan assets through the utilization of multiple institutional mutual and money market funds, providing exposure to different segments of the fixed income, equity and short-term cash markets. Approximately 12% of the postretirement benefits plan assets are invested in VEBA and 401(h) arrangements that are not subject to income taxes. The remainder is invested in arrangements subject to income taxes.

New York State Electric & Gas Corporation

Iberdrola USA has established a target asset allocation policy within allowable ranges for its postretirement benefits plan assets of 56% equity securities, 37% fixed income and 7% for all other types of investments. The target allocations within allowable ranges are further diversified into 30% large cap domestic equities, 7% medium and small cap domestic equities, 13% international developed market and 6% emerging market equity securities. Fixed income investment targets and ranges are segregated into core fixed income at 30%, global high yield fixed income 4% and international developed market debt 3%. Other, alternative investment targets are 4% for real estate and 3% absolute return. Systematic rebalancing within target ranges, should any asset categories drift outside their specified ranges, increases the probability that the annualized return on the investments will be enhanced, while realizing lower overall risk.

The fair values of Iberdrola USA consolidated other postretirement benefits plan assets at December 31, 2010 and 2009, by asset category are shown in the following table. NYSEG's share of the total consolidated assets is approximately 79% for 2010 and 70% for 2009.

		Fair Value Measurements at December 31, Using		
Asset Category	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
(Thousands)				
2010				
Money market funds	**$7,907**	**$7,907**	**-**	**-**
Mutual funds, fixed	**49,100**	**49,100**	**-**	**-**
Mutual funds, equity	**90,964**	**90,964**	**-**	**-**
Other investments	**27**	**27**	**-**	**-**
Total	**$147,998**	**$147,998**	**-**	**-**
2009				
Money market funds	$4,214	$4,214	-	-
Mutual funds, fixed	51,061	51,061	-	-
Mutual funds, equity	82,089	82,089	-	-
Other investments	3,109	1,865	$774	$470
Total assets measured at fair value	$140,473	$139,229	$774	$470
Whole life insurance contract	5,836			
Total	$146,309			

Valuation techniques: Iberdrola USA values its postretirement benefits plan assets as follows:

- Money market funds and Mutual funds, fixed and equity – based upon quoted market prices, which represent the NAV of the shares held.
- Other investments – these are primarily 401(h) investments that are an allocation of pension Master Trust investments.

The whole life insurance contract is presented at the contract value at December 31, 2009, which is not a fair value measurement.

Diversified equity securities did not include any Iberdrola common stock at December 31, 2010.

Notes to Financial Statements

New York State Electric & Gas Corporation

Cash Flows

Contributions: In accordance with our funding policy we make annual contributions of not less than the minimum required by applicable regulations. We do not expect to contribute to our pension benefit plans in 2011 and expect to contribute $21 million to our other postretirement benefit plans in 2011.

Estimated future benefit payments: Our expected benefit payments and expected Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) subsidy receipts, which reflect expected future service, as appropriate, are:

(Thousands)	Pension Benefits	Postretirement Benefits	Medicare Act Subsidy Receipts
2011	$86,587	$23,576	$2,228
2012	$89,640	$23,759	$2,511
2013	$91,925	$23,941	$2,757
2014	$93,936	$24,248	$2,991
2015	$95,507	$24,406	$3,200
2016- 2020	$496,837	$120,456	$18,661

Note 13. Sale of Seneca Lake Storage Facility

In January 2010 we entered into an agreement to sell our Seneca Lake Storage facility and related assets for $65 million. The carrying amount of the facility assets is separately stated on the balance sheet and was approximately $33 million at December 31, 2010, and December 31, 2009. The sale of the facility is contingent on receiving appropriate regulatory approvals from the NYPSC. The FERC issued an order on August 26, 2010, authorizing the parties to proceed with the transaction, subject to compliance requirements that the buyer must attend to but that should not delay the closing. The NYPSC issued an order on March 4, 2011, approving the transaction, but included several conditions in the order. We are unable to predict at this time when the closing may conclude. Because current rates include recovery of depreciation on these assets, we are continuing to record depreciation expense even though we have classified the assets as held for sale. Depreciation expense for 2010 was $1.5 million.