NEW ISSUE—Full-Book-Entry

In the opinion of Bond Counsel to the Authority, under existing statutes and court decisions and assuming continuing compliance with the tax covenants described herein, (i) interest on the Offered Securities is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), and (ii) interest on the Offered Securities is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. See “Tax Matters” in Part 1 of this Official Statement. In addition, in the opinion of Bond Counsel to the Authority, under existing statutes, interest on the Offered Securities is exempt from personal income taxes imposed by the State of New York or any political subdivision thereof, and the Offered Securities are exempt from all taxation directly imposed thereon by or under the authority of the State of New York, except estate or gift taxes and taxes on transfers.

$515,110,000

LONG ISLAND POWER AUTHORITY

Electric System General Revenue Bonds, Series 2006E

Dated: Date of Delivery

The Electric System General Revenue Bonds, Series 2006E (the “Offered Securities”) will be issued only as fully registered bonds registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York, which will act as securities depository for the Offered Securities under the book-entry-only system described herein. Individual purchases of beneficial ownership interests in the Offered Securities may be made in the principal amount of $5,000 or any integral multiple thereof. Beneficial Owners of the Offered Securities will not receive physical delivery of bond certificates. The Bank of New York, New York, New York, is the Trustee under the Resolution.

The Offered Securities are being issued for refunding purposes as described herein. Interest on the Offered Securities is payable on each June 1 and December 1 beginning December 1, 2006.

The Offered Securities are subject to optional redemption prior to maturity as and to the extent described herein.

The scheduled payment of principal of and interest on the Offered Securities maturing on December 1, 2017 (principal amount of $81,820,000 bearing an interest rate of 5.000%), 2018 (principal amount of $38,545,000 bearing an interest rate of 5.000%), 2021 (principal amount of $80,845,000 bearing an interest rate of 5.000%) and 2022 (principal amount of $3,260,000 bearing an interest rate of 4.125% and principal amount of $115,895,000 bearing an interest rate of 5.000%) when due will be guaranteed under an insurance policy to be issued by Financial Guaranty Insurance Company concurrently with the delivery of the Offered Securities.

The scheduled payment of principal of and interest on the Offered Securities maturing on December 1, 2018 (principal amount of $5,650,000 bearing an interest rate of 4.000% and principal amount of $69,260,000 bearing an interest rate of 5.000%), 2020 and 2021 (principal amount of $43,115,000 bearing an interest rate of 5.000%) when due will be guaranteed under an insurance policy to be issued by MBIA Insurance Corporation concurrently with the delivery of the Offered Securities.

MATURITY SCHEDULE — See Inside Cover Page

The Offered Securities are special obligations of the Authority payable principally from the revenues generated by the electric system owned by its subsidiary, LIPA, after the payment of operating expenses of the System, on a parity with other Electric System General Revenue Bonds and other Parity Obligations of the Authority. The Offered Securities shall not be a debt of the State of New York or of any municipality, and neither the State of New York nor any municipality shall be liable thereon. The Authority shall not have the power to pledge the credit, the revenues or the taxing power of the State of New York or any municipality, and neither the credit, the revenues nor the taxing power of the State of New York or any municipality shall be, or shall be deemed to be, pledged to the payment of any of the Offered Securities. The Authority has no taxing power.

The Offered Securities are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the Authority. Certain legal matters with respect to the Authority and LIPA will be passed upon by Stanley B. Klimberg, Esquire, General Counsel to the Authority and LIPA, and by Clifford Chance US LLP, New York, New York, Disclosure Counsel to the Authority and LIPA. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York, Counsel to the Underwriters. It is expected that the Offered Securities will be available for delivery in book-entry-only form through The Depository Trust Company in New York, New York on or about September 26, 2006.

Lehman Brothers

Goldman, Sachs & Co.

UBS Investment Bank

A.G. Edwards

First Albany Capital Inc.

First Southwest Co.

Loop Capital Markets LLC

Merrill Lynch & Co.

RBC Capital Markets

Roosevelt & Cross, Incorporated

Wachovia Bank, National Association

Dated: September 14, 2006

Banc of America Securities LLC

JPMorgan

Ramirez & Co., Inc.

Siebert Brandford Shank & Co., LLC

JPMorgan

Siebert Brandford Shank & Co., LLC

Long Island Power Authority

Part 1 of this Official Statement. In addition, in the opinion of Bond Counsel to the Authority, under existing statutes, interest on the Offered Securities is exempt from personal income taxes imposed by the State of New York or any political subdivision thereof, and the Offered Securities are exempt from all taxation directly imposed thereon by or under the authority of the State of New York, except estate or gift taxes and taxes on transfers.
# Maturity Schedule

**LONG ISLAND POWER AUTHORITY**

**$515,110,000 Electric System General Revenue Bonds, Series 2006E**

<table>
<thead>
<tr>
<th>Maturity December 1</th>
<th>Principal Amount</th>
<th>Interest Rate</th>
<th>Price or Yield</th>
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<tr>
<td>2019</td>
<td>—</td>
<td>—</td>
<td>—</td>
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(1) Insured by Financial Guaranty Insurance Company.

(2) Insured by MBIA Insurance Corporation.

* CUSIP numbers have been assigned by an organization not affiliated with the Authority and are included solely for the convenience of the holders of the Offered Securities. The Authority is not responsible for the selection or uses of these CUSIP numbers, nor is any representation made as to the correctness of the CUSIP numbers on the Offered Securities or as indicated above.

** Priced to first par call on December 1, 2016.
LONG ISLAND POWER AUTHORITY  
333 Earle Ovington Blvd.  
Uniondale, New York 11553  
Telephone: (516) 222-7700  
Facsimile: (516) 222-9137  

BOARD OF TRUSTEES  
Richard M. Kessel—Chairman  
Patrick J. Foye—Deputy Chairman  
Howard E. Steinberg—Deputy Chairman  

Michael J. Affrunti  
Nancy Ann Akeson  
Harvey Auerbach  
Lawrence E. Elovich  
   John Fabio  
   Edna Gerrard  
   Harriet A. Gilliam  
   James C. Herrmann  
   Robert S. Maimoni  
   Nancy Nugent  
   Jonathan Sinnreich  

AUTHORITY MANAGEMENT  
Edward J. Grilli—Chief of Staff  
Seth D. Hulkower—Chief Operating Officer  
Elizabeth M. McCarthy—Chief Financial Officer  
Stanley B. Klimberg—General Counsel  
Richard J. Bolbrock—Vice President of Power Markets  
Bert J. Cunningham—Vice President of Communications  
Bruce Germano—Vice President of Retail Services  
Michael D. Hervey—Vice President of Operations  
Kenneth Kane—Controller  

Financial Advisor  
Bear, Stearns & Co. Inc.  
New York, New York  

Bond Counsel  
Hawkins Delafield & Wood LLP  
New York, New York  

Independent Accountants  
KPMG LLP  
Melville, New York  

Federal Energy Regulatory Counsel  
Van Ness Feldman P.C.  
Washington, D.C.  

Disclosure Counsel  
Clifford Chance US LLP  
New York, New York  

Trustee  
The Bank of New York  
New York, New York
No dealer, broker, salesperson or other person has been authorized by the Authority or the Underwriters to give any information or to make any representation, other than the information and representations contained in this Official Statement, in connection with the offering of the Offered Securities, and, if given or made, such information or representations must not be relied upon as having been authorized by the Authority or the Underwriters. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy any of the Offered Securities in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction.

The information set forth herein has been furnished by the Authority and LIPA and includes information obtained from other sources, all of which are believed to be reliable. The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, LIPA or KeySpan Corporation since the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party.

Other than with respect to information concerning Financial Guaranty Insurance Company ("FGIC") and MBIA Insurance Corporation ("MBIA"), respectively, contained under the caption "BOND INSURANCE" and Appendix 3 - "Specimen Municipal Bond Insurance Policies" herein, none of the information in this Official Statement has been supplied or verified by FGIC or MBIA and FGIC and MBIA make no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Offered Securities; or (iii) the tax exempt status of the interest on the Offered Securities.

This Official Statement contains statements which, to the extent they are not recitations of historical fact, constitute "forward-looking statements." In this respect, the words "estimate", "project", "anticipate", "expect", "intend", "believe" and similar expressions are intended to identify forward-looking statements. A number of important factors affecting the Authority's and LIPA's business and financial results could cause actual results to differ materially from those stated in the forward-looking statements.

In connection with the offering of the Offered Securities, the Underwriters may overallot or effect transactions that stabilize or maintain the market price of the Offered Securities at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE OFFICIAL STATEMENT AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS OFFICIAL STATEMENT CONSISTS OF THE COVER PAGE, THE INSIDE COVER PAGE, THE TABLE OF CONTENTS, THE SUMMARY STATEMENT AND THIS PART 1, INCLUDING THE APPENDICES TO THIS PART 1 (ALL OF THE FOREGOING ARE REFERRED TO COLLECTIVELY AS "PART 1") AND THE ATTACHED PART 2, INCLUDING ITS TABLE OF CONTENTS AND ALL APPENDICES THERETO (COLLECTIVELY, "PART 2"). BOTH THIS PART 1 AND PART 2 ARE DATED THE DATE SHOWN ON THE COVER PAGE OF PART 1. THIS PART 1, TOGETHER WITH PART 2, CONSTITUTES THE AUTHORITY'S OFFICIAL STATEMENT RELATING TO THE OFFERED SECURITIES (AND ONLY SUCH OFFERED SECURITIES). BOTH PART 1 AND PART 2 SHOULD BE READ IN THEIR ENTIRETY. INFORMATION CONTAINED ON THE AUTHORITY'S WEB SITE DOES NOT CONSTITUTE PART OF THIS OFFICIAL STATEMENT.
SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Official Statement and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Offered Securities to potential investors is made only by means of the entire Official Statement. Certain terms used herein are defined in this Official Statement.

The Authority

The Long Island Power Authority (the "Authority") is a corporate municipal instrumentality and political subdivision of the State of New York. The Authority has a wholly-owned subsidiary, the Long Island Lighting Company, which does business under the name of LIPA ("LIPA").

LIPA

LIPA owns and operates the electric transmission and distribution system located in its service area, which includes the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County, New York known as the Rockaways. LIPA also owns an 18% interest in the Nine Mile Point 2 nuclear generating facility located in Oswego, New York.

The Purpose of the Offered Securities

The Offered Securities are being issued to refund certain outstanding Bonds of the Authority and to pay costs relating to the issuance of the Offered Securities.

Outstanding Indebtedness

As of August 1, 2006, the Authority had senior lien Electric System General Revenue Bonds outstanding in the aggregate principal amount of $6,082,022,327. The Offered Securities will be on a parity with these Bonds. The Authority also had outstanding, as of August 1, 2006, subordinate lien Electric System Subordinated Revenue Bonds in the aggregate principal amount of $1,034,225,000. As of August 1, 2006, LIPA had outstanding $155,420,000 of NYSERDA Financing Notes that the Authority is responsible for providing the funds to pay.

Authority to Set Electric Rates

Under current New York law, the Authority is empowered to set rates for electric service in its service area without being required to obtain the approval of the New York State Public Service Commission ("PSC") or any other State regulatory body. However, the Authority has agreed with the Public Authorities Control Board of the State of New York ("PACB") that, among other things, it will not impose any permanent increase in average customer rates over a 12-month period in excess of 2.5% without approval of the PSC as described in Part 2 of this Official Statement.
On May 3, 2006, LIPA voluntarily filed two petitions with the PSC requesting a review of the reasonableness and appropriateness of the costs recovered through the Fuel and Purchased Power Cost Adjustment and a ruling that the cost categories the PSC allows utilities to recover through escalator clauses include a range of costs beyond merely fuel costs. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, also on June 20, 2006, the PSC issued an Order declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. See "Rates and Charges – Modification to the FPPCA Mechanism" in Part 2 of this Official Statement.

In February 2006, litigation was commenced against the Authority challenging LIPA's rates. See "Litigation" in Part 2 of this Official Statement.

Rate Structure ..............................................

The Authority has adopted a set of customer rates, which include base rates, a fuel and purchased power adjustment clause, and certain riders and credits.

Service Area ..................................................

LIPA's service area includes approximately 1.1 million customers and had a peak usage of approximately 5,667 MW in the summer of 2006. Approximately 52 percent of annual electric revenues are received from residential customers, with 46 percent coming from commercial/industrial customers, and the balance from sales to other municipalities and public authorities. LIPA's largest customer, the Long Island Rail Road, accounts for less than two percent of LIPA's total sales and less than two percent of revenue.

Transmission and Distribution Facilities ..............................................

LIPA's transmission system includes approximately 1,290 miles of overhead and underground lines with voltage levels ranging from 23 kV to 345 kV. The distribution system has approximately 13,130 circuit miles of overhead and underground line (8,904 overhead and 4,226 underground) and approximately 181,423 line transformers with a total capacity of approximately 11,400 MVA.

Power Supply Resources .................................

LIPA's power supply resources consist principally of various power purchase contracts. The principal power purchase contract is a Power Supply Agreement under which LIPA obtains rights to and
has obligations to pay for all of the capacity of the fossil-fueled generating facilities formerly owned by LILCO and purchased by a subsidiary of KeySpan in 1998. Such agreement entitles LIPA to purchase all of the energy produced by such facilities for its own customers or for resale to others. This Agreement has a term ending in 2013 and is renewable on similar terms.

LIPA has an 18% ownership interest in the 1,148 MW Nine Mile Point 2 nuclear unit currently operated by Constellation Nuclear LLC, which owns the remaining 82% interest.

Plan of System Operation

The Authority manages LIPA's retail electric business and controls costs through a senior management team supported by a small staff to minimize the size of its total work force.

The day-to-day operations of the electric system are accomplished through three principal contracts: (i) a Management Services Agreement providing for operation of the transmission and distribution system, (ii) the Power Supply Agreement mentioned above and (iii) an Energy Management Agreement providing for the management of LIPA's power supply resources and fuel procurement. Each such agreement is with a subsidiary of KeySpan Corporation. KeySpan Corporation has guaranteed the performance, and any payments, by these subsidiaries. In January 2006, the Authority entered into amendments of such agreements, which are subject to certain governmental approvals and other conditions prior to becoming effective. See "LIPA's Retail Electric Service Business – Operating Agreements" in Part 2 of this Official Statement.

To assist management in the supervision of these three principal agreements and to provide other functions requiring specific expertise, the Authority employs outside consultants.

Projected Revenues, Revenue Requirements and Debt Service Coverages

Appendix B to Part 2 of this Official Statement sets forth the Authority's estimates for its revenues and revenue requirements for its 2006 through 2010 fiscal years (the "Projection Period"). These projections show that the Authority's debt service coverages during the Projection Period will be no less than approximately: (i) 2.36x on the senior lien debt outstanding and estimated to be outstanding; (ii) 2.06x on the senior lien debt (including the Offered Securities) and the subordinated lien debt, in
both cases outstanding and estimated to be outstanding; and (iii) 2.03x on the senior and subordinate lien debt mentioned in clause (ii) and on the NYSERDA Financing Notes.

### Accelerated Debt Retirement

The Authority's Trustees have undertaken a plan to implement the accelerated retirement of a principal amount of the Authority's Bonds, Subordinated Indebtedness and other indebtedness of LIPA approximately equal to the $4.0 billion Acquisition Adjustment. This accelerated debt retirement plan, which is a matter of Authority policy and may be changed at any time, has both scheduled and optional elements and also takes into account the funding of capital expenditures with operating revenues.

Current projections show that the plan approved by the Trustees as described herein will enable the Authority, in aggregate, to fund capital expenditures or retire an amount approximately equal to the original $4.0 billion Acquisition Adjustment by the year 2013.

### Security and Sources of Payment for Bonds

The Offered Securities, all Bonds heretofore and hereafter issued on a parity therewith and all Parity Obligations will be payable from and secured by the Trust Estate pledged under the Authority's Resolution, subject to the prior payment of Operating Expenses. The Trust Estate consists principally of the revenues generated by the operation of LIPA's electric transmission and distribution system.

The Bond Resolution contains a basic flow of funds, including a Rate Stabilization Fund, but does not require specific periodic advance deposits to be made into, or specific balances maintained in, the various funds and accounts.

Additional Bonds may be issued without any historical or projected debt service coverage test and, in the case of Refunding Bonds, without compliance with any debt service savings test.

The Bond Resolution contains a rate covenant providing for 1.0x debt service coverage on Bonds and other senior lien obligations and 1.0x coverage of all other expenses, including Subordinated Indebtedness. The 1.0x coverage requirement for Bonds and other senior lien obligations was reduced from 1.2x, and historical and projected debt service tests for the issuance of additional Bonds and other senior lien obligations were eliminated, when the Authority retired an amount equal to approximately
25% of its Acquisition Debt, which occurred in 2005. See "Accelerated Debt Retirement" in Part 2 of this Official Statement.

**Financial Advisor**

The Authority has retained Bear, Stearns & Co. Inc., New York, New York ("Bear Stearns") as its financial advisor. Although Bear Stearns has assisted in the preparation of this Official Statement, Bear Stearns is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy or completeness of the information contained in this Official Statement.
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PART 1

of the

OFFICIAL STATEMENT

of the

LONG ISLAND POWER AUTHORITY

Relating to its

$515,110,000 Electric System General Revenue Bonds, Series 2006E

INTRODUCTION

The $515,110,000 Electric System General Revenue Bonds, Series 2006E (the "Offered Securities"), are being issued by the Long Island Power Authority (the "Authority") pursuant to the Long Island Power Authority Act, being Title 1-A of Article 5 (§ 1020 et seq.) of the Public Authorities Law of the State of New York, as amended (the "Act"), and the Electric System General Revenue Bond Resolution of the Authority adopted on May 13, 1998 (the "Bond Resolution"), as supplemented by a resolution of the Authority adopted on April 27, 2006 authorizing the Offered Securities (the "Supplemental Resolution"). The Bond Resolution, as supplemented to the date hereof, including as supplemented by the Supplemental Resolution and as it may be further supplemented or amended in the future, is herein called the "Resolution."

As of August 1, 2006, the Authority had outstanding $6,082,022,327 of senior lien bonds (the "Outstanding Senior Lien Bonds"), all of which were issued under the Bond Resolution. The Offered Securities will be on a parity as to security and source of payment with the Outstanding Senior Lien Bonds. The Authority has the ability to issue under the Bond Resolution additional senior lien bonds, and other obligations ("Parity Obligations"), that will be on a parity as to security and source of payment with the Outstanding Senior Lien Bonds and the Offered Securities. As used in this Official Statement, the term "Bonds" means the Outstanding Senior Lien Bonds, the Offered Securities and all additional senior lien bonds, notes or other evidence of indebtedness and Parity Obligations of the Authority hereafter issued under the Resolution which are on a parity as to security and source of payment. The Bonds have priority as to security and payment over the Subordinated Indebtedness mentioned in the next paragraph and over the NYSERDA Financing Notes mentioned in the second following paragraph.

The Authority also had outstanding $1,034,225,000 of subordinate lien bonds (the "Outstanding Subordinated Lien Bonds") as of August 1, 2006. The Outstanding Subordinated Lien Bonds were all issued under the Authority's Electric System General Subordinated Revenue Bond Resolution adopted on May 20, 1998 (the "General Subordinated Resolution") and various supplemental resolutions (the General Subordinated Resolution, as so supplemented, is herein called the "Subordinated Resolution"). The Authority has the ability to issue under the General Subordinated Resolution additional subordinated lien bonds and other obligations that will be on a parity as to security and source of payment with the Outstanding Subordinated Lien Bonds. As used in this Official Statement, the term "Subordinated Indebtedness" means the Outstanding Subordinated Lien Bonds and all other subordinated lien bonds, notes or other evidence of indebtedness of the Authority issued pursuant to the Subordinated Resolution which are on a parity as to security and source of payment. All Subordinated Indebtedness is, in all respects, on a junior and subordinate basis as to security and source of payment to the Bonds.

Pursuant to the Bond Resolution, the Authority is also obligated to provide funds to LIPA for LIPA to pay principal and interest on $155,420,000 principal amount of LIPA's NYSERDA Financing Notes. This obligation of the Authority is subordinate to the obligations of the Authority to pay, when due, operating expenses, the Bonds and the Subordinated Indebtedness. For a further description of the NYSERDA Financing Notes and certain promissory notes issued by KeySpan Corporation (the "KeySpan Promissory Notes") which provide the Authority with funds equal to the amounts due on these obligations, see "Debt Service" in this Part 1 and "LIPA's Retail Electric Service Business – LIPA Assets and Liabilities" in Part 2 of this Official Statement.

Capitalized terms not otherwise defined in this Official Statement have the meanings set forth in Appendix C to Part 2 of this Official Statement.
USE OF PROCEEDS

The proceeds of the Offered Securities will be used to refund the Outstanding Bonds of the Authority listed on Appendix 2 hereto (the "Refunded Bonds") and to pay costs (estimated to be $6,341,668.48) relating to the issuance of the Offered Securities, including underwriters' discount.

DEBT SERVICE

The following table shows information regarding the Authority's consolidated debt service requirements following the issuance of the Offered Securities (based on the assumptions in the footnotes to said table), including debt service payable on the NYSERDA Financing Notes. It also shows the amounts to be paid to LIPA by KeySpan Corporation and one or more of its subsidiaries (the "Promissory Note Obligors") under the KeySpan Promissory Notes. Payments under the KeySpan Promissory Notes are general revenues of LIPA pledged under the Financing Agreement to the Authority and are not dedicated to the payment of any NYSERDA Financing Notes. For a description of the NYSERDA Financing Notes and KeySpan Promissory Notes, see "LIPA's Retail Electric Service Business – LIPA Assets and Liabilities" in Part 2 of this Official Statement.

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## DEBT SERVICE

<table>
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<tr>
<th>Twelve Months Ended</th>
<th>Series 2006E Bonds</th>
<th>Outstanding Senior Lien (1)</th>
<th>Total Senior Lien Debt Service</th>
<th>Subordinate Lien</th>
<th>NYSERDA Debt Service</th>
<th>LESS: KeySpan Promissory Notes (5)</th>
<th>Net Total Debt Service</th>
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(1) Amounts reflect results of refunding of bonds listed in Appendix 2.
(2) Accreted interest on capital appreciation bonds is shown in the year of maturity.
(3) Variable rate bonds with associated floating-to-fixed rate swaps are assumed to pay interest at the fixed swap rate. Unhedged variable rate bonds are assumed to pay interest at the rate of 3.50% for 2006 and thereafter. The interest payments on variable rate bonds also include certain ongoing fees (e.g. broker-dealer, auction agent, remarketing agent fees), which are assumed at current levels through maturity. Expected net receipts under certain fixed-to-floating rate and basis swaps are not shown as offsets to debt service.
(4) Certain subordinated bonds are subject to mandatory tender and remarketing prior to maturity on April 1, 2007 and April 1, 2008. These bonds are assumed to bear interest at their initial rates through maturity, April 1, 2012. Additionally, the interest payments assumed on these bonds include annual insurance payments.
(5) KeySpan Promissory Notes are payable to LIPA 30 days prior to the applicable due dates on the NYSERDA Financing Notes in an amount equal to the principal of and interest on such notes.
DESCRIPTION OF THE OFFERED SECURITIES

General

The Offered Securities will be dated the date of delivery and will mature at the times and in the principal amounts as set forth on the inside cover page of this Official Statement. Interest on the Offered Securities will be payable semiannually on June 1 and December 1 commencing December 1, 2006. The Offered Securities will be offered in authorized denominations of $5,000 and integral multiples thereof.

Securities Depository

Upon initial issuance, the Offered Securities will be available only in book-entry form. The Depository Trust Company, New York, New York ("DTC") will act as securities depository for the Offered Securities, and the ownership of one fully registered bond for each maturity of Offered Securities in the principal amount of such maturity will be registered in the name of Cede & Co., as nominee for DTC, and deposited with DTC. See Appendix H to Part 2 of this Official Statement for a description of DTC and its book-entry-only system that will apply to the Offered Securities.

As long as the book-entry system is used for the Offered Securities, The Bank of New York, New York, New York (the "Trustee") and the Authority will give any notice required to be given owners of Offered Securities only to DTC. BENEFICIAL OWNERS SHOULD MAKE APPROPRIATE ARRANGEMENTS FOR THE DIRECT DTC PARTICIPANT THROUGH WHOSE DTC ACCOUNT THEIR BENEFICIAL OWNERSHIP INTEREST IS RECORDED TO RECEIVE NOTICES THAT MAY BE CONVEYED TO DIRECT DTC PARTICIPANTS AND INDIRECT DTC PARTICIPANTS.

Redemption

Optional. The Offered Securities are subject to redemption prior to maturity, at the option of the Authority, on any date on and after December 1, 2016 in whole, or in part from time to time, at a redemption price of par together with the interest accrued on such principal amount to the redemption date.

Notice of Redemption

If any of the Offered Securities are to be redeemed (either optionally or as required to satisfy mandatory sinking fund installments), notice of such redemption is to be mailed by the Trustee to registered owners of such Offered Securities to be redeemed not less than 30 nor more than 45 days preceding each redemption date. Any notice of optional redemption may provide that such redemption is conditioned on, among other things, the availability of sufficient moneys on the redemption date.

The Trustee, so long as a book-entry-only system is used for determining ownership of the Offered Securities, shall send the notice to DTC or its nominee, or its successor. If less than all of the Offered Securities of a maturity are to be redeemed, DTC and the Direct DTC Participant and, where appropriate, Indirect DTC Participants will determine the particular beneficial ownership interests of such Offered Securities of such maturity to be redeemed. Any failure of DTC or a Direct DTC Participant or, where appropriate, Indirect DTC Participants to do so, or to notify a Beneficial Owner of an Offered Security of such redemption, will not affect the sufficiency or the validity of the redemption of such Bond. The Authority can make no assurances that DTC, Direct DTC Participants, Indirect DTC Participants or other nominees of the Beneficial Owners of the Offered Securities to be redeemed will distribute such notices to the Beneficial Owners of such Bonds, or that they will do so on a timely basis. See "Book-Entry-Only System" in Appendix H to Part 2 of this Official Statement.
BOND INSURANCE

General

It is a condition to the issuance of the Offered Securities that (i) Financial Guaranty Insurance Company ("FGIC") issues its Municipal Bond New Issue Insurance Policy (the "FGIC Policy") for the maturities of the Offered Securities indicated on the inside front cover of this Official Statement and (ii) MBIA Insurance Corporation ("MBIA" and, together with FGIC, the "Insurers") issues its Financial Guaranty Insurance Policy (the "MBIA Policy" and, together with the FGIC Policy, the "Policies") for the maturities of the Offered Securities indicated on the inside front cover of this Official Statement (collectively, the "Insured Bonds"). FGIC and MBIA have agreed to issue the Policies concurrently with the initial issuance of the Offered Securities. The Policies guarantee the scheduled payment of principal and of interest on the Insured Bonds when due as set forth in the form of the Policies included as Appendix 3 hereto.

There follows under this caption certain information concerning the Insurers and the Policies, which has been supplied by the respective Insurers, as well as certain provisions relating to the Resolution relating thereto.

No representation is made by the Authority or the Underwriters or their counsel as to the accuracy, completeness or adequacy of such information, or as to the absence of material adverse changes in such information subsequent to the date hereof. Neither the Authority nor the Underwriters have made any independent investigation of the Insurers or the Policies, and references should be made to the information set forth below for a description thereof. The Policies do not constitute a part of the contract between the Authority and the holders of the Insured Bonds as evidenced by such Bonds or the Resolution. Except for the payment of the premiums for the Policies, the Authority has no responsibility whatsoever with respect to the Policies, including the maintenance or enforcement thereof or collection of amounts payable thereunder.

So long as FGIC and MBIA are not in default under the FGIC Policy or the MBIA Policy, respectively, the Resolution provides that the Insurers shall be deemed to be the sole holders of the Insured Bonds to which their respective policy pertains for the purpose of exercising any voting rights or privileges or giving any consents or directions or taking any other action that the holders of the Insured Bonds are entitled to take under the provisions of the Resolution pertaining to supplemental resolutions, amendments, defaults and remedies and the Trustee.

The Financial Guaranty Insurance Company Policy

FGIC has supplied the following information for inclusion in this Official Statement. No representation is made by the Authority or the Underwriters as to the accuracy or completeness of this information.

Payments Under the Policy

Concurrently with the issuance of the Offered Securities, FGIC will issue its FGIC Policy for the Offered Securities indicated on the inside front cover of this Official Statement (the "FGIC Insured Bonds"). The FGIC Policy unconditionally guarantees the payment of that portion of the principal or accreted value (if applicable) of and interest on the FGIC Insured Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Authority. FGIC will make such payments to U.S. Bank Trust National Association, or its successor as its agent (the "Insurer’s Fiscal Agent"), on the later of the date on which such principal, accreted value or interest (as applicable) is due or on the business day next following the day on which FGIC shall have received notice (in accordance with the terms of the FGIC Policy) from an owner of FGIC Insured Bonds or the trustee or paying agent (if any) of the nonpayment of such amount by the Authority. The Insurer’s Fiscal Agent will disburse such amount due on any FGIC Insured Bond to its owner upon receipt by the Insurer’s Fiscal Agent of evidence satisfactory to the Insurer’s Fiscal Agent of the owner's right to receive payment of the principal, accreted value or interest (as applicable) due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal, accreted value or interest (as applicable) shall be vested in FGIC. The term "nonpayment" in respect of a FGIC Insured Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a FGIC Insured Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.
Once issued, the FGIC Policy is non-cancellable by FGIC. The FGIC Policy covers failure to pay principal (or accreted value, if applicable) of the FGIC Insured Bonds on their stated maturity dates and their mandatory sinking fund redemption dates, and not on any other date on which the FGIC Insured Bonds may have been otherwise called for redemption, accelerated or advanced in maturity. The FGIC Policy also covers the failure to pay interest on the stated date for its payment. In the event that payment of the FGIC Insured Bonds is accelerated, FGIC will only be obligated to pay principal (or accreted value, if applicable) and interest in the originally scheduled amounts on the originally scheduled payment dates. Upon such payment, FGIC will become the owner of the FGIC Insured Bond, appurtenant coupon or right to payment of principal or interest on such FGIC Insured Bond and will be fully subrogated to all of the Bondholder's rights thereunder.

The FGIC Policy does not insure any risk other than Nonpayment by the Authority, as defined in the FGIC Policy. Specifically, the FGIC Policy does not cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity; (ii) payment of any redemption, prepayment or acceleration premium; or (iii) nonpayment of principal (or accreted value, if applicable) or interest caused by the insolvency or negligence or any other act or omission of the trustee or paying agent, if any.

As a condition of its commitment to insure FGIC Insured Bonds, FGIC may be granted certain rights under the Resolution. The specific rights, if any, granted to FGIC in connection with its insurance of the FGIC Insured Bonds may be set forth in the description of the principal legal documents appearing elsewhere in this Official Statement, and reference should be made thereto.

The FGIC Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty Insurance Company

FGIC is a New York stock insurance corporation that writes financial guaranty insurance in respect of public finance and structured finance obligations and other financial obligations, including credit default swaps. FGIC is licensed to engage in the financial guaranty insurance business in all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands and the United Kingdom.

FGIC is a direct, wholly owned subsidiary of FGIC Corporation, a Delaware corporation. At June 30, 2006, the principal owners of FGIC Corporation and the approximate percentage of its outstanding common stock owned by each were as follows: The PMI Group, Inc. – 42%; affiliates of the Blackstone Group L.P. – 23%; and affiliates of the Cypress Group L.L.C. – 23%. Neither FGIC Corporation nor any of its stockholders or affiliates is obligated to pay any debts of FGIC or any claims under any insurance policy, including the FGIC Policy, issued by FGIC.

FGIC is subject to the insurance laws and regulations of the State of New York, where FGIC is domiciled, including New York's comprehensive financial guaranty insurance law. That law, among other things, limits the business of each financial guaranty insurer to financial guaranty insurance (and related lines); requires that each financial guaranty insurer maintain a minimum surplus to policyholders; establishes limits on the aggregate net amount of exposure that may be retained in respect of a particular issuer or revenue source (known as single risk limits) and on the aggregate net amount of exposure that may be retained in respect of particular types of risk as compared to the policyholders' surplus (known as aggregate risk limits); and establishes contingency, loss and unearned premium reserve requirements. In addition, FGIC is also subject to the applicable insurance laws and regulations of all other jurisdictions in which it is licensed to transact insurance business. The insurance laws and regulations, as well as the level of supervisory authority that may be exercised by the various insurance regulators, vary by jurisdiction.

At June 30, 2006, FGIC had net admitted assets of approximately $3.752 billion, total liabilities of approximately $2.616 billion, and total capital and policyholders' surplus of approximately $1.136 billion, determined in accordance with statutory accounting practices ("SAP") prescribed or permitted by insurance regulatory authorities.
The unaudited consolidated financial statements of FGIC and subsidiaries, on the basis of U.S. generally accepted accounting principles ("GAAP"), as of June 30, 2006 and the audited consolidated financial statements of FGIC and subsidiaries, on the basis of GAAP, as of December 31, 2005 and 2004, which have been filed with the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"), are hereby included by specific reference in this Official Statement. Any statement contained herein under the heading "BOND INSURANCE—The Financial Guaranty Insurance Company Policy" or in any documents included by specific reference herein, shall be modified or superseded to the extent required by any statement in any document subsequently filed by FGIC with such NRMSIRs, and shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement. All financial statements of FGIC (if any) included in documents filed by FGIC with the NRMSIRs subsequent to the date of this Official Statement and prior to the termination of the offering of the FGIC Insured Bonds shall be deemed to be included by specific reference into this Official Statement and to be a part hereof from the respective dates of filing of such documents.

The New York State Insurance Department recognizes only SAP for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under the New York Insurance Law, and for determining whether its financial condition warrants the payment of a dividend to its stockholders. Although FGIC prepares both GAAP and SAP financial statements, no consideration is given by the New York State Insurance Department to financial statements prepared in accordance with GAAP in making such determinations. A discussion of the principal differences between SAP and GAAP is contained in the notes to FGIC's audited SAP financial statements.

Copies of FGIC's most recently published GAAP and SAP financial statements are available upon request to: Financial Guaranty Insurance Company, 125 Park Avenue, New York, NY 10017, Attention: Corporate Communications Department. FGIC's telephone number is (212) 312-3000.

Financial Guaranty Insurance Company’s Credit Ratings

The financial strength of FGIC is rated "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc., "Aaa" by Moody's Investors Service, and "AAA" by Fitch Ratings. Each rating of FGIC should be evaluated independently. The ratings reflect the respective ratings agencies' current assessments of the insurance financial strength of FGIC. Any further explanation of any rating may be obtained only from the applicable rating agency. These ratings are not recommendations to buy, sell or hold the FGIC Insured Bonds, and are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the FGIC Insured Bonds. FGIC does not guarantee the market price or investment value of the FGIC Insured Bonds nor does it guarantee that the ratings on the FGIC Insured Bonds will not be revised or withdrawn.

Neither FGIC nor any of its affiliates accepts any responsibility for the accuracy or completeness of the Official Statement or any information or disclosure that is provided to potential purchasers of the FGIC Insured Bonds, or omitted from such disclosure, other than with respect to the accuracy of information with respect to FGIC or the FGIC Policy under the heading "BOND INSURANCE—The Financial Guaranty Insurance Company Policy." In addition, FGIC makes no representation regarding the FGIC Insured Bonds or the advisability of investing in the FGIC Insured Bonds.

The MBIA Insurance Corporation Insurance Policy

Concurrently with the issuance of the Offered Securities, MBIA will issue the MBIA Policy for Offered Securities indicated on the inside front cover of this Official Statement (the "MBIA Insured Bonds"). The following information has been furnished by MBIA for use in this Official Statement.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the MBIA Policy and MBIA set forth under the heading "BOND INSURANCE—The MBIA Insurance Corporation Insurance Policy." Additionally, MBIA makes no representation regarding the MBIA Insured Bonds or the advisability of investing in the MBIA Insured Bonds.
The MBIA Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Authority to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the MBIA Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the MBIA Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the MBIA Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

The MBIA Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bond. The MBIA Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of the MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The MBIA Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the MBIA Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of an MBIA Insured Bond the payment of an insured amount for which is then due, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such MBIA Insured Bonds or presentment of such other proof of ownership of the MBIA Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the MBIA Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the MBIA Insured Bonds in any legal proceeding related to payment of insured amounts on the MBIA Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such MBIA Insured Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

MBIA Insurance Corporation

MBIA is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA, either directly or through subsidiaries, is licensed to do business in the Republic of France, the United Kingdom and the Kingdom of Spain and is subject to regulation under the laws of those jurisdictions.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

Regulation

As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and
requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

The MBIA Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Strength Ratings of MBIA

Moody's Investors Service, Inc. rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA "AAA."

Fitch Ratings rates the financial strength of MBIA "AAA."

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the MBIA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the MBIA Insured Bonds. MBIA does not guaranty the market price of the MBIA Insured Bonds nor does it guaranty that the ratings on the MBIA Insured Bonds will not be revised or withdrawn.

MBIA Financial Information

As of December 31, 2005, MBIA had admitted assets of $11.0 billion (audited), total liabilities of $7.2 billion (audited), and total capital and surplus of $3.8 billion (audited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of June 30, 2006, MBIA had admitted assets of $11.3 billion (unaudited), total liabilities of $6.9 billion (unaudited), and total capital and surplus of $4.3 billion (unaudited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2005 and December 31, 2004 and for each of the three years in the period ended December 31, 2005, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2005 and the consolidated financial statements of MBIA and its subsidiaries as of June 30, 2006 and for the six month periods ended June 30, 2006 and June 30, 2005 included in the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the internet at the Company's web site at http://www.mbia.com and at no cost, upon request to MBIA at its principal executive offices.

Incorporation of Certain Documents by Reference

The following documents filed by the Company with the Securities and Exchange Commission (the "SEC") are incorporated by reference into this Official Statement:

(1) The Company's Annual Report on Form 10-K for the year ended December 31, 2005; and
Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the MBIA Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and (2) the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006 are available (i) over the internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington, D.C. (iii) over the internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA at its principal executive offices.

TAX MATTERS

Opinion of Bond Counsel

In the opinion of Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the Authority ("Bond Counsel"), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Offered Securities is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (as used in this section, the "Code") and (ii) interest on the Offered Securities is not treated as a preference item in calculating the alternative minimum tax that may be imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of facts, and statements of reasonable expectations made by the Authority and LIPA in connection with the Offered Securities, and Bond Counsel has assumed compliance by the Authority and LIPA with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Offered Securities from gross income under Section 103 of the Code.

In addition, in the opinion of Bond Counsel to the Authority, under existing statutes, interest on the Offered Securities is exempt from personal income taxes imposed by the State of New York or any political subdivision thereof, and the Offered Securities are exempt from all taxation directly imposed thereon by or under the authority of the State of New York, except estate or gift taxes and taxes on transfers.

Bond Counsel expresses no opinion regarding any other federal or state tax consequences with respect to the Offered Securities. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of interest on the Offered Securities, or under state and local tax law.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Offered Securities in order that interest on the Offered Securities be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to the use and expenditure of gross proceeds of the Offered Securities, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the
Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral federal income tax matters with respect to the Offered Securities. It does not purport to address all aspects of federal taxation that may be relevant to a particular owner of the Offered Securities. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the federal tax consequences of owning and disposing of the Offered Securities.

Prospective owners of the Offered Securities should be aware that the ownership of such obligations may result in collateral federal income tax consequences to various categories of persons, such as corporations (including S Corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits and individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for federal income tax purposes. Interest on the Offered Securities may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

Original issue discount ("OID") is the excess of the sum of all amounts payable at the stated maturity of an Offered Security (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the "issue price" of a maturity means the first price at which a substantial amount of the Offered Securities of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of Offered Securities is expected to be the initial offering price set forth on the cover page of this Official Statement. Bond Counsel further is of the opinion that, for any Offered Securities having OID (a "Discount Bond"), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for federal income tax purposes to the same extent as other interest on the Offered Securities.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Discount Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for federal income tax purposes, including various special rules relating thereto, and the state and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Bond Premium

In general, if an owner acquires an Offered Security for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the Offered Security after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Offered Security (a "Premium Bond"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond, determined based on constant yield principles (in certain cases involving a Premium Bond callable prior to its stated...
maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond. An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period, under the owner's regular method of accounting, against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost.

Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on sale, exchange, or other disposition of Premium Bonds.

Legislation

Legislation affecting municipal bonds is regularly under consideration by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Securities will not have an adverse effect on the tax-exempt status or market price of the Offered Securities.

VERIFICATION

The accuracy of (i) the mathematical computations of the adequacy of the maturing principal and interest earned on the government obligations to be held in escrow to pay principal, interest not otherwise paid and redemption premiums, if any, on the Refunded Bonds and (ii) certain mathematical computations supporting the conclusion that the Offered Securities are not "arbitrage bonds" under the Code, will be verified by a verification agent selected by the Authority.

UNDERWRITING

The Underwriters listed on the cover page of this Official Statement, for which Lehman Brothers Inc. is acting as the Senior Manager, have agreed, jointly and severally and subject to certain conditions, to purchase all, but not less than all, of the Offered Securities from the Authority at an underwriters' discount of $2,639,986.91. The Underwriters will be obligated to purchase all of the Offered Securities if any of the Offered Securities are purchased. The initial public offering prices of the Offered Securities may be changed from time to time by the Underwriters.

The Offered Securities may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Offered Securities into investment trusts) at prices lower than such public offering prices.

CONTINUING DISCLOSURE UNDERTAKING

The Offered Securities will be subject to the continuing secondary market disclosure requirements of Rule 15c2-12 of the Securities and Exchange Commission (the "Rule") and will be made subject to the Continuing Disclosure Certificate referred to in "Continuing Disclosure Undertakings for the Offered Securities" in Part 2 of this Official Statement. The Offered Securities being made subject to the Continuing Disclosure Certificate is a condition precedent to the obligation of the Underwriters to purchase the Offered Securities.

CREDIT RATINGS

It is a condition to the obligation of the Underwriters to purchase the Offered Securities that, at the date of delivery thereof to the Underwriters, the Offered Securities be rated "A-" by Fitch, "A3" by Moody's and "A-" by S&P, except for the Insured Bonds, which are to be rated "AAA" by Fitch, "Aaa" by Moody's and "AAA" by S&P. The Insured Bonds are expected to be assigned such long-term ratings based upon, and solely as a result of, the issuance of the Policies by the Insurers. The respective ratings by Fitch, Moody's and S&P of the Offered Securities reflect only the views of such organizations and any desired explanation of the significance of such ratings and any
outlooks or other statements given by the rating agencies with respect thereto should be obtained from the rating agency furnishing the same, at the following addresses: Fitch, Inc., One State Street Plaza, New York, New York 10004; Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007; and Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041. Generally, a rating agency bases its rating and outlook (if any) on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings for the Offered Securities will continue for any given period of time or that any of such ratings will not be revised downward or withdrawn entirely by any of the rating agencies, if, in the judgment of such rating agency or agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Offered Securities.

APPROVAL OF LEGAL PROCEEDINGS

Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the Authority, will render opinions with respect to the validity of the Offered Securities in substantially the form set forth in Appendix 1 to this Part 1. Certain legal matters with respect to the Authority and LIPA will be passed upon by Stanley B. Klimberg, Esquire, General Counsel to the Authority and LIPA, and by Clifford Chance US LLP, New York, New York, Disclosure Counsel to the Authority and LIPA. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York, Counsel to the Underwriters.

MISCELLANEOUS

This Official Statement (which includes Part 1 and Part 2) includes, among other things, descriptions of (i) the Authority, LIPA, the System and NMP2 and (ii) the terms of the Offered Securities, the Operating Agreements, the Resolution, the Continuing Disclosure Certificate and certain provisions of the Act. Such descriptions are not complete and all such descriptions and references thereto are qualified by reference to each such document, copies of which may be obtained from the Authority.

The agreements with the holders of the Offered Securities are fully set forth in the Bond Resolution, as supplemented by the Supplemental Resolution, which authorizes their issuance. This Official Statement is not to be construed as a contract with the purchasers of the Offered Securities or of any other obligations of the Authority.

This Official Statement has been approved by the Trustees of the Authority and has been executed on behalf of the Authority by the Chairman of its Trustees pursuant to the authority of the Trustees.

LONG ISLAND POWER AUTHORITY

By: /s/ Richard M. Kessel
Chairman
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APPENDIX 1

Form of Opinion of Hawkins Delafield & Wood LLP
Bond Counsel to the Authority

September 26, 2006

Long Island Power Authority
333 Earle Ovington Blvd.
Uniondale, NY 11553

Ladies and Gentlemen:

We have examined a certified record of proceedings relating to the issuance of $515,110,000 Electric System General Revenue Bonds, Series 2006E (the "2006E Bonds"), of the Long Island Power Authority (the "Authority"), a corporate municipal instrumentality of the State of New York (the "State") constituting a body corporate and politic and a political subdivision of the State.

The 2006E Bonds are issued under and pursuant to the Constitution and statutes of the State, including the Long Island Power Authority Act, being Title 1-A of Article 5 of the Public Authorities Law, Chapter 43-A of the Consolidated Laws of the State of New York, as amended (herein called the "Act"), and under and pursuant to proceedings of the Authority duly taken, including a resolution adopted by the Trustees of the Authority on May 13, 1998 entitled "Electric System General Revenue Bond Resolution", as supplemented by a resolution of said Trustees adopted on April 27, 2006 (collectively, the "Resolution").

The Authority has heretofore issued bonds (the "Outstanding Bonds") under the Resolution. The Resolution provides that the Authority may issue additional Bonds (as defined in the Resolution), and incur Parity Obligations (as defined in the Resolution), thereunder from time to time on the terms and conditions and for the purposes stated therein. The Outstanding Bonds, the 2006E Bonds, such additional Bonds, if issued, and such Parity Obligations, if incurred, will be equally and ratably secured under the Resolution, except as otherwise provided therein.

The 2006E Bonds are dated, mature, are payable, bear interest and are subject to redemption, all as provided in the Resolution.

We are of the opinion that:

1. The Authority is duly created and validly existing under the laws of the State, including the Constitution of the State and the Act. Under the laws of the State, including the Constitution of the State, and under the Constitution of the United States, the Act is valid with respect to all provisions thereof material to the subject matters of this opinion letter.

2. The Authority has the right and power under the Act to adopt the Resolution and to perform its obligations thereunder, including its rate covenant relating to the establishment and maintenance of System fees, rates, rents, charges and surcharges. The Authority has received all approvals of any governmental agency, board or commission necessary for the adoption of, or performance of its obligations under, the Resolution, including the approval of the New York State Public Authorities Control Board. The approval of the Public Authorities Control Board of the acquisition of the Long Island Lighting Company by the Authority directs the Authority to obtain the approval of the New York State Public Service Commission prior to implementing certain rate increases.

3. The Resolution has been duly and lawfully adopted by the Authority, is in full force and effect, is valid and binding upon the Authority, and is enforceable in accordance with its terms. The Resolution creates the valid pledge which it purports to create of the Trust Estate (as defined in the Resolution), subject only to the provisions of the Resolution permitting the application thereof for the purposes and on the terms and conditions set forth in the Resolution.
4. The 2006E Bonds have been duly and validly authorized and issued in accordance with the laws of the State, including the Constitution of the State and the Act, and in accordance with the Resolution, and are valid and binding special obligations of the Authority, enforceable in accordance with their terms and the terms of the Resolution, payable solely from the Trust Estate as provided in the Resolution. The Authority has no taxing power, the 2006E Bonds are not debts of the State or of any municipality thereof, and the 2006E Bonds will not constitute a pledge of the credit, revenues or taxing power of the State or of any municipality thereof. The Authority reserves the right to issue additional Bonds and to incur Parity Obligations on the terms and conditions, and for the purposes, provided in the Resolution, on a parity of security and payment with the 2006E Bonds and the Outstanding Bonds.

5. Any registration with, consent of, or approval by, any governmental agency, board, or commission that is necessary for the execution and delivery and the issuance of the 2006E Bonds has been obtained.

6. The adoption of the Resolution, compliance with all of the terms and conditions of the Resolution and the 2006E Bonds, and the execution and delivery of the 2006E Bonds, will not result in a violation of or be in conflict with any term or provision of any existing law, or of any approval by any governmental agency, board or commission necessary for the adoption of, or performance of the Authority's obligations under, the Resolution.

7. The Financing Agreement, dated as of May 1, 1998, between the Authority and Long Island Lighting Company d/b/a LI PA (as successor by merger to LIPA Acquisition Corp.) (the "Subsidiary") has been duly authorized, executed and delivered by the Authority and the Subsidiary and is a valid and binding obligation of the parties thereto, enforceable in accordance with its terms.

8. Under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described below, (i) interest on the 2006E Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the 2006E Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering the opinions in this paragraph 8, we have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Authority and the Subsidiary in connection with the 2006E Bonds, and we have assumed compliance by the Authority and the Subsidiary with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the 2006E Bonds from gross income under Section 103 of the Code.

9. The original issue discount on the 2006E Bonds, if any, that has accrued and is properly allocable to the owners thereof under Section 1288 of the Code is excludable from gross income for federal income tax purposes to the same extent as other interest on the 2006E Bonds.

10. Under existing statutes, interest on the 2006E Bonds is exempt from personal income taxes imposed by the State or any political subdivision thereof, and the 2006E Bonds are exempt from all taxation directly imposed thereon by or under the authority of the State, except estate or gift taxes and taxes on transfers.

The opinions expressed in paragraphs 2, 3, 4 and 7 above are subject to applicable bankruptcy, insolvency, reorganization, moratorium and other laws heretofore or hereafter enacted affecting creditors' rights, and are subject to the application of principles of equity relating to or affecting the enforcement of contractual obligations, whether such enforcement is considered in a proceeding in equity or at law.

Except as stated in paragraphs 8, 9, and 10, we express no opinion regarding any other federal or state tax consequences with respect to the 2006E Bonds. We render our opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. We express no opinion on the effect of any
action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of interest on the 2006E Bonds, or under state and local tax law.

We express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information, which has been or will be supplied to purchasers of the 2006E Bonds.

This opinion is issued as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law, or in interpretations thereof, that may hereafter occur, or for any other reason whatsoever.

Very truly yours,
## APPENDIX 2

### List of Refunded Bonds

<table>
<thead>
<tr>
<th>Series</th>
<th>Maturity</th>
<th>Par Amount(^{(1)})</th>
<th>CUSIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998A</td>
<td>December 1, 2018</td>
<td>$ 228,030,000</td>
<td>542690BE1</td>
</tr>
<tr>
<td>1998A</td>
<td>December 1, 2022</td>
<td>297,580,000</td>
<td>542690YM8</td>
</tr>
</tbody>
</table>

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\(^{(1)}\) The amount shown represents all of the maturity.
APPENDIX 3

Specimen Municipal Bond Insurance Policy
# Municipal Bond
## New Issue Insurance Policy

<table>
<thead>
<tr>
<th>Issuer:</th>
<th>Policy Number:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Control Number: 0010001</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bonds:</th>
<th>Premium:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to U.S. Bank Trust National Association or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder’s right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder’s rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder’s rights thereunder, including the Bondholder’s right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term “Bondholder” means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. “Due for Payment” means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date for payment of interest. “Nonpayment” in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all...
Municipal Bond
New Issue Insurance Policy

principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

[Signature]

President

Effective Date: 

Authorized Representative

U.S. Bank Trust National Association, acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

[Signature]

Authorized Officer
Endorsement
To Financial Guaranty Insurance Company
Insurance Policy

Policy Number:  
Control Number: 0010001

It is further understood that the term “Nonpayment” in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the Issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

[Signature]

President

Effective Date: 

[Signature]

Authorized Representative

Acknowledged as of the Effective Date written above:

[Signature]

Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent
Mandatory New York State
Amendatory Endorsement
To Financial Guaranty Insurance Company
Insurance Policy

Policy Number:  

Control Number: 0010001

The insurance provided by this Policy is not covered by the New York Property/Casualty Insurance Security Fund (New York Insurance Code, Article 76).

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

[Signature]

President

Effective Date:  

Authorized Representative

Acknowledged as of the Effective Date written above:

[Signature]

Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent
Mandatory New York State
Amendatory Endorsement
To Financial Guaranty Insurance Company
Insurance Policy

Policy Number: __________________________ Control Number: 0010001

Notwithstanding the terms and conditions in this Policy, it is further understood that there shall be no acceleration of payment due under such Policy unless such acceleration is at the sole option of Financial Guaranty.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

[Signature]
President

Effective Date: __________________________ Authorized Representative

Acknowledged as of the Effective Date written above:

[Signature]
Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent
FINANCIAL GUARANTY INSURANCE POLICY
MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects, in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

This policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

President

Assistant Secretary
LONG ISLAND POWER AUTHORITY SERVICE AREA
PART 2

of the

OFFICIAL STATEMENT

of the

LONG ISLAND POWER AUTHORITY
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PART 2
of the
OFFICIAL STATEMENT
of the
LONG ISLAND POWER AUTHORITY

INTRODUCTION

The purpose of this Part 2 is to describe, among other things, the Long Island Power Authority (the "Authority") and its wholly-owned subsidiary, the Long Island Lighting Company ("LILCO") which does business as the retail electric supplier on Long Island, New York ("Long Island") under the name LIPA ("LIPA"). The Authority, acting through LIPA, provides this electric service in its service area (the "Service Area") which includes two counties on Long Island — Nassau County ("Nassau County") and Suffolk County ("Suffolk County") (except for the Nassau County villages of Freeport and Rockville Centre and the Suffolk County village of Greenport, each of which has its individually owned municipal electric system) — and a portion of the Borough of Queens of The City of New York known as the Rockaways. Capitalized terms used but not defined in this Part 2 have the meanings given those terms in Appendix C to this Part 2.

The Authority is a corporate municipal instrumentality and a political subdivision of the State of New York (the "State"), exercising essential governmental and public powers. The Authority was created by the State Legislature under and pursuant to the Long Island Power Authority Act, being Title 1-A of Article 5 (§ 1020 et seq.) of the Public Authorities Law of the State of New York, as amended (the "Act"). LIPA is a stock corporation formed and existing under the Business Corporation Law of the State of New York.

The Authority took over as the retail supplier of electric service in the Service Area on May 28, 1998 by acquiring LILCO as a wholly-owned subsidiary of the Authority through a merger (the "LIPA/LILCO Merger"). Since the LIPA/LILCO Merger, LILCO has done business under the name LIPA. Before the LIPA/LILCO Merger, LILCO was a publicly traded, shareholder-owned corporation that was the sole supplier of both retail electric and gas service in the Service Area. LIPA (LILCO) no longer provides gas service in the Service Area. For the period prior to the LIPA/LILCO Merger, LILCO is referred to herein as "LILCO" and, for the subsequent period, is referred to herein as "LIPA."

As part of the LIPA/LILCO Merger, LIPA retained the electric transmission and distribution systems (the "T&D System"), certain agreements and contracts for power supply and transmission, an 18% undivided ownership interest in Unit 2 of the Nine Mile Point nuclear electric generating station located in Oswego, New York and certain other assets and liabilities (for a discussion of these other assets and liabilities, see "LIPA's Retail Electric Service Business – LIPA Assets and Liabilities" in this Part 2). The term "System" means all of the assets of the Authority and LIPA that are used in the furnishing of electric service.

As part of the LIPA/LILCO Merger, the remainder of LILCO's electric service assets (including all of its then-existing fossil-fueled generating units), and its entire gas supply system, were transferred to certain wholly-owned subsidiaries (each a "KeySpan Sub" and, collectively, the "KeySpan Subs") of KeySpan Corporation. KeySpan Corporation is a publicly-traded, shareholder-owned corporation with its corporate headquarters located in Brooklyn, New York. KeySpan Corporation does business under the
name KeySpan Energy ("KeySpan"). On February 27, 2006 KeySpan announced a definitive agreement under which KeySpan would be acquired in early 2007 by an affiliate of National Grid plc, a company organized under the laws of England and Wales. The transaction is subject to the approval of the shareholders of both companies and to various regulatory approvals. In the event there is a change of control of KeySpan, the Authority and LIPA would have the option of canceling their contracts with KeySpan and the KeySpan Subs. See "Operating Agreements" in this Part 2.

Strategic Organization Review

In August 2004, the Authority began an extensive analysis of its organizational structure. The purpose of the review was to decide whether the Authority, as currently organized and governed, was in the best position to provide Long Island with reliable power at the lowest possible cost over the long term. The review also evaluated whether the Authority should exercise its option to acquire the former LILCO on-Island generation consisting of 53 generating units at 13 locations totaling approximately 4,000 megawatts (the "GPRA Option"). In December 2005, the Authority announced that it had completed its review and determined that it would remain in its current structure as a governmental authority and retain its public/private partnership model. The Authority also announced that, in connection with this determination, it had reached an agreement in principle with KeySpan to (i) substantially amend the Management Services Agreement between the Authority and KeySpan Electric Services LLC (the "MSA") and extend its term to December 31, 2013, (ii) settle certain disputes with KeySpan and the KeySpan Subs and (iii) provide the Authority with an option to acquire two of KeySpan's generating facilities with a combined capacity of 450 megawatts (the Barrett and Far Rockaway plants).

In January 2006, LIPA entered into definitive agreements to amend the MSA and certain other operating agreements entered into with certain of the KeySpan Subs, subject to certain governmental approvals and other conditions. See "Operating Agreements" in this Part 2 for information regarding such amendments. LIPA also entered into a Settlement Agreement, dated as of January 1, 2006 (the "2006 Settlement Agreement"), with KeySpan and certain of the KeySpan Subs to resolve certain outstanding disputes. LIPA will receive approximately $120 million in payments or credits pursuant to the 2006 Settlement Agreement. LIPA has announced that it will reserve a portion of such amount to allow it to avoid increasing its electric rates and surcharges through 2007, absent a world-wide energy crisis. In addition, LIPA expects to pay down approximately $25 million of its outstanding debt and provide each residential customer with a one-time refund of $35. LIPA also entered into an option agreement (the "2006 Option Agreement") with KeySpan Generation LLC ("GENCO") which provides LIPA with an option (the "2006 Purchase Option"), exercisable not later than December 31, 2006, to acquire the Barrett and Far Rockaway plants (as defined in such agreement) from GENCO. In the event that LIPA acquires either or both of such plants, LIPA and KeySpan have agreed that KeySpan, acting through a subsidiary to be designated, will operate and maintain such plants.

Such agreements are subject to approval by the New York State Comptroller (the "Comptroller") and, as to form, by the New York State Attorney General (the "Attorney General") and are also subject to the condition that each of the 2006 Settlement Agreement, the 2006 Option Agreement and the amendment to the MSA must become effective or none will become effective. If such agreements become effective, the GPRA Option will expire. However, if such agreements do not become effective, the Authority will have 90 days to exercise the GPRA Option. The Authority does not expect the Comptroller or the Attorney General to take action on this matter until the Authority resolves its concerns with the acquisition of KeySpan by National Grid plc discussed below. See "Power Plant Purchase Right" in this Part 2.
LIPA'S RETAIL ELECTRIC SERVICE BUSINESS

Relationship of the Authority and LIPA

LIPA is a New York corporation and a wholly-owned subsidiary of the Authority. The members of the board of directors of LIPA are elected by the Authority. Accordingly, LIPA is controlled by the Authority. The present members of the board of directors of LIPA are the Trustees of the Authority (the "Trustees"). The Trustees are the Authority's governing body.

The Authority and LIPA are parties to a Financing Agreement (the "Financing Agreement") providing for their respective duties and obligations relating to the financing and operation of the retail electric business in the Service Area. See Appendix D to this Part 2 for a summary of the Financing Agreement.

Pursuant to the terms of the Financing Agreement, the Authority is to issue all debt necessary for the Authority and LIPA. This debt includes all Bonds and Subordinated Indebtedness issued and to be issued. The proceeds of all such debt are to be treated as being loaned to LIPA, which will repay such loans from the revenues it receives from its electric business. To secure the loans, LIPA has pledged all of its revenues to the Authority, which has, in turn, pledged such revenues as security for such debt.

Pursuant to the terms of the Financing Agreement, LIPA conducts the electric business in the Service Area and is responsible for providing service to customers in the Service Area. The Authority and LIPA are also parties to an Administrative Services Agreement pursuant to which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area. See "Long Island Power Authority – Management and Operations of the System" in this Part 2.

System Operation by the Authority

In order to assist the Authority (acting through LIPA) in providing electric service in the Service Area, the Authority entered into the Management Services Agreement (the "MSA"), a Power Supply Agreement (the "PSA") and an Energy Management Agreement (the "EMA") (these three agreements are collectively referred to as the "Operating Agreements"), each with a separate KeySpan Sub, and assigned them to LIPA. These KeySpan Subs include those subsidiaries to which LILCO transferred its fossil-fueled generating facilities simultaneously with the LIPA/LILCO Merger. The performance of each such KeySpan Sub under its respective Operating Agreement as well as any payment obligations it may have under such agreement are guaranteed by KeySpan (see "Guarantees and Indemnities" below). The purpose of the Operating Agreements is to provide the Authority and LIPA with the operating personnel and a significant portion of the power supply resources necessary for LIPA to continue to provide electric service in the Service Area. The Authority assigned its rights and obligations under the Operating Agreements to LIPA. As described below, LIPA and the applicable KeySpan Sub have agreed to amend the Operating Agreements, subject to certain governmental approvals and other conditions.

The Authority oversees the operation of the System and manages the Operating Agreements with a staff of approximately 100 and through the support of outside financial, engineering, accounting and legal advisors and consultants. Day-to-day operations and maintenance during the terms of the Operating Agreements are being performed by the workforce of the KeySpan Subs.

The Authority provides the continuity of policy making, rate setting, financial planning and management of the System by maintaining the capability of its management team and in-house staff to administer the Operating Agreements and to make efficient use of outsourced services. A wide variety of skills and experience are required to establish policy, evaluate System needs, and assess System
operations and related matters. The requirements are periodic and vary in the level of effort required. Outsourcing some of these services enables the Authority to have the skills needed without the expense of committing to full-time positions. The Authority employs several outside consultants to assist it in managing the System.


Operating Agreements

The parties to each of the Operating Agreements described below have agreed to amendments of such agreements, subject to certain governmental approvals, including approval by the Comptroller and, as to form, by the Attorney General, and other conditions. If any one of the 2006 Settlement Agreement, the 2006 Option Agreement or the amendment to the MSA does not become effective, none of such agreements will become effective. On February 27, 2006 KeySpan announced a definitive agreement under which KeySpan would be acquired in early 2007 by an affiliate of National Grid plc, a company organized under the laws of England and Wales. The transaction is subject to the approval of the shareholders of both companies and to various regulatory approvals. The Authority is evaluating the acquisition of KeySpan by National Grid plc and its effect on the Authority's agreements with KeySpan and the potential benefits to LIPA's customers of the acquisition. The Authority has begun discussions with National Grid plc and KeySpan regarding the proposed acquisition of KeySpan and such discussions are continuing. In the event there is a change of control of KeySpan, the Authority and LIPA have the option of canceling their contracts with KeySpan and the KeySpan Subs. The amendments to such agreements described below do not affect this option.

MSA. The MSA provides for the KeySpan Sub party thereto (the "Manager") to perform the day-to-day operation and maintenance of the T&D System, including, among other functions, transmission and distribution facility operation, customer service, billing and collection, meter reading, financial and operations reporting, planning, engineering, and construction, all in accordance with policies and procedures adopted by LIPA. All cash collected by the Manager for the account of LIPA is deposited on each business day in bank accounts in such bank as the Authority directs and upon such terms and conditions as specified by the Authority. See "Billing and Collections" in this Part 2.

The Authority and LIPA exercise control over the performance of the T&D System through specific standards for performance and incentives to the Manager contained in the MSA. The primary standards of performance for the delivery of power are adherence to capital and operating budgets and the frequency and duration of outages on the System.

Under the MSA, the Manager is paid an annual service fee as compensation. The service fee is paid on a monthly basis and is calculated based on five components, consisting of: (i) a fixed direct fee; (ii) a third-party cost reimbursement component; (iii) a variable payment; (iv) a cost incentive fee; and (v) a non-cost performance component. In addition to the service fee, the Manager is reimbursed for all approved third-party costs and is paid or reimbursed for certain capital and unforeseeable costs. The Manager is also entitled to incentive payments for cost savings and is subject to penalties for cost overruns on both the operating and capital budgets. In addition to the cost savings incentives, the Manager is subject to penalties for performance below certain threshold minimum levels with regard to System reliability. The MSA also provides for certain performance incentives, which averaged approximately $7.2 million in the years 2001 through 2005. The 2006 amendment to the MSA agreed to by the Manager and LIPA extends the expiration date of the MSA to December 31, 2013 with a reduction in costs of approximately $34 million per year on a net present value basis from the amount paid for such services in 2005. As amended, the MSA provides for payment based on a fixed rate per kilowatt-hour of retail electric sales which is subject to an inflation factor, subject to a floor and a cap. The amended MSA also eliminates the cost and performance incentives and provides for penalties for failure by KeySpan to
perform within specified performance metrics and the pass through of certain costs such as capital expenditures and storm restoration costs on an actual cost basis. See Appendix E to this Part 2 for a summary of the MSA and Appendix F for a summary of the 2006 amendment to the MSA. In the event the required governmental approvals for the 2006 amendment to the MSA are not obtained and the amendment does not become effective, LIPA and the Manager would continue under the MSA as in effect prior to such amendment. Prior to the 2006 amendment, the MSA was to expire December 31, 2008.

PSA. The PSA provides for the sale to LIPA by GENCO of all of the capacity and, to the extent LIPA requests, energy from the existing oil and gas-fired generating plants on Long Island owned by GENCO formerly owned by LILCO (the "GENCO Generating Facilities"). Such sales of capacity and energy from the GENCO Generating Facilities are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission ("FERC"). These rates may be modified in the future in accordance with the terms of the PSA for (i) agreed upon labor and expense indices applied to the base year; (ii) a return of and on net capital additions required for the GENCO Generating Facilities, which additions will require approval by the Authority; and (iii) reasonably incurred expenses that are outside the control of GENCO. This rate formula provides for the reasonable containment of GENCO costs. See "The System – Power Supply – KeySpan – Power Supply Agreement" in this Part 2. In the event LIPA purchases one or more generating units pursuant to the 2006 Purchase Option, the parties to the PSA have agreed to amend such agreement in various respects to reflect the fact that such generating unit or units are no longer owned by GENCO. The amendment to the PSA is subject to the approval of the Comptroller, the Attorney General (as to form) and FERC.

The PSA provides incentives and penalties for GENCO of up to $4 million annually to maintain the output capability of the GENCO Generating Facilities, as measured by annual industry-standard tests of operating capability, and to maintain and/or make capital improvements which benefit plant availability. The performance incentives described in this paragraph averaged approximately $3.9 million in the years 2001 through 2005.

The PSA provides LIPA with all of the capacity from the GENCO Generating Facilities. However, LIPA has no obligation to purchase energy from the GENCO Generating Facilities and is able to purchase energy on a least-cost basis from all available on-Island sources, as well as off-Island sources, consistent with existing transmission interconnection limitations of the T&D System. The PSA expires on May 28, 2013 and is renewable on similar terms. However, the PSA provides LIPA the option of electing to reduce or "ramp-down" the capacity it purchases from GENCO beginning May 28, 2004, in accordance with schedules set forth in the PSA. LIPA has not exercised such option as of this time. See Appendix E to this Part 2 for a summary of the PSA.

EMA. The EMA provides for the KeySpan Sub party thereto ("Energy Manager") to (i) procure and manage fuel supplies for LIPA to fuel the GENCO Generating Facilities, (ii) perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs, and (iii) make off-system sales of energy, capacity and other ancillary services from the GENCO Generating Facilities and other power supplies either owned or under contract to LIPA. LIPA is entitled to two-thirds of the profit from any off-system energy sales arranged by the Energy Manager. The term for the service provided in (i) above is until May 28, 2013, and the term for the service provided in (ii) and (iii) above was until May 28, 2006 and an amendment that provides for extension of the contract up to December 31, 2007 has been executed by KeySpan and submitted to the Comptroller for approval. LIPA has commenced a competitive procurement process for the services provided in (ii) and (iii) above and expects to make a decision on the award of a new contract by the end of 2006. In the event LIPA purchases one or more generating units pursuant to the 2006 Purchase Option, the parties to the EMA have agreed to amend such agreement to reflect the fact that such generating unit or units are no longer owned by GENCO. The amendment to the EMA is subject to the approval of the Comptroller and the Attorney General (as to form).
The Energy Manager is compensated for fuel management services through the payment by LIPA of: (i) a monthly fuel management fee; (ii) the cost of fuel purchased on LIPA's behalf; and (iii) a fuel purchase performance incentive/disincentive payment. Additionally, the Energy Manager receives one-third of net revenues from off-system sales, plus an annual system power supply management fee and a system power supply performance incentive/disincentive payment. While LIPA pays for the actual fuel and electricity purchased, the EMA further provides incentives for control of the cost of fuel and off-system electricity purchased on behalf of LIPA by the Energy Manager. See Appendix E to this Part 2 for a summary of the EMA. The electricity purchase incentive or penalty under the EMA, together with the net other performance incentives and penalties under the MSA, cannot exceed $7.5 million for any year. The financial performance incentives described in this paragraph averaged approximately $5 million in the years 2001 through 2005.

Power Plant Purchase Right

When the Authority became the retail supplier of electric service in the Service Area through the acquisition of LILCO in May 1998, it entered into the Generation Purchase Right Agreement (the "GPRA") which provided for a one-time unilateral right (the "GPRA Option") to acquire all the equity interests in GENCO at fair market value. GENCO owns all of the former LILCO on-Island generation consisting of 53 generating units at 13 locations totaling approximately 4,000 megawatts in capacity. The GPRA was amended to provide that the GPRA Option could be exercised only during the period beginning on November 29, 2004 and ending on December 31, 2005. In December 2005, LIPA announced that it had reached an agreement in principle with KeySpan that the GPRA would terminate as of December 31, 2005 except that LIPA would retain an option to purchase two of KeySpan's generating facilities (the Barrett and Far Rockaway plants) which have a combined capacity of 450 megawatts. The 2006 Purchase Option, exercisable not later than December 31, 2006, permits LIPA to acquire the Barrett and Far Rockaway generating units (as defined in such agreement) at book value at the time of sale, which, as of June 30, 2004, was approximately $63,000,000 for the Barrett facility and $12,000,000 for the Far Rockaway facility. Such agreement is subject to approval by the Comptroller, and, as to form, by the Attorney General. If the required governmental approvals for the 2006 Option Agreement are not obtained, the Authority and KeySpan have agreed that the GPRA Option will be effective for 90 days following the inability to obtain the required governmental approvals.

The purchase of either or both of the generating units pursuant to the 2006 Purchase Option is subject to approval by the Comptroller, the Attorney General, as to form, and the New York Public Authorities Control Board ("PACB").

In the event LIPA acquires one or more generating units pursuant to the 2006 Purchase Option, LIPA and KeySpan have agreed to enter into an Operation and Maintenance Agreement (the "O&M Agreement") which will provide that a subsidiary of KeySpan to be designated will perform the services necessary to operate and maintain such generating unit or units. Such services include fuel management, development of operation and maintenance procedures and a preventive maintenance program, performance of routine repairs and arranging for major maintenance services, the procurement of necessary supplies and services and making recommendations for capital improvements. The KeySpan Sub will be compensated by a fee which has both fixed and variable components and by a fuel management fee. In the event LIPA enters into the O&M Agreement, the amounts payable by LIPA under the operating agreements described above will be reduced so that there will be no incremental cost to LIPA resulting from the O&M Agreement. The O&M Agreement will be subject to the approval of the Comptroller, the Attorney General (as to form) and the PACB and will have an expiration date of the earlier of the retirement or closure of the unit for repowering or May 28, 2013.
Other Rights

Pursuant to certain other agreements between LIPA and KeySpan or KeySpan Subs, certain future rights are granted to LIPA. These rights include continuation of the present gas transportation rate for gas delivered over the gas distribution system to the GENCO Generating Facilities and to certain new generation resources until 2009, with cost-based adjustments to meet gas delivery system expansion needs. Subject to certain conditions, these rights also include the right until 2097 to lease or purchase, or to allow its designee to lease or purchase, at fair market value, parcels of land and to acquire unlimited access to, as well as appropriate easements at, each parcel of land upon which an existing GENCO Generating Facility is situated and land contiguous thereto for the purpose of constructing new electric generating facilities to be owned by LIPA or its designee. Subject to LIPA's right of first refusal, KeySpan and its subsidiaries also have the right to sell or lease these properties to third parties.

KeySpan or various of its subsidiaries owns the common plant (such as administrative office buildings and computer systems) formerly owned by LILCO and charges LIPA for its beneficial use through the Operating Agreements. KeySpan has agreed to provide LIPA, for the period through 2097, the right to enter into leases at fair market value for common plant or sub-contract for common services which it may assign to a subsequent manager of the T&D System. KeySpan has also agreed for the period through 2097 not to compete with LIPA as a provider of transmission or distribution service on Long Island.

Guarantees and Indemnities

KeySpan has absolutely and unconditionally guaranteed to the Authority (i) the full and prompt payment when due of all amounts required to be credited or paid by KeySpan Subs under the Operating Agreements and (ii) the full and prompt performance of the covenants and agreements of the KeySpan Subs under the Operating Agreements. Upon certain reductions in the credit ratings of KeySpan, LIPA has the right to have KeySpan obtain letters of credit securing these undertakings and agreements.

KeySpan and various subsidiaries (the "KeySpan Parties") have entered into an indemnification agreement with the Authority and LIPA (the "LIPA Parties") pursuant to which the KeySpan Parties agreed to indemnify the LIPA Parties and hold them harmless from a variety of specified liabilities in connection with the LIPA/LILCO Merger, including, among others, the unpaid debts, liabilities or obligations relating to the LILCO assets transferred to the KeySpan Parties prior to the LIPA/LILCO Merger. The LIPA Parties have entered into a similar indemnification agreement with the KeySpan Parties pursuant to which the LIPA Parties agreed to indemnify the KeySpan Parties and hold them harmless from a variety of specified liabilities in connection with the LIPA/LILCO Merger, including, among others, the unpaid debts, liabilities or obligations relating to the Retained Assets. These agreements, which are each referred to herein as a "Liabilities Undertaking and Indemnification Agreement", also allocate certain liabilities (including environmental liabilities) arising from events occurring prior to the LIPA/LILCO Merger and relating to the business and operations to be conducted by the LIPA Parties and the KeySpan Parties after the LIPA/LILCO Merger. See "Environmental Matters" in this Part 2.

LIPA Assets and Liabilities

At the time of the LIPA/LILCO Merger, in addition to the electric assets described under "Introduction," LILCO also retained certain other of its former assets (these electric and other retained assets are referred to collectively as the "LIPA Assets") and liabilities (the "LIPA Liabilities" and, together with the LIPA Assets, the "LIPA Assets and Liabilities"). The LIPA Assets included (i) certain regulatory assets of LILCO, including the Shoreham Regulatory Asset of approximately $4.7 billion, (ii) promissory notes (the "KeySpan Promissory Notes") evidencing the obligation of KeySpan and
certain of its subsidiaries to pay to LIPA amounts equal to the principal and interest on certain debentures described below and on the NYSEMA Financing Notes described below, (iii) the judgments, actions and claims of LILCO for refunds of property taxes, including the judgment resulting from the litigation contesting the assessment of certain Shoreham Nuclear Power Station property and (iv) other intangible assets of LILCO's former retail electric business, including the right to provide electric service in the Service Area.

Upon the consummation of the LIPA/LILCO Merger, LIPA recorded various purchase accounting adjustments to give recognition to the fact that LIPA is not subject to the regulatory jurisdiction of the New York State Public Service Commission ("PSC") and is exempt from federal income tax. The primary result of these adjustments was the elimination of the regulatory assets and liabilities of LILCO, including the Shoreham Regulatory Asset, and the elimination of LILCO's net deferred federal income tax liability. The unamortized balance of the excess of the acquisition costs over the original net book value of the transmission and distribution and nuclear assets and the fair value of the other net assets retained appears on the financial statements set forth in Appendix A to this Part 2 as the "Acquisition Adjustment."

The LIPA Liabilities included (i) LILCO's obligation to pay the principal of and interest on certain unsecured debentures of LILCO that had been issued prior to the LIPA/LILCO Merger (the "Debentures") (all of which have been retired); (ii) LILCO's obligation to pay the principal of and interest on notes (the "NYSEMA Financing Notes") issued by LILCO to secure tax-exempt bonds issued on behalf of LILCO by the New York State Energy Research and Development Authority ("NYSEMA") prior to the LIPA/LILCO Merger; $155,420,000 which remain outstanding as of August 1, 2006; (iii) certain customer deposits and payables; and (iv) other liabilities, including environmental liabilities of LILCO not otherwise transferred to or indemnified by a subsidiary of KeySpan.

KeySpan is obligated to make payments to LIPA under the KeySpan Promissory Notes equal to the principal and interest on all of the NYSEMA Financing Notes. If at any time during the term of the KeySpan Promissory Notes, the long-term senior debt of KeySpan is not rated at least "A" by two or more nationally recognized rating services, then KeySpan is obligated to either: (i) deliver a letter of credit issued by a financial institution whose long-term senior debt is or would be rated "A" by at least two such rating services to secure the KeySpan Promissory Notes; or (ii) economically defease the KeySpan Promissory Notes by delivering to LIPA U.S. treasury securities sufficient, as determined by LIPA, to pay all amounts due in respect of the debt related to the KeySpan Promissory Notes. Payments under the KeySpan Promissory Notes are general revenues of LIPA payable by LIPA to the Authority under the Financing Agreement and are not dedicated to the payment of any NYSEMA Financing Note. The Authority is obligated to pay to LIPA, from the Authority's general revenues, funds sufficient to pay the NYSEMA Financing Notes. This obligation of the Authority, however, is subordinate to the obligations of the Authority to pay, when due, operating expenses and principal and interest on the Bonds and the Subordinated Indebtedness.

ACCELERATED DEBT RETIREMENT

Since the acquisition of LILCO, the Trustees have sought to accelerate the retirement of a principal amount of Bonds, Subordinated Indebtedness, Debentures and NYSEMA Financing Notes in an amount approximately equal to the $4.0 billion Acquisition Adjustment. Such plan is a matter of Authority policy and may be changed at any time. This accelerated debt retirement plan has both scheduled and optional elements and also takes into account the funding of capital expenditures with operating revenues. The Authority implemented the scheduled element through the scheduled amortization of approximately $1.253 billion of certain of its outstanding Senior Lien Bonds and by increasing the scheduled amortization of certain of its Bonds in years 2000 through 2012 by approximately $872 million. The optional element of the plan contemplates using excess cash flow over
Debt Service and favorable budget variances to retire debt on a non-scheduled basis through a combination of (i) open market purchases and tender offers; (ii) cash defeasances; and (iii) the exercise of the Authority's optional redemption rights. In addition, the Authority considers the use of revenues to fund capital expenditures which otherwise could have been financed with borrowings as satisfying the optional element of the plan.

In accordance with the optional element of this plan, the Authority (i) in December 1999 successfully tendered for, purchased and retired $148,195,000 of its then Outstanding Senior Lien Bonds, (ii) in March 2000 defeased $54,166,000 of LIPA's high-coupon Debentures, (iii) in March 2003 redeemed $270,000,000 of Debentures and $177,005,000 of NYSERDA Financing Notes and (iv) through December 31, 2005 funded $602,000,000 of capital expenditures eligible for bonding in all cases using excess cash flow as discussed above.

Current projections show that the plan approved by the Trustees as described above will enable the Authority, in aggregate, to fund capital expenditures or retire an amount approximately equal to the original $4.0 billion Acquisition Adjustment by the year 2013.

Both the Rate Covenant and the additional Bonds test under the Resolution originally included coverage calculations based, in part, on 120% of Debt Service and payments under Parity Contract Obligations. This percentage coverage was reduced to 100% pursuant to the Resolution when the Authority retired, with funds other than proceeds of Bonds or Subordinated Indebtedness, Acquisition Debt (as defined in Appendix C to this Part 2) in an amount equal to 25% of total Acquisition Debt net of the then outstanding balance of the KeySpan Promissory Notes. The 25% level of retirements was achieved in 2005.

FINANCIAL INFORMATION

The Authority's Basic Financial Statements for the years ended December 31, 2005 and 2004 are attached hereto as Appendix A. The Authority's Basic Financial Statements contain Management's Discussion and Analysis of the Results of Operations for the year ended December 31, 2005. Certain prior period amounts have been reclassified in the financial information to conform to the current year presentation.

The table below provides certain financial information with respect to the Authority. The information regarding the years ended 2005 and 2004 has been derived from the Authority's audited Basic Financial Statements and should be read in conjunction with the notes accompanying the Authority's Basic Financial Statements for the years ended December 31, 2005 and 2004 contained in Appendix A to this Part 2. The information for the six-month periods ended June 30, 2006 and June 30, 2005 is from the Authority's unaudited financial records.

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<th>Years Ended December 31,</th>
<th>Six Months Ended June 30,</th>
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<tr>
<td></td>
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<td>2004</td>
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<td>(in thousands)</td>
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MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE
RESULTS OF OPERATIONS FOR THE SIX MONTH
PERIODS ENDED JUNE 30, 2006 AND 2005

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the six months ended June 30, 2006 and 2005.

Change in Net Assets

The Authority generated revenue over expenses of $107 million for the six months ended June 30, 2006 compared with expenses over revenue of $107 million for the six months ended 2005.

Revenue

Revenue for the six months ended June 30, 2006, increased approximately $289 million as compared with the same period in 2005. The increase is attributable to higher recoveries of excess fuel costs totaling approximately $295 million, higher average pricing of approximately $12 million, offset by decreased load and sales mix totaling approximately $4 million and the negative effects of weather estimated to be $14 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). The FPPCA was modified in 2003 by the Board to allow LIPA to recover in the period incurred fuel and purchased power costs beyond those included in base rates ("Excess Fuel Costs"). As a result of this modification, the FPPCA was designed to recover a sufficient amount of Excess Fuel Costs to allow the Authority to earn $20 million of excess revenue over expenses each year as a reserve. If fuel prices change such that LIPA would exceed or fail to meet that financial target, the FPPCA would be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA in 2005 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8. In December 2005 the Authority proposed a modification to the FPPCA to allow the Authority to achieve $75 million of excess revenue over expenses each year with a variance of $50 million above or below such amount in each year. This modification was approved by the Board of Trustees in April 2006 after public hearings held in March and April regarding this modification. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% annually effective January 1, 2006.

Fuel and purchased power costs for the six months ended June 30, 2006, increased approximately $79 million as compared to the same period in 2005. This increase is primarily attributable to increased
commodity costs totaling $91 million partially offset by lower sales volumes totaling approximately $12 million.

Operations and Maintenance

Operations and maintenance decreased approximately $6 million due to lower MSA expenses totaling approximately $26 million, due in part to the newly negotiated annual fee, which through June contributed approximately $8 million to this decrease. The remaining change is due to the timing and type of work performed under the agreement. This decrease was partially offset by increased PSA capacity costs totaling $9 million, higher storm cost accruals totaling approximately $6 million, higher clean energy expenses totaling approximately $2 million and higher bad debt expense totaling approximately $3 million.

General and Administrative

General and administrative expenses decreased approximately $1 million due to lower consulting costs, primarily as a result of costs incurred in 2005 related to the strategic assessment to evaluate LIPA's long-term organizational and business options.

Depreciation and Amortization

Depreciation and amortization increased approximately $4 million due to higher utility plant balances in 2006 when compared to 2005.

Payments in Lieu of Taxes

Payments in lieu of taxes increased approximately $2 million due primarily to increased revenue taxes (due to higher fuel cost recoveries).

Other Income

Other income increased approximately $4 million due primarily to higher earnings of approximately $5 million on investment balances offset by lower sales of emissions credits totaling approximately $1 million.

Interest Charges

Interest charges increased approximately $1 million due primarily to higher rates on variable rate debt.

Other Significant Items

In March 2006, the Authority issued Series 2006A Electric System General Revenue Bonds, totaling approximately $853 million to refund approximately $844 million par value of Series 1998 Bonds. This refunding produced approximately $49 million net present value savings. The 2006A Bonds have an average life of 16.5 years and an all in cost of 4.6%. The Authority also issued Series 2006B Electric System General Revenue Bonds, totaling approximately $97 million to reimburse LIPA's treasury for or to fund capital expenditures for system improvements. The 2006B bonds have an average life of 29 years and an all in cost of 4.8%.

In July 2006, the Authority issued Series 2006C Electric System General Revenue Bonds, totaling approximately $198 million to reimburse LIPA's treasury for or to fund capital expenditures for
system improvements. The Series 2006C bonds have an average life of 29 years and an all-in cost of approximately 4.9%. The Authority also issued Series 2006D Electric System General Revenue Bonds totaling approximately $335 million to refund approximately $328 million of existing Authority debt including portions of Series 1998A, Series 1998B, Series 2001A and Series 2003C Bonds. The refunding will produce debt service savings of approximately $11.6 million on a net present value basis. The average life of the Series 2006D Bonds is approximately 11 years with an all-in cost of approximately 4.5%.

DERIVATIVES AND HEDGE ACTIVITIES

The Authority uses financial derivative instruments to manage the impact of interest rate, energy price and fuel cost changes on its earnings and cash flows. LIPA oversees its risk management program through an executive risk management committee comprised of the Chief of Staff; General Counsel; Vice President – Power Markets; Chief Operating Officer; the Chief Financial Officer who chairs the committee and an independent risk management consultant. The risk management program is intended to identify exposures to movements in fuel and purchased power prices, quantify the impacts of these exposures in the Authority's financial position and the FPPCA and mitigate these exposures in line with the Authority's identified level of risk tolerance. The Authority monitors its interest rate derivatives exposure through its quarterly swap report.

Effective January 1, 2001 the Authority adopted Statement of Financial Accounting Standards ("FAS") No. 133, "Accounting for Derivatives and Hedging Activities", as amended by FAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" and as further amended by FAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", to the extent appropriate under Governmental Accounting Standards. These financial accounting standards establish accounting and reporting requirements for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The standard requires that the Authority recognize the fair value of all derivative instruments as either an asset or liability on its balance sheet with the offsetting gains or losses recognized in earnings or deferred charges. Application of FAS No. 133 may increase the volatility of reported earnings. For a further discussion of these matters, and for a summary of certain interest rate exchange agreements, see the Authority's Basic Financial Statements for the years ended December 31, 2005 and 2004, Note 4. Neither the Authority nor LIPA entered into any new interest rate exchange agreements during the first quarter of 2006. In July 2006, in connection with the issuance of certain variable rate Bonds, the Authority entered into an interest rate swap agreement with Morgan Stanley Capital Services Inc. pursuant to the terms of which the Authority is required to pay a fixed interest rate and is entitled to receive a floating interest rate, each based on a notional amount equal to the principal amount of such variable rate Bonds.

PROJECTED REVENUE REQUIREMENTS AND DEBT SERVICE COVERAGE

Attached as Appendix B to this Part 2 are projections of the Authority's annual revenues and revenue requirements for the period January 1, 2006 through December 31, 2010 (the "Projection Period"). The projections show that the Authority's Debt Service coverages during the Projection Period will be no less than approximately: (i) 2.36x on the senior lien debt outstanding and estimated to be outstanding; (ii) 2.06x on the senior lien debt (including the Offered Securities) and the subordinated lien debt, in both cases outstanding and estimated to be outstanding; and (iii) 2.03x on the senior and subordinate lien debt mentioned in clause (ii) and on the NYSERDA Financing Notes outstanding on December 31, 2005. The projections are based on the information available at the time they were prepared during the fourth quarter of 2005 including an estimate at such time of the results of the Authority's financing activities in 2006.
THE PROJECTIONS CONTAINED IN APPENDIX B AND ELSEWHERE IN THIS OFFICIAL STATEMENT ARE FORWARD LOOKING STATEMENTS PREDICATED UPON ASSUMPTIONS PRESENTED HEREIN. NEITHER THE AUTHORITY, LIPA NOR THE UNDERWRITERS MAKE ANY REPRESENTATION THAT THESE ASSUMPTIONS WILL, IN FACT, OCCUR. THESE PROJECTIONS MAY BE AFFECTED FAVORABLY OR UNFAVORABLY BY UNFORESEEN FUTURE EVENTS, AND THEREFORE, TO THE EXTENT CONDITIONS DIFFER FROM THOSE ASSUMED HEREIN, THE RESULTS THAT WILL BE ACHIEVED BY THE AUTHORITY WILL VARY FROM THOSE PROJECTED.

SECURITY AND SOURCES OF PAYMENT FOR THE BONDS

Under the MSA, the Manager is required to bill and collect such fees, rates, rents and charges for the use and services of the T&D System as are established by the Authority in accordance with the Bond Resolution and the Act. See "Billing and Collections" in this Part 2.

Since LIPA owns the System, the Financing Agreement contains covenants as to the operation and maintenance of the System, and the Resolution contains covenants of the Authority to enforce the Financing Agreement and assigns to the Trustee certain of the Authority's rights and interests under the Financing Agreement, including the right to bring actions and proceedings for the enforcement of the Financing Agreement.

Pledge of Trust Estate

The Resolution pledges the Trust Estate for the payment of the Bonds and all Parity Obligations, subject to the provisions of the Resolution, the Act and the Financing Agreement permitting certain applications of the Trust Estate and subject to the prior payment of Operating Expenses.

The Resolution authorizes the application of Revenues to certain purposes free and clear of the lien of the pledge. These applications include payment of Operating Expenses from the Operating Expense Fund prior to the deposit of Revenues in the Debt Service Fund. In addition, the Resolution provides that amounts on deposit in the Rate Stabilization Fund may be used for any lawful purpose of the Authority or LIPA, and amounts retained in the Revenue Fund may be used for any lawful purpose of the Authority or LIPA, as determined by the Authority.

The principal items in the Trust Estate pledged by the Resolution include:

(i) all payments received by the Authority from LIPA under the Financing Agreement, and all rights to receive the same;

(ii) all Revenues and all right, title and interest of the Authority in and to Revenues, and all rights of the Authority to receive the same;

(iii) the proceeds of sale of Bonds until expended for the purposes authorized by the Supplemental Resolution authorizing such Bonds; and

(iv) all funds, accounts and subaccounts established by the Resolution, including securities credited thereto and investment earnings thereon.

The Authority covenants in the Resolution that it will not, and will not permit LIPA to, issue any bonds, notes or other evidences of indebtedness or otherwise incur any indebtedness, other than Bonds or Parity Obligations, secured by a pledge of or other lien or charge on the Trust Estate which is prior to or of equal rank or priority with the pledge made by the Resolution, and that it will not create or cause to be
created any lien or charge on the Trust Estate which is prior to or of equal rank or priority with the pledge made by the Resolution.

Payment of Revenues Pursuant to Financing Agreement

Under the Financing Agreement, LIPA transfers to the Authority all of its right, title and interest in and to the Revenues, including all right to collect and receive the same, subject to the provisions of the Financing Agreement and the Resolution providing for the application of Revenues, and consents to the assignment by the Authority to the Trustee of its interest therein.

Revenues are defined in the Resolution to mean all revenues, rates, fees, charges, surcharges, rents, proceeds from the sale of LIPA assets, proceeds of insurance, and other income and receipts, as derived in cash, directly or indirectly from any of LIPA's operations, by or for the account of the Authority or LIPA including but not limited to all payments received by the Authority or LIPA with respect to KeySpan Promissory Notes, any guaranty of performance under any System Agreement and all dividends received by the Authority as a result of ownership of any stock or other evidence of an equity interest in LIPA; provided, however, that Revenues shall not include (i) any Transition Charge, (ii) any such income or receipts attributable directly or indirectly to the ownership or operation of any Separately Financed Project, or (iii) any federal or State grant moneys the receipt of which is conditioned upon their expenditure for a particular purpose unless the Authority determines that such moneys constitute Revenues. Revenues also do not include any amounts, or amounts from any sources, as may be specified from time to time by Supplemental Resolution; provided, however, that at such time the applicable additional Bonds tests of the Resolution will be satisfied (whether or not the tests are then required to be met for other purposes) without regard to such amounts. Transition Charge means any rates, fees, charges or surcharges relating to the T&D System or the customers thereof established by irrevocable rate order or other action or instrument, and applicable to or by the Authority or LIPA, in conjunction with the issuance of debt or other securities under a separate resolution, indenture or similar instrument (other than the Resolution) to the extent such rates, fees, charges or surcharges are pledged or otherwise encumbered or conveyed as security for such debt or other securities.

Funds

The Resolution establishes the following Funds: the Construction Fund; the Revenue Fund; the Operating Expense Fund; the Debt Service Fund; the Parity Contract Obligations Fund; the Subordinated Indebtedness Fund; the LIPA Unsecured Debt Fund; the PILOTs Fund; and the Rate Stabilization Fund, all to be held by or on behalf of the Authority with the exception of the Debt Service Fund, which is to be held by the Trustee.

Flow of Funds

The Authority is required by the Resolution, as promptly as practicable after receipt thereof by LIPA, to deposit all Revenues in the Revenue Fund. Amounts on deposit from time to time in the Revenue Fund shall be withdrawn and deposited in the following order of priority:

FIRST: to the Operating Expense Fund, the amount determined by the Authority from time to time to be deposited to pay, or to be set aside therein as a reserve for the payment of, Operating Expenses;

SECOND: (A) to the Debt Service Fund, the amounts required to pay or provide for the payment of the Principal Installments and Redemption Price of and interest on Bonds and Parity Reimbursement Obligations; and

(B) to the Parity Contract Obligations Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Parity Contract Obligations;
THIRD: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST and SECOND, to the Subordinated Indebtedness Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Subordinated Indebtedness;

FOURTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND or THIRD above, to the LIPA Unsecured Debt Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Outstanding LIPA Unsecured Debt (including the Debentures and NYSERDA Financing Notes);

FIFTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD or FOURTH, to the PILOTs Fund, the amount determined by the Authority to be required to be deposited in such Fund to pay or provide for the payment of PILOTs; and

SIXTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD, FOURTH or FIFTH, to the Rate Stabilization Fund, the amount determined by the Authority to be deposited therein to provide for any payments or deposits from Revenues thereafter.

Any moneys remaining in the Revenue Fund may be used for any lawful purpose of the Authority or LIPA, as determined by the Authority, including, but not limited to, the purchase or redemption of any bonds, notes or other obligations of the Authority or LIPA.

The Trustees have stated a goal of maintaining cash balances, including the Rate Stabilization Fund, of $250 million. Such balances have fluctuated in the past and are expected to fluctuate from time to time in the future.

Rate Covenant

The Authority covenants in the Resolution to establish and maintain System fees, rates, rents, charges and surcharges sufficient in each Fiscal Year so that Revenues reasonably expected to be produced in such Fiscal Year will be at least equal to the sum of:

(i) 100% (reduced from 120% because the Authority has retired, other than from the proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the KeySpan Promissory Notes; see "Accelerated Debt Retirement" in this Part 2) of Debt Service, and amounts under all Parity Contract Obligations, payable by the Authority in such Fiscal Year;

(ii) 100% of the Operating Expenses payable in such Fiscal Year;

(iii) 100% of the amount necessary to pay all PILOTs payable in such Fiscal Year; and

(iv) 100% of the amount necessary to pay other Required Deposits, all other payments required pursuant to the Resolution and the Financing Agreement, and all other payments required for the System, for such Fiscal Year.

If at any time such fees, rates, rents, charges and surcharges are or will be insufficient to meet the Rate Covenant, it will not constitute an Event of Default if and to the extent the Authority promptly takes action reasonably expected by the Authority to cure or avoid any such deficiency or to cause the same to be cured or avoided. In addition, the failure in any Fiscal Year to comply with the covenant in clauses (iii) and (iv) above (the "non-debt service and operating expense rate covenant"), will not constitute an Event of Default if the Authority retains a Rate Consultant and a Consulting Engineer for the
purpose of reviewing System fees, rates, rents, charges and surcharges and reviewing the System Budget and complies with the following sentence. If the Rate Consultant (relying upon a certificate of the Consulting Engineer) is of the opinion that a schedule of fees, rates, rents, charges and surcharges for the T&D System which would provide funds to meet the requirements specified in the non-debt service and operating expense rate covenant is impracticable at that time and the Authority therefore cannot comply with the non-debt service and operating expense rate covenant, then the Authority will fix and establish such schedule of System fees, rates, rents, charges and surcharges as is recommended in such certificate by the Rate Consultant to comply as nearly as practicable with the non-debt service and operating expense rate covenant, and in such event the failure of the Authority to comply with the non-debt service and operating expense rate will not constitute an Event of Default.

For purposes of the Rate Covenant, at any time, (i) Revenues include any amounts withdrawn or expected to be withdrawn thereafter in any Fiscal Year from the Rate Stabilization Fund which were either (a) on deposit therein prior to such Fiscal Year or (b) proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits, (ii) Revenues do not include any proceeds from the sale of LIPA assets or proceeds of insurance, and (iii) Debt Service, Parity Contract Obligations, PILOTs and other Required Deposits will not include any amounts expected by the Authority to be paid from any funds, other than Revenues, reasonably expected by the Authority to be available therefor (including without limitation the anticipated receipt of proceeds of sale of Bonds or Subordinated Indebtedness, or moneys not a part of the Trust Estate, expected by the Authority to be used to pay the principal of Bonds, Parity Contract Obligations, Outstanding LIPA Unsecured Debt or Subordinated Indebtedness, other than proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits), which expectations, if included in a resolution of the Authority or Certificate of an Authorized Representative, will be conclusive.

In addition, the Authority covenants in the Resolution to review, or cause LIPA to review, the adequacy of System fees, rates, rents, charges and surcharges at least annually. Except to the extent required by law, the Authority covenants not to permit LIPA to furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private, unless the Authority determines that other adequate consideration has been, or is expected to be, received in connection therewith, and to cause LIPA to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

Additional Bonds Test

The Resolution originally required that, as a condition to the delivery of additional Bonds, except Refunding Bonds, the Authority must satisfy historical or projected debt service coverage tests. The Resolution also provides that such tests shall not apply at any time after the Authority first shall have retired, other than from proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the KeySpan Promissory Notes. This occurred in 2005. As a consequence, there is no limit or test for the issuance of additional Bonds under the Resolution. See "Accelerated Debt Retirement" in this Part 2.

Subordinated Indebtedness; Acceleration of Subordinated Indebtedness

There is no limit or test for the issuance of Subordinated Indebtedness under the Resolution.

Subordinated Indebtedness is subject to acceleration prior to maturity upon the occurrence of certain events.
Such accelerations would not cause an acceleration of the Bonds or affect the priority of the application of Revenues to the payment of the Bonds. In such an event any amounts then available under the Resolution after the payment of Operating Expenses and Debt Service on any Bonds and Parity Contract Obligations could be required to be applied to the payment of the Subordinated Indebtedness.

LONG ISLAND POWER AUTHORITY

The Authority is a corporate municipal instrumentality and a political subdivision of the State of New York created by the Act, which was enacted in 1986. LIPA is a wholly-owned subsidiary of the Authority, which was formed and exists under the Business Corporation Law of the State of New York.

The Act

Pursuant to the Act, the Authority has all of the powers necessary or convenient to carry out the purposes and provisions of the Act including, without limitation, to (i) acquire real or personal property; (ii) enter into agreements or contracts consistent with the exercise of its powers; (iii) borrow money, issue notes, bonds or other obligations and secure its obligations by mortgage or pledge of its property; (iv) create or acquire one or more wholly-owned subsidiaries; (v) set its rates and charges; and (vi) make inquiries, investigations and studies necessary to carry out its objectives.

The Authority may enter into agreements to purchase power from the Power Authority of the State of New York ("NYPA"), the State, any State agency, any municipality, any private entity or any other available source (excluding Canada unless negotiated through NYPA) at such price as may be negotiated. The Authority is specifically authorized to provide and maintain generating and transmission facilities and enter into management agreements for the operation of all or any of the property or facilities owned by it. Finally, the Authority may transfer any of its assets to one or more private utilities or municipal gas or electric agencies for such consideration and upon such terms as the Authority may determine to be in the best interest of the gas and electric ratepayers in the Service Area. The Act permits the Authority to file a petition under Chapter 9 of Title 11 of the United States Bankruptcy Code or take other similar action for the adjustment of its debts. LIPA as a corporation may file a petition under Chapter 7 or Chapter 11 of Title 11 of the United States Bankruptcy Code.

The Act requires that any resolution authorizing the issuance of bonds contain a covenant by the Authority that it will at all times maintain rates, fees or charges sufficient to pay, and that any contracts entered into by the Authority for the sale, transmission or distribution of electricity shall contain rates, fees or charges sufficient to pay, the costs of operation and maintenance of the facilities owned or operated by the Authority, payments in lieu of taxes, renewals, replacements and capital additions, the principal of and interest on any obligations issued pursuant to such resolution as they become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

Trustees

The Authority is governed by a fifteen-member board of Trustees who are required under the Act to be residents of the Service Area. The Governor appoints nine of the Trustees. Of the six remaining, three are appointed by the Majority Leader of the New York State Senate, and three are appointed by the Speaker of the New York State Assembly. A chairman of the Trustees is also appointed by and serves at the pleasure of the Governor. Each Trustee serves for a staggered term of four years. A Trustee whose term expires continues to serve until his or her successor is appointed. Pursuant to the Act the Trustees and the officers of the Authority are not subject to any personal or civil liability resulting from the exercise, carrying out or advocacy of any of the Authority's purposes or powers. Trustees are entitled to reimbursement for reasonable expenses in the performance of their duties. The By-laws and other
instruments of the Authority and LIPA provide for the indemnification of the Trustees, officers and employees of the Authority and the directors, officers and employees of LIPA. In January 2006, Governor Pataki signed the Public Authorities Accountability Act of 2005, which makes changes regarding the duties of the Trustees. See "Public Authorities Accountability Act of 2005" in this Part 2.

Management and Operation of the System

Administrative Services Agreement. The Authority and LIPA are parties to an Administrative Services Agreement (the "Administrative Services Agreement"), which sets forth the terms and conditions under which the Authority will provide personnel, personnel-related services and other services (including management, supervisory, payroll and other services) necessary for LIPA to provide electric service in the Service Area. Except for services of the type and nature provided to LIPA by outside independent agents, attorneys and consultants and for any other services provided under agreements approved by the Authority, LIPA will meet its personnel and personnel-related needs exclusively through the Administrative Services Agreement. The Administrative Services Agreement may be amended from time to time to reflect the changing needs of the Authority and LIPA.

Under the Administrative Services Agreement, the services provided by the Authority include, but are not limited to: (i) performance of LIPA's duties and obligations and enforcing its rights under any existing and future contracts between LIPA and any other person, including, but not limited to, the MSA, EMA and PSA; (ii) coordination of services for which LIPA contracts; (iii) coordination of negotiations and studies authorized by LIPA for any project for the supply of power and energy or the provision of transmission capacity to LIPA; (iv) reviewing invoices; (v) disbursement of all funds of LIPA; (vi) preparation of construction and operating budgets on behalf of LIPA; (vii) provision or coordination of all other accounting matters and preparation of billings to, and collection from, LIPA's customers; (viii) coordination of all other matters arising under any agreements relating to any project that LIPA might undertake; (ix) securing information from any persons required to fulfill LIPA's obligations under any agreements arising from the Administrative Services Agreement, the agreements referred to in clauses (i) and (viii), and any project LIPA might undertake; (x) provision or coordination of rate matters; and (xi) provision or coordination of such other services as LIPA determines are required to carry out its business in an economical and efficient manner.

Management. The present officers, and senior management of the Authority, with information covering their background and experience, are listed below. Pursuant to the provisions of the Public Authorities Accountability Act of 2005, which requires that no board member, including the Chairperson can serve as Chief Executive Officer, Mr. Kessel resigned as President and Chief Executive Officer of the Authority in 2006. As Chairman, Mr. Kessel will retain overall responsibility for oversight of the Authority's strategic direction and operations. The Trustees of the Authority will undertake a search for a successor as President and Chief Executive Officer. See "Public Authorities Accountability Act of 2005" in this Part 2.

Richard M. Kessel (56) is the Chairman of the Authority. Mr. Kessel has served as a Trustee of the Authority since the Authority's inception. Prior to his resignation in 2006, he had also served as President and Chief Executive Officer. Mr. Kessel, who first served as Chairman of the Authority from 1989 to 1995, was reappointed Chairman in April 1997 by Governor George Pataki. Mr. Kessel was appointed as Executive Director and Chairman of New York State's Consumer Protection Board in January 1984 and served until January 1995. Mr. Kessel served as an ex-officio member of Governor Cuomo's Advisory Commission on Liability Insurance. Mr. Kessel is Vice-Chairman of the Board of Directors of the Nassau County Interim Finance Authority. He received his Masters in Political Science from Columbia University.
Patrick Foye (49) is a Deputy Chairman of the Authority. Mr. Foye became a Trustee in September 1995. Mr. Foye has served as the President and Chief Executive Officer of United Way of Long Island since February 2004. Prior to that, he was the Executive Vice President of Apartment Investment and Management Company, a New York Stock Exchange listed multi-family real estate investment trust. He was a partner from 1989 to 1998 in the law firm of Skadden, Arps, Slate, Meagher & Flom LLP. Mr. Foye is a graduate of Fordham College and Fordham Law School.

Howard E. Steinberg (61) is a Deputy Chairman of the Authority. Mr. Steinberg became a Trustee in April 1999. He is a senior partner at the law firm McDermott Will & Emery. Mr. Steinberg served as Chairman of the New York State Thruway Authority and Chairman of the New York State Canal Corporation from 1996 to 1999. Mr. Steinberg has served as a member of the Board of Regents of Georgetown University, a member of the Board of Directors of Sheltering Arms Children's Services, and a member of the Board of Overseers of the University of Pennsylvania School of Arts and Sciences. He holds a B.A. from the University of Pennsylvania, and a J.D. from Georgetown University Law Center.

Edward J. Grilli (54) is the Chief of Staff of the Authority. He was appointed to this position in November of 2000. Prior to joining the Authority, Mr. Grilli for twenty-one years served as the Director of Public Relations for the Nassau County District Attorney's Office. In addition to supervising the dissemination of all information from an office of over 300 attorneys and support staff, Mr. Grilli directed the Crime Victims Program for the Office and served as a key advisor to the District Attorney. Prior to this, he worked as the Press Secretary to the New York State Assembly Ways and Means Committee. Mr. Grilli has also worked as an Adjunct Professor at several universities and colleges, a media consultant and journalist. Mr. Grilli holds a B.F.A. in Communications from the New York Institute of Technology.

Seth D. Hulkower (48) is the Chief Operating Officer of the Authority. He was appointed to this position in June of 1999. Prior to this appointment, he was the Authority's Executive Director, a position he held beginning in July 1996. Prior to his association with the Authority, Mr. Hulkower was a Vice President of Merrill International Ltd., an energy project development and consulting company. Prior to Merrill International, Mr. Hulkower was a Vice President of JFG Associates, Inc. a financial advisory and management consulting firm. He has also held positions with the consulting firm of Putnam, Hayes, & Bartlett, Inc., New England Power Company and Stone & Webster Engineering Company. Mr. Hulkower received his S.M. in Technology and Policy from the Massachusetts Institute of Technology and his B.S. in Mechanical Engineering and B.A. in Economics from Tufts University.

Elizabeth M. McCarthy (47) is the Chief Financial Officer of the Authority. She joined the Authority in July 2003. Prior to joining the Authority, Ms. McCarthy served as Group Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer of DPL, Inc., a public utility holding company. Prior to her work with DPL, Inc., she was a partner in the Accounting and Business Advisory Services and Transaction Services section of PricewaterhouseCoopers, LLP where she was one of the original team members involved with LIPA's purchase of LILCO's retail electric system in 1998. Ms. McCarthy graduated from St. Louis University with a B.S. in Business Administration.

Stanley B. Klimberg (61) is the General Counsel of the Authority. He joined the Authority in 1987 as its General Counsel and Acting Executive Director. Before joining the Authority, Mr. Klimberg was General Counsel of the New York State Energy Office from 1979-1987, and before that he was Assistant General Counsel and Staff Counsel of the New York State Public Service Commission. Mr. Klimberg received his law degree (J.D.) from New York University School of Law and his undergraduate degree (B.A.) in history with high honors from Lehigh University.

Richard J. Bolbrock (60) is Vice President of Power Markets for the Authority. He joined the Authority in May 1998. Prior to his employment at the Authority, Mr. Bolbrock held several positions at New England Power Pool over a 24-year period including Director–Planning and Information Technology for ISO New England, Inc., Director of New England Power Planning from 1983-1997, and
Manager of Billing for the New England Power Exchange from 1979-1983. Prior to this, Mr. Bolbrock held various positions at Northeast Utilities and American Electric Power. He serves on the Boards of the New York Energy Group, Inc., the Northeast Power Coordinating Council, and the New York State Reliability Council, LLC. Mr. Bolbrock received his B.S. in Electrical Engineering and his M.E. in Electric Power Engineering from Rensselaer Polytechnic Institute and is a Registered Professional Engineer.

Bert J. Cunningham (58) is Vice President of Communications for the Authority. He joined the Authority in September 1998. Prior to joining the Authority, Mr. Cunningham was President/Chief Operating Officer of The Blankman Cunningham Group, LLC (formerly Howard Blankman Incorporated), a regional public relations and marketing communications firm that represents clients in the fields of energy, telecommunications, transportation, banking, and government. Before that, he served as Chief of Staff and Executive Director of Government and Community Affairs of The Long Island Rail Road, an operating agency of the Metropolitan Transportation Authority. Mr. Cunningham has also served as Chief of Staff to the Supervisor of the Town of North Hempstead in Nassau County, and Director of Public Affairs for both the New York State Senate Standing Committee on Transportation and the New York State Legislative Commission on Critical Transportation Choices. Mr. Cunningham holds a B.F.A. in Communications from the New York Institute of Technology.

Bruce Germano (54) is Vice President of Retail Services for the Authority. He joined the Authority in 1999. Mr. Germano has worked in the energy field both domestically and internationally for almost 30 years, holding positions with KeySpan Energy, Long Island Lighting Co., American Electric Power, and Gibbs and Hill Inc. Mr. Germano holds a B.S. in Engineering from Manhattan College and a M.S. in Industrial Management from SUNY Stonybrook. He is Chairman of the Steering Committee of CEIDS, an international electric utility consortium whose mission is to develop the electric infrastructure required to fulfill the needs of a digital society in the 21st century. He is also Co-Chairman of the Long Island Business Development Council, a Vice President of the Board for the Advancement of Commerce, Industry and Technology, and a member of the Board of the Hauppauge Industrial Association.

Michael D. Hervey (48) is Vice President of Operations for the Authority. He was appointed to this position in May 2006 after over five years of service to the Authority as the Executive Director of Transmission and Distribution Operations. Prior to joining LIPA in 2000, Mr. Hervey held several positions of increasing responsibility with Commonwealth Edison Company in Chicago, Illinois. Responsibilities at Commonwealth Edison included workforce management, construction, maintenance, quality assurance, disaster recovery, process computing, organizational design, and asset management. He holds a B.S. in Electrical Engineering from Iowa State University and an M.B.A. from Hofstra University.

Kenneth Kane (46) is the Controller of the Authority. He joined the Authority in 1999 as its Director of Financial Reporting. Prior to joining the Authority, Mr. Kane held the position of Manager of Regulatory and Financial Reporting for LILCO. Prior to this, Mr. Kane held positions at Mitchell Hutchins Institutional Investors and Ernst & Young, LLP. Mr. Kane is a Certified Public Accountant in the State of New York, is a member of the American Institute of Certified Public Accountants and holds a B.A. from Pace University.

Public Authorities Accountability Act of 2005

On January 13, 2006, Governor Pataki signed the Public Authorities Accountability Act of 2005 (the "PAAA") which makes changes regarding the operation and governance of New York State public authorities, including the Authority. The PAAA affects the Authority in the following ways:
(1) **Annual Report by Authorities.**

(a) The PAAA requires, as part of the annual report currently required to be submitted by the Authority pursuant to Section 2800 of the New York Public Authorities Law ("PAL"), the following: (i) a schedule of debt issuance; (ii) a compensation schedule relating to all officers, directors, and employees of the Authority in decision-making or managerial positions whose salary is in excess of $100,000; (iii) a list of projects undertaken during the past year; (iv) a listing of all real property of the Authority having an estimated fair market value in excess of $15,000 that the Authority intends to dispose of, all such property held by the Authority at the end of the reporting period, and all such property disposed of during such period, including the estimated fair market value of all such property held by the Authority, the sale price of sold property, and the purchaser; (v) the Authority's code of ethics; and (vi) an assessment of the effectiveness of the Authority's internal control structure and procedures;

(b) The PAAA requires that the Authority make accessible to the public, to the extent practicable, through its official website, documentation of the Authority's mission, current activities, most recent annual financial reports, current year budget, and most recent independent audit report unless such information is covered by Section 87(2) of the New York Public Officers Law, which protects certain information from public disclosure; and

(c) Every financial report submitted under Section 2800 of the PAL is to be approved by the Authority's board and contain a certification in writing by the chief executive officer and the chief financial officer of the Authority that, based on the officer's knowledge, (i) the information provided therein is accurate, correct and does not contain any untrue statement of material fact; (ii) does not omit any material fact which, if omitted, would cause the financial statements to be misleading in light of the circumstances under which such statements are made; and (iii) fairly presents in all material respects the financial condition and results of operations of the authority as of, and for, the periods presented in the financial statements.

(2) **Budget Reports.** The PAAA modifies Section 2801 of the PAL by requiring the Authority to submit annual budget information 90 days prior to the commencement of its fiscal year.

(3) **Independent Audits and Audit Reports.**

(a) The PAAA modifies Section 2802 of the PAL to require the Authority to provide the Governor and other specified individuals with a copy of the annual independent audit report, performed by a certified public accounting firm in accordance with U.S. generally accepted government auditing standards, and management letter and any other external examination of the books and accounts of such authority other than copies of reports of any State Comptroller examinations.

(b) The PAAA requires that any certified independent public accounting firm ("CIPAF") that performs an audit for the Authority required by the PAL must timely report to the audit committee of the Authority (i) all critical accounting
policies and practices to be used, (ii) all alternative treatments of financial information, within U.S. generally accepted accounting principles, that have been discussed with Authority management, (iii) the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the CIPAF, and (iv) other material written communications between the CIPAF and the management of the Authority such as the management letter along with management's response or plan of corrective action.

(c) The PAAA places restrictions on the ability of the CIPAF to do other work for the Authority and on the ability of the Authority to choose a CIPAF with priorities to personnel at the authority.

(4) Role and Responsibility of Board Members.

(a) The PAAA establishes a new Section 2824 of the PAL which requires Authority board members to (i) provide direct oversight of the Authority's chief executive and other senior management in the effective and ethical management of the Authority, (ii) understand, review, and monitor the implementation of fundamental financial and management controls and operational decisions, (iii) establish policies regarding salary, compensation and reimbursements to the chief executive and senior management, and rules governing their time and attendance, (iv) adopt a code of ethics, (v) establish written policies and procedures on, among other things, personnel (including "whistle-blower" protections), investments, travel, the acquisition and disposal of property and procurement procedures, (vi) adopt a defense and indemnification policy, and (vii) participate, within one year of appointment, in State-approved training relating to their legal, fiduciary, financial and ethical responsibilities, and participate in relevant continuing education programs.

(b) Under the PAAA, (i) no board member, including the chairperson, may serve as the Authority's chief executive officer, executive director, chief financial officer, comptroller, or hold any other equivalent position while also serving as a member of the board; (ii) board members shall establish an audit committee, to be comprised of independent members, which will, among other things, recommend to the Board the hiring of a CIPAF and provide direct oversight of the performance of audits performed by the CIPAF; (iii) no board shall extend, maintain, or renew credit in the form of a personal loan to any officer, board member or employee; (iv) to the extent practicable, members of an audit committee should be familiar with corporate financial and accounting practices; and (v) board members shall establish a governance committee comprised of independent members to, among other things, keep the board informed of current best governance practices.

(5) Memberships on Authority Board; Independence; and Financial Disclosure. The PAAA modifies Section 2825 of the PAL to (a) establish rules governing the independence of Authority board members, including the requirement that a majority of the board members (other than members who serve by virtue of holding a civil office of the state) shall be independent members with respect to appointments made after the effective date of the PAAA, and (b) require the filing of annual financial disclosure statements by board members, officers, and employees of a State authority pursuant to Section 73-a of the New York Public Officers Law.
For the purposes of the PAAA, an independent member would be one who:

(a) is not, and in the past two years has not been, employed by the Authority or an affiliate in an executive capacity;

(b) is not, and in the past two years has not been, employed by an entity that received remuneration valued at more than $15,000 for goods and services provided to the Authority or received any other form of financial assistance valued at more than $15,000 from the Authority;

(c) is not a relative of an executive officer or employee in an executive position of the Authority or an affiliate; and

(d) is not, and in the past two years has not been, a lobbyist registered under a state or local law and paid by a client to influence the management decisions, contract awards, rate determinations or any other similar actions of the Authority or one of its affiliates.

(6) Disposition of Property. The PAAA creates a new Title 5-A of the PAL entitled "Disposition of Property by Public Authorities," which is applicable to all personal property valued in excess of $5,000, real property and any inchoate or other interest in such property to the extent that such interest can be conveyed to another person for any purpose, excluding an interest securing a loan or other financial obligation of another party, and requires the Authority to:

(a) adopt, by resolution, guidelines (i) detailing policy and instructions regarding the use, awarding, monitoring, and reporting of contracts for the disposal of property, which shall be subject to annual review and approval by the Authority's board and annual filing with the State Comptroller and posting on the Authority website, and (ii) designating, by resolution, an employee or officer as "contracting officer" who shall be responsible for the disposition of property and compliance with, and enforcement of, the guidelines;

(b) maintain inventory controls and accountability systems for all property under its control; periodically inventory property for disposition; and effectuate transfer or dispose of such property as promptly as possible;

(c) publish a report, at least annually, of all real property of the Authority and all real and personal property disposed of during the reporting period, the price received, and the name of the purchaser, and deliver a copy of the report to the Comptroller, Budget Director, the State Commissioner of General Services and the State Legislature;

(d) with certain exceptions, dispose of property under the supervision and direction of the contracting officer for not less than fair market value, and with respect to any interest in real property, or any other property which because of its unique nature is not subject to fair market pricing, the disposition must include an appraisal of the value of the property by an independent appraiser which is included in the record of the transaction; and
except for specified circumstances, dispose of property by public advertising for
bids, with the award being to the responsible bidder whose bid will be the most
advantageous.

(7) **Access for Legislative Committees.** The PAAA amends Section 30 of the New York
Legislative Law by adding the Authority to the designated entities to which the Finance
and the Ways and Means Committees of the New York State Legislature shall have
access for the purpose of obtaining information as to the method of operation, general
condition, and management of the entity, including review and examination of books,
papers, and public records.

(8) **Authority Budget Office.** The PAAA creates an organization to be known as the
"Authority Budget Office" to provide the Governor and the New York State Legislature
with conclusions and opinions concerning the performance of public authorities,
including the Authority, and to study, review and report on their operations, practices and
finances. The Authority Budget Office would have the powers: to conduct reviews and
analysis of the operations, practices, and reports of public authorities; to establish a
comprehensive inventory of public authorities and their subsidiaries, including their
annual reports; to assist authorities in improving management and disclosure practices;
to provide recommendations for improved performance, reporting, reformation, structure,
and oversight of authorities; and annually, commencing July 1, 2007, to report on its
findings and analysis to the Governor, the New York State Comptroller, the New York
State Attorney General, and specified members of the New York State Senate and
Assembly; and would have the authority to request from authorities such assistance,
personnel, information, books, records, and other documents as may be needed to
perform its duties.

(9) **State Inspector General.** The PAAA creates the Office of State Inspector General in the
Executive Department and confers jurisdiction on such Office over public authorities,
including the Authority. The State Inspector General is to receive and investigate
complaints from any source concerning allegations of conspiracy, fraud, criminal
activity, conflicts of interest and abuse in any possible authority. The State Inspector
General shall have the right to subpoena and enforce the attendance of witnesses,
examine witnesses under oath and require the production of documents.

**THE SYSTEM**

**Service Area**

The Service Area consists of Nassau and Suffolk Counties in Long Island (with certain limited
exceptions) and a small portion of Queens in New York City known as the Rockaways. The population
of the Service Area was estimated by LIPA at 2.83 million as of December 31, 2005, an increase of over
19,000 since December 31, 2004 and an increase of over 79,000 since December 31, 2000. As of
December 31, 2005, the Authority had approximately 1.1 million customers in the Service Area.

Once considered a "bedroom community" of New York City, Long Island has evolved into a
significant regional economy that benefits from its proximity to Manhattan, but also generates its own
income, employment, and regional output. Long Island's assets include a highly skilled labor force, close
proximity to New York City, diverse institutions of higher education, a strong, diversified technology
base, core research institutions, such as Brookhaven National Laboratory, Long Island High Tech
Incubator at Stony Brook and Cold Spring Harbor Laboratory, and medical research centers, such as North Shore Hospital, and a suburban lifestyle.

The Long Island economy benefits from high average personal income, and a strong service-based economy. The unemployment rate was approximately 4.2% in 2005, down from 4.6% in 2004 and 4.8% in 2003. During 2005, building permits were issued in Nassau and Suffolk Counties for 4,914 new residential housing units, a figure above the average of 4,839 permits issued for the 1990 through 1999 period, and the highest since the 5,369 units for 2002. Year-end 2005 office vacancy levels stood at approximately 10.9 percent, up from the 8.6 percent a year ago but down from the recent high of 11.3 percent in 2002. The latest data available shows that in 2003 Nassau County had per capita income of $50,242, the third highest in New York State, while Suffolk County's per capita income of $37,901 was the sixth highest statewide.

In the year ending December 31, 2005, approximately 52% of LIPA's annual retail revenues were received from residential customers and 46% from commercial and industrial customers with the balance derived from sales to other municipalities and public authorities. Individual commercial and industrial customers are relatively small with approximately 93% of these customers having peak demands less than 75 kW. The largest customer in the Service Area (the Long Island Rail Road) accounted for less than two percent of total sales and less than two percent of revenue.

The Transmission and Distribution System

The T&D System is an integrated electric system consisting of overhead and underground facilities, vehicles, equipment, land parcels, easements, contractual arrangements and other assets used to provide the transmission and distribution of electric capacity and energy to and within the Service Area. The T&D System includes six transmission interconnections that are owned in part or under contract that link the T&D System to utilities outside the Service Area.

Transmission Facilities

LIPA's transmission facilities provide for the delivery of capacity and energy from the transmission interconnections and on-Island generating stations to LIPA's electric distribution system. As of December 31, 2005, the transmission system consists of approximately 1,290 miles of overhead and underground lines with voltage levels ranging from 23 kilovolts ("kV") to 345 kV.

The on-Island transmission system has been constructed following standards similar to those employed by other major electric utilities in the Northeast and includes wood poles, steel poles, and lattice steel towers. Many of the existing transmission structures support distribution circuits and/or connections for telephone, cable television, or fiber optics.

Thirty-seven transmission substations are in service and utilized on the T&D System. The combined capability of these substations is approximately 7,915 million volt-amperes ("MVA"). The transmission system includes transformation equipment at 17 generating sites that is used to step up the generation voltage to transmission voltage levels. With the exception of certain facilities at the GENCO generating facilities (e.g., auxiliary and starting transformers), transformation equipment is owned by LIPA.

Distribution Facilities

The distribution system is comprised of 13 kV and 4 kV facilities and is comprised of a combination of overhead and underground equipment. There are currently 146 substations throughout the Service Area that step the voltage down from transmission to distribution levels. These distribution substations have a combined transformation capability of approximately 6,724 MVA. As of December 31, 2005, the distribution system also includes 13,130 circuit miles of overhead and
underground line (8,904 overhead and 4,226 underground), and 181,423 line transformers with a total capacity of approximately 11,400 MVA. Approximately 43.5 percent of the poles on which LIPA's distribution facilities have been installed are owned by Verizon Communications and used by LIPA pursuant to a joint-use agreement.

Reliability

LIPA undertakes programs intended to maintain and/or improve the reliability and quality of electric service within the Service Area. For the distribution system, this program is focused on several major areas: (i) circuit reconfiguration and reinforcement; (ii) pole replacement; (iii) system automation; (iv) tree trimming; (v) targeted system enhancements; and (vi) circuit conversion and reinforcement projects to serve new customer loads. For the transmission system, the improvement program is focused on: (i) transmission system reliability; (ii) substation reliability improvements; (iii) transmission breaker replacements; and (iv) structure inspection program. These program elements are a key part of LIPA's efforts to achieve and maintain good results in both the frequency and duration of customer outages.

The MSA establishes incentive measures for the Manager to maintain frequency and duration of outages for the T&D System below prescribed levels. Statistics for the 1999 through 2005 period indicate that LIPA's systemwide frequency and duration of outages were much better than average for similar New York State utilities.

The average period between interruptions for a customer served by LIPA during 2005 was approximately 14.1 months. For those LIPA customers affected by an interruption during 2005, the average length of interruption was approximately 64 minutes. These statistics compare to an average time between interruption of 14.4 months and an average interruption of 62 minutes for a LIPA customer during 2004.

Over the five-year period 2001 through 2005, LIPA's customers experienced an average of 13.8 months between interruptions and average interruption times of 64.6 minutes. Based on data provided by the State for all State utilities (other than Consolidated Edison Company of New York, Inc. ("Con Edison")), the average time between interruptions during this five-year period was 11.3 months and the average duration of an interruption was 112 minutes.

Long Island experiences seasonal conditions typical of the northeast United States. Summers are usually hot with high temperatures in excess of 90°F. Winters include snow and icing conditions that can be damaging to overhead power lines. In addition, the Service Area experiences severe storms, including hurricanes, which can be particularly damaging due to Long Island's coastal location. In response to these conditions, the T&D System has been constructed and maintained to minimize damage from high winds, and LIPA has adopted storm response procedures that are designed to restore service expeditiously.

Transmission Interconnection Facilities

The geographic location of the Service Area restricts the number of transmission interconnections between LIPA's T&D System and other systems in the region. Currently, six major transmission lines connect the T&D System with Con Edison and NYPA systems to the west and with Connecticut Light and Power ("CL&P") to the north. These interconnections are summarized in the table below.
## Service Area Transmission Interconnections

<table>
<thead>
<tr>
<th>Name</th>
<th>Off System Terminal Locations</th>
<th>Interconnecting Utility¹</th>
<th>Voltage Level²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dunwoodie to Shore Road</td>
<td>Westchester County, NY</td>
<td>Con Edison</td>
<td>345 kV</td>
</tr>
<tr>
<td>East Garden City to Sprainbrook</td>
<td>Westchester County, NY</td>
<td>NYPA</td>
<td>345 kV</td>
</tr>
<tr>
<td>Northport to Norwalk Harbor</td>
<td>Norwalk, CT</td>
<td>CL&amp;P³</td>
<td>138 kV</td>
</tr>
<tr>
<td>Jamaica to Lake Success</td>
<td>Queens, NY</td>
<td>Con Edison</td>
<td>138 kV</td>
</tr>
<tr>
<td>Jamaica to Valley Stream</td>
<td>Queens, NY</td>
<td>Con Edison</td>
<td>138 kV</td>
</tr>
<tr>
<td>Shoreham to New Haven</td>
<td>New Haven, CT</td>
<td>United Illuminating</td>
<td>138 kV⁴</td>
</tr>
</tbody>
</table>

¹ These utilities own the portion of the interconnections not owned by LIPA, except for the interconnection with NYPA, which is entirely owned by NYPA.
² Kilovolt or "kV."
³ CL&P = Connecticut Light and Power. CL&P is the wholly-owned operating subsidiary of Northeast Utilities.
⁴ This cable carries high voltage direct current, which is converted and delivered at 138 kV.

The Con Edison cable extending approximately 18 miles from Dunwoodie to Shore Road (the "Y-50 Cable") was placed in operation in August 1978 and is jointly owned by LIPA and Con Edison. This is a major transmission interconnection that has failed on a number of occasions. The cable is currently operating at full capacity.

The East Garden City to Sprainbrook interconnection (the "Y-49 Cable"), installed in 1991, is another major transmission interconnection. The Y-49 Cable is comprised of submarine and land-based portions totaling approximately 23 miles. This line is owned entirely by NYPA; however, most of the capacity of the Y-49 Cable is used by LIPA under the terms of a contract with NYPA. The Y-49 Cable has generally performed well with only a few instances of outages due to terminal equipment failures and one interruption due to an anchor dragging across the submerged cable.

The cable from Northport to Norwalk Harbor (the "NUSCO Cable"), installed in 1969, extends approximately twelve miles under the Long Island Sound from the Northport generating station in Suffolk County, New York to Norwalk Harbor, Connecticut. LIPA owns that portion of the line from Northport to the New York-Connecticut state boundary. LIPA's usage of the NUSCO Cable to transfer power is presently limited by the fact that ISO-New England, Inc ("ISO-NE") and the New York Independent System Operator ("NYISO") do not allow separately scheduled transactions over the cable. Instead, the NUSCO Cable is reserved for emergency transactions in the event that other ties between New York and New England are forced out of service. Anchors from barges and ships operating in Long Island Sound have repeatedly damaged the NUSCO Cable but the Cable is currently operating at full capacity. As part of the June 25, 2004 settlement of the dispute relating to the CSC, described below, LIPA agreed to work with CL&P to develop and implement a plan, subject to regulatory and other approvals, to replace the NUSCO cable. LIPA and CL&P recently completed selection of a contractor and issued a Notice to Proceed with the construction and installation of a replacement cable.

The cable from Shoreham to New Haven (the "Cross Sound Cable" or "CSC") was constructed pursuant to a capital lease agreement (the "CSC Agreement") entered into between LIPA and Cross Sound Cable Company, LLC ("CSC LLC") in 2000 pursuant to which LIPA agreed to purchase up to 330 megawatts of transmission capacity. Due to the existence of bedrock underneath the CSC and the inability to remedy such condition, CSC LLC had not been able to comply with the depth requirement of the permit required to satisfy a condition of the lease agreement between the Authority and CSC LLC. As a result, the CSC did not operate and LIPA was not required to make lease payments. After the August 14, 2003 blackout, at LIPA's request, the United States Secretary of Energy issued an Emergency Order providing for the commercial operation of the cable. The Emergency Order was rescinded in May of 2004. After the May rescission of the emergency order, the Authority sought an order from FERC to require operation of the CSC. On June 25, 2004, an agreement (the "Settlement Agreement") was reached between the Authority, the Connecticut Department of Environmental Protection ("CTDEP"), the
Connecticut Department of Public Utility Control, CL&P and CSC LLP that provided for the immediate energization and operation of the CSC while CSC LLP sought to come into compliance with the CTDEP permits. In January 2005, CSC LLC completed the work needed to bury the CSC at the depth required by the construction permit.

The CSC is now in operation. CSC LLC is providing transmission service to LIPA pursuant to a temporary Bridge Period Firm Transmission Capacity Purchase Agreement ("Bridge Agreement"), dated as of June 27, 2004. Certain conditions in the CSC Agreement between LIPA and CSC LLC had not then been satisfied. Under the terms of the Bridge Agreement, LIPA is obligated to pay approximately $18.1 million, annually, escalating to approximately $21.5 million. During the term of the Bridge Agreement, it is anticipated that CSC LLC will satisfy all remaining conditions. Effective July 1, 2008, or earlier if the remaining conditions are satisfied (but not before July 1, 2007), the CSC Agreement, as amended, will become effective. The amended CSC Agreement provides for up to 330 megawatts of firm transmission capacity and expires in 2031.

In September 2005, LIPA entered into a 20-year contract with Neptune Regional Transmission System LLC ("Neptune") to permit LIPA to import power from New Jersey over an undersea high-voltage transmission cable capable of carrying 660 megawatts of electricity, which Neptune is constructing. The cable will run from Sayerville, New Jersey under the Atlantic Ocean and connect with LIPA at its Newbridge Road substation in Levittown. Construction of the cable is underway and is expected to be completed by early 2007.

Capital Improvement Plan

During the period 2000 through 2005, an average of approximately $212 million per year was spent on capital additions and improvements including NMP2 expenditures. Such expenditures included interconnection costs associated with new generating stations on Long Island, reliability enhancements, capability expansion, new customer connections, facility replacements and public works. Capital expenditures for 2003, 2004 and 2005 were $202 million, $208 million and $229 million, respectively. Capital expenditures for 2006 are estimated to total approximately $279 million. The 2006 capital expenditure program provides for a continuation of the historical programs to improve reliability and quality of electric service, as well as expenditures for capability expansion, new customer connections, facility replacements, reliability enhancements and public work projects that are comparable to historical levels.

As shown in the table below, LIPA’s 18 percent share of capital expenditures for NMP2 during the period 2000 through 2005 averaged approximately $10.8 million annually for plant modifications and nuclear fuel purchases.

<table>
<thead>
<tr>
<th>Year</th>
<th>Plant Modifications</th>
<th>Fuel</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$3.6</td>
<td>$7.6</td>
<td>$11.2</td>
</tr>
<tr>
<td>2001</td>
<td>4.9</td>
<td>1.8</td>
<td>6.7</td>
</tr>
<tr>
<td>2002*</td>
<td>3.6</td>
<td>8.2</td>
<td>11.8</td>
</tr>
<tr>
<td>2003</td>
<td>4.7</td>
<td>1.3</td>
<td>6.0</td>
</tr>
<tr>
<td>2004*</td>
<td>7.1</td>
<td>9.4</td>
<td>16.5</td>
</tr>
<tr>
<td>2005*</td>
<td>3.1</td>
<td>11.1</td>
<td>14.2</td>
</tr>
</tbody>
</table>

* Year of a refueling or fuel purchase.
Budgeted capital expenditures for NMP2 for calendar year 2006 total $7.4 million reflecting approximately $5.6 million for anticipated expenditures for routine projects and approximately $1.8 million for nuclear fuel costs.

The table below shows projected capital expenditures through 2010.

### Capital Expenditures

<table>
<thead>
<tr>
<th>Capital Expenditures</th>
<th>Estimated</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>T&amp;D System1:</td>
<td></td>
</tr>
<tr>
<td>System Enhancements</td>
<td>$167</td>
</tr>
<tr>
<td>Interconnections</td>
<td>68</td>
</tr>
<tr>
<td>New Customers</td>
<td>32</td>
</tr>
<tr>
<td>Public Works</td>
<td>3</td>
</tr>
<tr>
<td>Total T&amp;D System</td>
<td>$270</td>
</tr>
<tr>
<td>NMP22</td>
<td>$7</td>
</tr>
<tr>
<td>LIPA Internal3</td>
<td>$2</td>
</tr>
<tr>
<td>Total Capital Expenditures</td>
<td>$279</td>
</tr>
</tbody>
</table>

2. Values do not include capitalized interest.
3. Reflects LIPA's 18 percent share of NMP2's nuclear fuel purchases and asset expenditures. Amounts exclude materials and supplies inventory purchases.
4. Capital expenditures for information systems, furniture, and equipment.

### Loads

The Service Area is characterized by customer usage patterns and weather conditions that result in peak usage during the summer and relatively low annual load factors. The peak usage set a new record in the summer of 2006, reaching approximately 5,792 megawatts ("MW") for the Long Island Control Area (the Service Area together with three municipalities within the Service Area served by their own utilities) of which LIPA accounted for 5,667 MW.

Under the MSA, the Manager prepares load growth forecasts annually. The Manager's most recent estimate of annual peak demand and energy requirements within the Service Area shows annual compound growth of approximately 1.6 percent over the 2006 to 2008 period. This growth rate would increase LIPA's summer peak demand, prior to the effects of cogeneration, NYPA supplied load and demand side management, to approximately 5,526 MW in 2008 on a weather normalized basis. The Manager updates its estimates for summer peak demand in the fourth quarter of each year.

In 2005, LIPA's new record setting peak demand was 5,115 MW, 534 MW higher than the peak demand in 2004 and 186 MW higher than the previous record high peak demand in 2002. On a weather-normalized basis, the 2005 peak load approximated 5,130 MW, which reflects an increase of approximately 3.5 percent over the weather-normalized 2004 peak load of 4,955 MW.

In 2004, LIPA's peak demand was 4,581 MW, approximately 213 MW less than the peak load for 2003. The decrease is attributable to weather and conservation efforts. On a weather-normalized basis, the 2004 peak load approximated 4,955 MW, which reflects an increase of approximately 2.9 percent over the weather normalized 2003 all-time peak load of 4,815 MW.

In 2003, LIPA's peak demand was 4,794 MW, approximately 135 MW less than the previous record peak load of 4,929 MW set in the summer of 2002. The decrease is attributable to the impact of weather, as LIPA experienced year-over-year weather normalized system load growth from 2002 to 2003. Weather conditions during 2003, were within 1% of normal, based on the past 30 years of data. On a
weather-normalized basis, the 2003 peak load approximated 4,815 MW, which reflects an increase of approximately 4.4 percent over the weather normalized 2002 all-time peak load of 4,611 MW.

**Power Supply**

LIPA currently expects to rely on existing power supply resources, additional power supply resources being developed, additional purchases and demand side management programs to meet its capacity and energy requirements during the 2006 through 2010 period. During 2005, LIPA's 18% interest in NMP2 and its rights to the capacity of the GENCO Generating Facilities provided approximately 4,283 MW of generating capacity. Other purchases, including on-Island independent power producers ("IPPs") and off-Island purchases from NYPA (including Power for Jobs) and other suppliers, provided approximately 1,219 MW of additional capacity. In aggregate, these resources provided approximately 5,502 MW in 2005.

To satisfy the growing capacity needs of its electric customers, LIPA expects to enter into additional power purchase agreements as more fully described under "New Power Supply Resources," below, and to implement customer peak load reductions through demand side management programs, cogeneration projects and NYPA's Power for Jobs program. Current reliability rules applied by the NYISO require LIPA to supply at least 99 percent of its projected peak load from on-Island installed capacity ("ICAP") resources (the "On-Island Requirement"). Effective May 1, 2006, the On-Island Requirement increased to 106%. Based on LIPA's current projections of its load and resources, LIPA's existing resources, including new generating plants and transmission resources expected to be added, are projected to be sufficient to meet or exceed this minimum requirement through 2015.

The power supply resources relied on by LIPA to supply the electric needs of its customers are described below. Potential new power supply resources are described below under "New Power Supply Resources."

*Existing Capacity and Energy Resources*

LIPA is expected to rely on existing power supply resources, including facilities owned by KeySpan, LIPA's share of NMP2, and recent and planned purchases of capacity and energy from new facilities constructed on Long Island to meet the bulk of its capacity and energy requirements during the Projection Period. The table below sets forth LIPA's historical loads and resources.
Historical Loads and Resources

<table>
<thead>
<tr>
<th></th>
<th>Calendar Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2001</td>
</tr>
<tr>
<td>Annual Peak Demand (Summer) (MW)(^1)</td>
<td>4,781</td>
</tr>
<tr>
<td>Capacity (MW)(^2)</td>
<td></td>
</tr>
<tr>
<td>Nuclear(^3)</td>
<td>207</td>
</tr>
<tr>
<td>Purchased Capacity:</td>
<td></td>
</tr>
<tr>
<td>GENCO</td>
<td></td>
</tr>
<tr>
<td>Steam(^4)</td>
<td>2,659</td>
</tr>
<tr>
<td>Other(^5)</td>
<td>1,378</td>
</tr>
<tr>
<td>Other Purchased Capacity(^4)</td>
<td>1,104</td>
</tr>
<tr>
<td>Total Purchased Capacity</td>
<td>5,141</td>
</tr>
<tr>
<td>Total Capacity</td>
<td>5,348</td>
</tr>
<tr>
<td>Annual Reserve Margin:</td>
<td></td>
</tr>
<tr>
<td>MW(^6)</td>
<td>567</td>
</tr>
<tr>
<td>Percent</td>
<td>11.9</td>
</tr>
<tr>
<td>Energy (MWh)</td>
<td></td>
</tr>
<tr>
<td>Annual Energy Requirements:</td>
<td></td>
</tr>
<tr>
<td>Retail Requirements</td>
<td>19,610,662</td>
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<tr>
<td>Sales for Resale</td>
<td>590,431</td>
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<tr>
<td>Total Energy Requirements(^7)</td>
<td>20,201,093</td>
</tr>
<tr>
<td>Generating Resources:</td>
<td></td>
</tr>
<tr>
<td>Nuclear(^3)</td>
<td>1,598,132</td>
</tr>
<tr>
<td>Purchased Energy:</td>
<td></td>
</tr>
<tr>
<td>GENCO</td>
<td></td>
</tr>
<tr>
<td>Steam</td>
<td>11,794,254</td>
</tr>
<tr>
<td>Other</td>
<td>892,258</td>
</tr>
<tr>
<td>Other Purchased Energy(^8)</td>
<td>5,916,449</td>
</tr>
<tr>
<td>Total Purchased Energy</td>
<td>18,602,961</td>
</tr>
<tr>
<td>Total Energy</td>
<td>20,201,093</td>
</tr>
</tbody>
</table>

\(^1\) Includes Long Island Choice load, Power-for-Jobs and the Grumman campus.
\(^2\) Summer capacity rating as measured in October of each year. Includes capacity under contract to LIPA.
\(^3\) LIPA's 18 percent share of NMP2.
\(^4\) Values from KeySpan Energy.
\(^5\) Includes on and off-island resources under contract at time of peak. Resources include capacity associated with independent power producers, Gilboa, firm capacity purchases, and Power-for-Jobs, and power supply agreements, including FPL Energy, Far Rockaway, Bayswater, Calpine Bethpage, KeySpan Glenwood Landing, KeySpan Port Jefferson, PPL Shoreham, PPL Edgewood and Cummings. Excludes short-term bi-lateral and NYSIO capacity market auction purchases.
\(^6\) Equal to capacity less demand.
\(^7\) Includes sales for resale, Power-for-Jobs, Long Island Choice and the Grumman campus.

KeySpan—Power Supply Agreement

LIPA entered into the Power Supply Agreement (the "PSA") with KeySpan whereby a subsidiary of KeySpan ("GENCO") supplies LIPA with all of the capacity of the GENCO Generating Facilities. The PSA terminates on May 28, 2013, and may be renewed by LIPA on terms comparable to the original PSA. The GENCO Generating Facilities consist of 53 fossil fuel generating units at 13 sites on Long Island totaling approximately 4,000 MW in capacity. These steam, combustion turbine, and internal combustion generating units operate using oil, natural gas, or both. The tables below provide a summary description of the GENCO Generating Facilities and historical generation levels for these facilities for the 2001 through 2005 period.

Under the PSA, LIPA pays GENCO certain fixed and variable rates for the generating capacity supplied by GENCO. LIPA and GENCO have agreed to a formula for the adjustment of these charges...
through the term of the PSA. These rates are subject to the jurisdiction of FERC. Pursuant to the terms of the PSA, the rates were reset effective January 1, 2004 and are to be reset again January 1, 2009.

GENCO's annual capital expenditures are subject to approval by LIPA. LIPA pays for approved GENCO capital expenditures through the depreciation accruals and return on investments included in the rates for capacity charged under the PSA. The PSA also provides for certain incentives and disincentives related to targeted performance levels by GENCO, including summer dependable maximum net capability, summer availability, and efficiency levels (heat rate) of the generating facilities.

LIPA is responsible for the supply of natural gas and fuel oil required for operation of the GENCO generating units. KeySpan, as the Energy Manager, procures and manages this fuel supply for LIPA pursuant to the EMA.
### GENCO Generating Facilities

#### Summary Description

<table>
<thead>
<tr>
<th>Facility</th>
<th>Nameplate Rating (MW)$^1$</th>
<th>Summer DMNC Rating (MW)$^2$</th>
<th>Fuel</th>
<th>Year of Commercial Operation</th>
<th>County</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Steam Turbine:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E.F. Barrett 1,2</td>
<td>350</td>
<td>398</td>
<td>Gas, Oil</td>
<td>1956, 1963</td>
<td>Nassau</td>
</tr>
<tr>
<td>Far Rockaway</td>
<td>100</td>
<td>111</td>
<td>Gas, Oil</td>
<td>1953</td>
<td>Queens</td>
</tr>
<tr>
<td>Glenwood 4,5</td>
<td>200</td>
<td>240</td>
<td>Gas</td>
<td>1952, 1954</td>
<td>Nassau</td>
</tr>
<tr>
<td>Northport 1,2,4</td>
<td>1,125</td>
<td>1,165</td>
<td>Gas, Oil</td>
<td>1967, 1968, 1977</td>
<td>Suffolk</td>
</tr>
<tr>
<td>Northport 3</td>
<td>375</td>
<td>390</td>
<td>Oil</td>
<td>1972</td>
<td>Suffolk</td>
</tr>
<tr>
<td>Port Jefferson 3,4</td>
<td>350</td>
<td>388</td>
<td>Gas, Oil</td>
<td>1958, 1960</td>
<td>Suffolk</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,500</td>
<td>2,691</td>
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<tr>
<td><strong>Combustion Turbine:</strong></td>
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</tr>
<tr>
<td>E.F. Barrett 1-12</td>
<td>311</td>
<td>311</td>
<td>Gas, Oil</td>
<td>1970-1971</td>
<td>Nassau</td>
</tr>
<tr>
<td>Wading River 4</td>
<td>242</td>
<td>238</td>
<td>Oil</td>
<td>1989</td>
<td>Suffolk</td>
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<tr>
<td>East Hampton 1</td>
<td>21</td>
<td>19</td>
<td>Oil</td>
<td>1970</td>
<td>Suffolk</td>
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<tr>
<td>Glenwood 1-3</td>
<td>126</td>
<td>118</td>
<td>Oil</td>
<td>1967-1972</td>
<td>Nassau</td>
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<tr>
<td>Holtsville 1-10</td>
<td>567</td>
<td>527</td>
<td>Oil</td>
<td>1974-1975</td>
<td>Suffolk</td>
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<tr>
<td>Northport G-1</td>
<td>16</td>
<td>14</td>
<td>Oil</td>
<td>1967</td>
<td>Suffolk</td>
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<td>Port Jefferson GT</td>
<td>16</td>
<td>14</td>
<td>Oil</td>
<td>1966</td>
<td>Suffolk</td>
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<tr>
<td>Shoreham 1-2</td>
<td>72</td>
<td>65</td>
<td>Oil</td>
<td>1966, 1971</td>
<td>Suffolk</td>
</tr>
<tr>
<td>Southampton 1</td>
<td>12</td>
<td>10</td>
<td>Oil</td>
<td>1963</td>
<td>Suffolk</td>
</tr>
<tr>
<td>Southhold 1</td>
<td>14</td>
<td>10</td>
<td>Oil</td>
<td>1964</td>
<td>Suffolk</td>
</tr>
<tr>
<td>West Babylon 4</td>
<td>52</td>
<td>48</td>
<td>Oil</td>
<td>1971</td>
<td>Suffolk</td>
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<td><strong>Subtotal</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,449</td>
<td>1,375</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Internal Combustion:</strong></td>
<td></td>
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</tr>
<tr>
<td>East Hampton 2-4</td>
<td>6</td>
<td>6</td>
<td>Oil</td>
<td>1962</td>
<td>Suffolk</td>
</tr>
<tr>
<td>Montauk 2-4</td>
<td>6</td>
<td>6</td>
<td>Oil</td>
<td>1961</td>
<td>Suffolk</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,961</td>
<td>4,055</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

1. Source: KeySpan.
2. DMNC values applicable for the 2005 Summer Capability Season. Values based upon the October 2005 Capacity Filing with the New York Independent System Operator.
3. Permitted for both oil and gas, but currently operational on gas only.
4. Includes increase in DMNC values associated with power recovery activities.
### Historical GENC0 Generation¹ (GWH)

<table>
<thead>
<tr>
<th>Generating Facility</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Steam Turbine:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E.F. Barrett 1,2</td>
<td>1,606.2</td>
<td>1,634.4</td>
<td>1,336.4</td>
<td>1,207.0</td>
<td>1,213.5</td>
</tr>
<tr>
<td>Far Rockaway 4</td>
<td>295.5</td>
<td>404.2</td>
<td>263.8</td>
<td>220.2</td>
<td>238.1</td>
</tr>
<tr>
<td>Glenwood 4,5</td>
<td>797.1</td>
<td>804.0</td>
<td>545.0</td>
<td>404.1</td>
<td>188.9</td>
</tr>
<tr>
<td>Northport 1-4</td>
<td>7,374.1</td>
<td>7,297.4</td>
<td>7,507.3</td>
<td>6,797.1</td>
<td>7,423.7</td>
</tr>
<tr>
<td>Port Jefferson 3,4</td>
<td>1,721.4</td>
<td>1,645.3</td>
<td>1,399.2</td>
<td>1,873.8</td>
<td>1,642.2</td>
</tr>
<tr>
<td><strong>Total Steam Turbine</strong></td>
<td>11,794.3</td>
<td>11,785.3</td>
<td>11,051.7</td>
<td>10,502.2</td>
<td>10,706.4</td>
</tr>
<tr>
<td><strong>Combustion Turbine:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E.F. Barrett 1-12</td>
<td>125.7</td>
<td>155.8</td>
<td>89.0</td>
<td>129.3</td>
<td>91.9</td>
</tr>
<tr>
<td>Wading River</td>
<td>409.1</td>
<td>256.2</td>
<td>305.6</td>
<td>192.6</td>
<td>156.2</td>
</tr>
<tr>
<td>East Hampton 1</td>
<td>16.1</td>
<td>16.4</td>
<td>16.4</td>
<td>4.0</td>
<td>5.4</td>
</tr>
<tr>
<td>Glenwood 1-3</td>
<td>19.6</td>
<td>35.8</td>
<td>23.6</td>
<td>13.3</td>
<td>24.3</td>
</tr>
<tr>
<td>Holtsville 1-10</td>
<td>293.8</td>
<td>290.9</td>
<td>284.1</td>
<td>147.5</td>
<td>135.2</td>
</tr>
<tr>
<td>Northport G-1</td>
<td>0.6</td>
<td>1.4</td>
<td>0.7</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Port Jefferson GT</td>
<td>1.9</td>
<td>1.2</td>
<td>0.7</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Shoreham 1-2</td>
<td>11.1</td>
<td>12.1</td>
<td>10.4</td>
<td>1.7</td>
<td>5.1</td>
</tr>
<tr>
<td>Southampton 1</td>
<td>2.9</td>
<td>2.0</td>
<td>1.7</td>
<td>0</td>
<td>0.4</td>
</tr>
<tr>
<td>Southhold 1</td>
<td>2.9</td>
<td>4.9</td>
<td>3.0</td>
<td>0.9</td>
<td>1.0</td>
</tr>
<tr>
<td>West Babylon 4</td>
<td>1.9</td>
<td>5.9</td>
<td>7.7</td>
<td>2.5</td>
<td>3.1</td>
</tr>
<tr>
<td><strong>Total Combustion Turbine</strong></td>
<td>885.6</td>
<td>782.6</td>
<td>742.2</td>
<td>492.2</td>
<td>423.0</td>
</tr>
<tr>
<td><strong>Internal Combustion:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East Hampton 2-4</td>
<td>4.1</td>
<td>3.9</td>
<td>4.0</td>
<td>1.8</td>
<td>.9</td>
</tr>
<tr>
<td>Montauk 2-4</td>
<td>2.4</td>
<td>3.2</td>
<td>3.2</td>
<td>1.2</td>
<td>.8</td>
</tr>
<tr>
<td><strong>Total Internal Combustion</strong></td>
<td>6.5</td>
<td>7.1</td>
<td>7.2</td>
<td>3.0</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12,686.4</td>
<td>12,575.0</td>
<td>11,801.1</td>
<td>10,997.8</td>
<td>11,131.1</td>
</tr>
</tbody>
</table>

¹ Source: KeySpan.

---

**Nine Mile Point Two Nuclear Station**

LIPA owns an undivided 18 percent interest (approximately 205 MW) in NMP2. NMP2 is one of two boiling-water reactor nuclear units at the Nine Mile Point nuclear power station located in Oswego, New York. NMP2 began commercial operation in April 1988 under a Nuclear Regulatory Commission ("NRC") license that expires in 2026.

Until November 6, 2001, NMP2 was operated by Niagara Mohawk Power Corporation ("NMPC") and owned by NMPC and four co-tenants, including LIPA. Concelollion Nuclear LLC ("Constellation"), a division of Constellation Energy Group (NYSE: CEG), purchased 100 percent of the Nine Mile Point 1 Nuclear Power Station from NMPC and 8 percent of NMP2 from the co-tenants, other than LIPA, on November 7, 2001. Constellation operates NMP2 under the terms of an amended and restated operating agreement with LIPA. On May 27, 2004, Constellation submitted an application to the NRC to extend by 20 years the operating licenses of Nine Mile Point Units One and Two (to 2029 and 2046, respectively). The NRC is expected to rule on the application in the fourth quarter of 2006. The Authority cannot predict the outcome of this application.

The operating agreement between LIPA and Constellation provides for a management committee comprised of one representative from each co-tenant. Additionally, LIPA employs an on-site representative to provide additional support to protect LIPA's interests. The annual NMP2 business plan and the operating and capital budgets are developed by Constellation and submitted to LIPA for review and approval. LIPA receives output from NMP2 and is responsible for operating and capital costs in proportion to its ownership interest.
The following table sets forth for each calendar year 2001 through 2005 the actual generation attributable to LIPA's 18% ownership interest in NMP2.

### NMP2 Energy Generation

<table>
<thead>
<tr>
<th>Year</th>
<th>Energy (GWh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>1,599.2</td>
</tr>
<tr>
<td>2002</td>
<td>1,519.7</td>
</tr>
<tr>
<td>2003</td>
<td>1,721.5</td>
</tr>
<tr>
<td>2004</td>
<td>1,584.4</td>
</tr>
<tr>
<td>2005</td>
<td>1,784.2</td>
</tr>
</tbody>
</table>

**Other Power Supply Agreements**

In addition to the generation subject to the PSA with GENCO described above, LIPA currently purchases approximately 1,152 MW of capacity from generation facilities on Long Island and elsewhere under various power purchase agreements. The tables below summarize these generating facilities and key terms of the associated power purchase agreements and the energy LIPA's purchases under these agreements.

The tables set forth below contain a summary of existing power supply agreements and show for each calendar year 2001 through 2005 the energy output from such power purchase agreements.

#### Summary of Power Supply Agreements

(Excluding GENCO)

<table>
<thead>
<tr>
<th>Unit Name</th>
<th>Capacity (MW)</th>
<th>Contract Expiration</th>
<th>Unit Type</th>
<th>Primary Fuel Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYPA Flynn</td>
<td>135</td>
<td>2020</td>
<td>CC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>Hempstead Resource Recovery</td>
<td>74</td>
<td>2009</td>
<td>ST</td>
<td>Refuse</td>
</tr>
<tr>
<td>Trigen NDEC Combined Cycle</td>
<td>52</td>
<td>2016</td>
<td>CC/Cogen</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>Huntington Resource Recovery</td>
<td>24</td>
<td>2012</td>
<td>ST</td>
<td>Refuse</td>
</tr>
<tr>
<td>Babylon Resource Recovery</td>
<td>15</td>
<td>2008</td>
<td>ST</td>
<td>Refuse</td>
</tr>
<tr>
<td>Islip Resource Recovery</td>
<td>9</td>
<td>2010</td>
<td>ST</td>
<td>Refuse</td>
</tr>
<tr>
<td>Yaphank Landfill</td>
<td>2</td>
<td>2008</td>
<td>IC</td>
<td>Methane</td>
</tr>
<tr>
<td>Smithtown Landfill</td>
<td>N/A</td>
<td>2010</td>
<td>IC</td>
<td>Methane</td>
</tr>
<tr>
<td>PPL Global Shoreham</td>
<td>79</td>
<td>2017</td>
<td>SC</td>
<td>Kerosene⁵,⁶</td>
</tr>
<tr>
<td>KeySpan Glenwood Landing</td>
<td>79</td>
<td>2027</td>
<td>SC</td>
<td>Natural Gas³,⁵,⁶</td>
</tr>
<tr>
<td>KeySpan Port Jefferson</td>
<td>79</td>
<td>2027</td>
<td>SC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>FPL Bayswater</td>
<td>51</td>
<td>2020</td>
<td>SC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>FPL Jamaica Bay</td>
<td>54</td>
<td>2018</td>
<td>SC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>Global Common Greenport</td>
<td>48</td>
<td>2018</td>
<td>SC</td>
<td>Oil⁷</td>
</tr>
<tr>
<td>Equus</td>
<td>47</td>
<td>2017</td>
<td>SC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>NYPA Power-for-Jobs</td>
<td>14</td>
<td>2006</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Gilboa</td>
<td>50</td>
<td>2015</td>
<td>PS</td>
<td>Water</td>
</tr>
<tr>
<td>Village of Freeport</td>
<td>10</td>
<td>2034</td>
<td>SC</td>
<td>Natural Gas³</td>
</tr>
<tr>
<td>Pinelawn Power</td>
<td>80</td>
<td>2025</td>
<td>CC</td>
<td>Natural Gas³,⁵,⁶</td>
</tr>
<tr>
<td>Calpine Bethpage 3</td>
<td>80</td>
<td>2025</td>
<td>CC</td>
<td>Natural Gas</td>
</tr>
</tbody>
</table>

1 In addition, LIPA has entered into two contracts to provide a total of 84 MW of temporary generation capacity at substation facilities located at Shoreham and Holtsville.
2 Summer capacity based upon summer 2005 ICAP test results.
3 CC = Combined Cycle; ST = Steam; Cogen = Cogeneration; IC = Internal Combustion; SC = Simple Cycle; PS = Pumped Storage.
4 Also burns No. 2 fuel oil.
5 Also burns kerosene.
6 LIPA is responsible for fuel procurement and has contracted with KeySpan for this service.
Energy Output of Power Supply Agreements\(^1\)  
(GWH)

<table>
<thead>
<tr>
<th>Type of Resource</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Power Producers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NYPA Flynn</td>
<td>1,206.3</td>
<td>1,250.2</td>
<td>1,068.9</td>
<td>1,229.4</td>
<td>1,171.9</td>
</tr>
<tr>
<td>Other(^2)</td>
<td>1,639.0</td>
<td>1,811.3</td>
<td>1,756.3</td>
<td>1,490.6</td>
<td>1,373.1</td>
</tr>
<tr>
<td>Subtotal IPPs</td>
<td>2,845.3</td>
<td>3,061.5</td>
<td>2,825.2</td>
<td>2,720.0</td>
<td>2,544.9</td>
</tr>
<tr>
<td>NYPA Off-Island: Fitzpatrick &amp; Gilboa</td>
<td>1,356.8</td>
<td>1,524.8</td>
<td>873.0(^3)</td>
<td>1,072.7</td>
<td>1,186.1</td>
</tr>
<tr>
<td>Off-Island Purchases(^3)</td>
<td>766.0</td>
<td>1,080.2</td>
<td>2,362.6</td>
<td>4,086.8</td>
<td>3,916.1</td>
</tr>
<tr>
<td>Other Purchases(^4)</td>
<td>948.3</td>
<td>1,050.0</td>
<td>894.9</td>
<td>566.8</td>
<td>1,217.2</td>
</tr>
<tr>
<td>Total Purchases</td>
<td>5,916.4</td>
<td>6,716.5</td>
<td>6,955.7</td>
<td>8,446.3</td>
<td>8,864.3</td>
</tr>
</tbody>
</table>

\(^1\) Source: KeySpan.  
\(^2\) Various suppliers or vendors.  
\(^3\) Energy purchases made on the spot market, net of sales on the spot market, plus bi-lateral purchases.  
\(^4\) Reflects Power-for-Jobs and Long Island Choice programs.  
\(^5\) Reflects the termination of capacity agreement with Fitzpatrick during 2003.

New Power Supply Resources

LIPA announced in May 2004 a comprehensive energy resource plan that will add over 1,000 MW of new capability under contract to LIPA over the period from 2004 to 2010. LIPA's plan is designed to help meet the region's growing demand for electricity in the most cost efficient way possible.

The comprehensive energy resource plan contained five key elements: (1) energy efficiency and demand reduction; (2) renewables and distributed generation; (3) additional on-island power supply; (4) new on-island "base-load" capacity; and (5) a new cable from New Jersey to Long Island capable of delivering capacity and/or energy.

New resources added during the four-year period ended December 31, 2005 are shown in the chart below. For 2006, the Authority has completed negotiations with Bear Swamp Power, LLC to provide up to 345 MW of additional capability. In addition LIPA has entered into an agreement with Neptune Regional Transmission System LLC ("Neptune") to purchase 660 MW of capacity over an undersea high voltage cable currently under construction between Sayerville, New Jersey and Levittown, New York. The cable is expected to be completed in 2007 thus permitting LIPA to import 660 MW of power and related energy from the Pennsylvania, New Jersey and Maryland markets. LIPA also entered into an agreement with Caithness Long Island LLC ("Caithness") to acquire 286 MW from a 326 MW plant to be constructed by Caithness expected to be in operation no later than 2009. The Authority has also proposed to enter into a power purchase agreement for a 140 MW wind farm off the Long Island coast to be constructed by FPL Energy.
Resources Added During 2002 - 2005

| Location                  | Vendor                      | Number of Units | Capacity (MW) *
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Babylon (2005)</td>
<td>Pinelawn Power LLC</td>
<td>1</td>
<td>79.9</td>
</tr>
<tr>
<td>Oyster Bay (2005)</td>
<td>CPN Bethpage 3rd Turbine, Inc.</td>
<td>1</td>
<td>79.9</td>
</tr>
<tr>
<td>Freeport (2004)</td>
<td>Village of Freeport</td>
<td>1</td>
<td>50</td>
</tr>
<tr>
<td>Freeport (2004)</td>
<td>Equus</td>
<td>1</td>
<td>49</td>
</tr>
<tr>
<td>Greenport (2003)</td>
<td>Global Common</td>
<td>1</td>
<td>48</td>
</tr>
<tr>
<td>Bayswater (2003)</td>
<td>FPL Energy</td>
<td>1</td>
<td>51</td>
</tr>
<tr>
<td>Jamaica Bay (2002)</td>
<td>FPL Energy</td>
<td>1</td>
<td>54</td>
</tr>
<tr>
<td>Bethpage (2002)</td>
<td>Calpine</td>
<td>1</td>
<td>47</td>
</tr>
<tr>
<td>Glenwood Landing (2002)</td>
<td>KeySpan</td>
<td>2</td>
<td>79</td>
</tr>
<tr>
<td>Port Jefferson (2002)</td>
<td>KeySpan</td>
<td>2</td>
<td>80</td>
</tr>
<tr>
<td>Shoreham (2002)</td>
<td>PPL Global</td>
<td>2</td>
<td>79</td>
</tr>
<tr>
<td>Pilgrim (2002)</td>
<td>PPL Global</td>
<td>2</td>
<td>79</td>
</tr>
</tbody>
</table>

1. Summer capacity based on 2005 ICAP test results.
2. Combined cycle.
3. LIPA contracts for 10 MW of capacity.
4. Limited to 79.9 MW by permit.

Short-Term Capacity Purchases

In addition to the resources described above, LIPA relies on short-term, firm capacity purchases to meet a portion of its total capacity requirements. LIPA anticipates the need to make additional capacity purchases during the remainder of the Projection Period. These purchases are accomplished through solicitations, auctions and/or bilateral arrangements. KeySpan, under LIPA's supervision, determines the requirement and timing of these capacity purchases as LIPA's Energy Manager pursuant to the EMA.

Market Energy Purchases

In addition to energy purchased under the terms of the agreements described above, LIPA routinely purchases energy in the day-ahead and real-time markets operated by the NYISO and ISO-NE. These purchases are generally made when the price of energy from these sources is below the incremental cost of generation from LIPA's contracted resources. During 2005, approximately thirteen percent of the Service Area's energy requirements were obtained through such energy purchases.

The tables below provide a summary of LIPA's estimated demand and energy requirements for the Projection Period. During this period, annual peak demands and energy requirements, after adjustment for various demand side programs, are estimated to increase at annual compound rates of growth of approximately 1.7 percent. The estimated demand and energy requirements shown in the tables below take into account the effects of LIPA's Long Island Choice program, as described below, and reflect the results of resource planning assessments conducted for purposes of the projections set forth in Appendix B in this Part 2. Such information is not intended to represent resource specific power supply expansion plans adopted by LIPA. The information contained in the table below is presented on a unforced capacity ("UCAP") basis in order to conform to the requirements of NYISO. Historical data throughout this Official Statement has been presented on an ICAP basis in order to be consistent with prior years. It is anticipated that the Authority will migrate to the UCAP basis as such information becomes available. ICAP is a measurement of a generating unit's maximum output under certain defined test conditions without considering the impact of forced outages. UCAP is a related measure that takes a generating unit's ICAP and reduces it based on the proportion of a generating unit's historic output that was not available due to forced outages.
**Estimated Capacity Requirements and Resources (UCAP Basis)**

(MW)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System Demand</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net LIPA Load¹</td>
<td>5,232</td>
<td>5,309</td>
<td>5,387</td>
<td>5,495</td>
<td>5,593</td>
</tr>
<tr>
<td>Plus: Transmission Loss Adjustment²</td>
<td>54</td>
<td>55</td>
<td>56</td>
<td>57</td>
<td>58</td>
</tr>
<tr>
<td>Net: LIPA Load with Losses</td>
<td>5,286</td>
<td>5,364</td>
<td>5,442</td>
<td>5,551</td>
<td>5,651</td>
</tr>
<tr>
<td>Required Reserve Margin³</td>
<td>613</td>
<td>622</td>
<td>631</td>
<td>643</td>
<td>655</td>
</tr>
<tr>
<td>Total Capacity Requirement</td>
<td>5,899</td>
<td>5,986</td>
<td>6,073</td>
<td>6,195</td>
<td>6,306</td>
</tr>
</tbody>
</table>

| **Resources (UCAP)** |       |       |       |       |       |
| Nine Mile Point 2 | 206 | 206 | 206 | 206 | 206 |
| GENCO⁴ | 3,891 | 3,891 | 3,891 | 3,891 | 3,891 |
| Fast Track GT’s | 522 | 522 | 522 | 522 | 522 |
| New Resource Additions⁴ | 151 | 151 | 151 | 151 | 151 |
| Non-Dispatchable IPP’s | 158 | 158 | 157 | 73 | 73 |
| NYPA (Flynn)⁵ | 127 | 127 | 127 | 127 | 127 |
| NYPA (Gilboa) | 50 | 50 | 50 | 50 | 50 |
| NYPA (Power for Jobs) | – | – | – | – | – |
| Future Resources Additions⁵ | – | – | – | 273 | 273 |
| UCAP Net Purchases/Sales⁶ | 795 | 882 | 970 | 903 | 1,014 |
| Total Capability | 5,899 | 5,986 | 6,073 | 6,195 | 6,306 |
| Reserve Margin | 112.0% | 112.0% | 112.0% | 112.0% | 112.0% |

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¹ LIPA’s estimated Net Peak Load including Long Island Choice customers and losses. Forecast after reductions for: Natural Conservation and NYISO credit for Demand Reduction Programs.
² NYISO Off-Island Transmission Loss Adjustment factor for LIPA.
³ NYISO required reserves based upon a 11.59% UCAP Reserve Margin (118% ICAP Equivalent).
⁴ KeySpan Generation covered under the PSA.
⁵ Includes 2005 Resource Additions of combined cycle units by Pinelawn Power & Calpine Bethpage 2.
⁶ NYPA Holtsville Facility.
⁷ Reflects the estimated capacity of the following unit resource additions expected to be in service: Caithness Project – gas fired combined cycle in service in 2009 – 242 MW UCAP Rating. Wind Farm – multiple wind turbines in service October 2008 – 32 MW UCAP Rating.
⁸ Short term UCAP purchases net of short term UCAP sales. Values include net purchases/sales on CSC & Neptune Cable (proposed resource addition).
### Estimated Energy Requirements and Resources (GWH)

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Energy Requirements</th>
<th>Resources</th>
<th>Net Economy</th>
<th>Total Resources</th>
</tr>
</thead>
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<tr>
<td></td>
<td>2006</td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
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<tr>
<td>Total Energy Requirements</td>
<td>21,430</td>
<td>21,706</td>
<td>22,022</td>
<td>22,399</td>
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<tr>
<td>NMP2</td>
<td>1,712</td>
<td>1,502</td>
<td>1,514</td>
<td>1,712</td>
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<td>GENCO3</td>
<td>11,925</td>
<td>10,597</td>
<td>9,001</td>
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<tr>
<td>New Resource Additions4</td>
<td>1,274</td>
<td>1,329</td>
<td>1,273</td>
<td>1,447</td>
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<tr>
<td>Non-Dispatchable IPPs</td>
<td>1,318</td>
<td>1,316</td>
<td>1,323</td>
<td>1,057</td>
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<tr>
<td>NYPA (Flynn)5</td>
<td>847</td>
<td>967</td>
<td>909</td>
<td>981</td>
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<tr>
<td>NYPA (Fitzpatrick)6</td>
<td>981</td>
<td>1,057</td>
<td>985</td>
<td>0</td>
</tr>
<tr>
<td>NYPA (Gilboa)</td>
<td>142</td>
<td>142</td>
<td>138</td>
<td>142</td>
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<tr>
<td>NYPA (Power for Jobs)</td>
<td>142</td>
<td>142</td>
<td>138</td>
<td>142</td>
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<td>Future Resources Additions7</td>
<td>8</td>
<td>61</td>
<td>208</td>
<td>2,217</td>
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<tr>
<td>Net Economy8</td>
<td>3,223</td>
<td>4,734</td>
<td>6,670</td>
<td>5,678</td>
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<tr>
<td>Total Resources</td>
<td>21,431</td>
<td>21,706</td>
<td>22,022</td>
<td>22,399</td>
</tr>
</tbody>
</table>

2. Includes the estimated GWH output of both the existing and future capacity resources expected to be under contract to LIPA during each year of the projection period.
3. Generating units covered under the PSA.
5. NYPA Holtsville facility.
6. Fitzpatrick energy only contract expires December 31, 2008. Thereafter, it is assumed that LIPA acquires the energy from the NYISO at market prices.
7. Reflects the estimated output from the generating unit resource additions expected to be placed in-service during the projection period:
   a. Fuel Cells – 2 MW in-service July 1, 2006, additional 8 MW in-service May 1, 2007
   b. FPL Wind Farm Project – multiple wind turbines in-service October 1, 2008
8. Short term purchases net of short term sales. Note: values include net energy purchases across the Cross Sound Cable, NYSCO 1385, Neptune, and from the NYISO market.

### New York Independent System Operator

#### General

The investor-owned utilities in the State, together with NYPA and LIPA (collectively, the "Transmission Owners"), are members of an independent transmission system operator called NYISO. NYISO is a not-for-profit corporation formed to provide for non-discriminatory open-access transmission over electric transmission systems belonging to the Transmission Owners, maintain the reliability of the combined systems and operate electric power markets within the State. Customers of NYISO pay non-transmission related charges to NYISO and pay the Transmission Service Charge ("TSC") to the Transmission Owners under the NYISO Open Access Transmission Tariff ("OATT"). LIPA participates in the NYISO under provisions designed to protect the Authority's tax-exempt status and recognize that the Authority, not FERC, is the entity with jurisdiction to set LIPA's rates. LIPA remains the entity responsible for billing and collecting its TSC for use of its transmission facilities pursuant to rates set by the Authority under State law. Further, LIPA retains ownership and operational control over its transmission facilities while coordinating the scheduling, maintenance and use of LIPA's transmission system with the NYISO.

In addition to its transmission-related responsibilities, the NYISO provides power pooling and power coordination functions. Operational features of the NYISO include (i) the establishment of a day-ahead and real-time bid-based spot energy market; (ii) the implementation of congestion pricing for
transmission services; (iii) the creation of transmission congestion contracts; (iv) the administration of a capacity market; and (v) markets for certain ancillary services. A significant feature of the NYISO's tariffs is its operation of an electric power market that uses a Locational Based Marginal Pricing Structure. The NYISO is also responsible for collecting charges from the market participants that consume electric power and paying market participants that provide electric power.

LIPA receives payments for use of its transmission system through the billing and collection of its TSC as well as contractual payments pursuant to certain grandfathered transmission agreements between LIPA and third parties. For non-grandfathered contracts, LIPA directly bills the TSC, a per kilowatt-hour charge, to transmission customers withdrawing energy from the System, and collects the TSC revenue directly from the customers. LIPA's TSC is developed, and updated annually, based upon a formula rate, which was approved by the Authority in October 2003.

LIPA is an unregulated transmitting utility under the Federal Power Act ("FPA") and therefore its TSC is not subject to review by FERC under FPA Sections 205 and 206. As a condition of LIPA's participation in the NYISO and to recognize LIPA's nonjurisdictional status, the NYISO OATT includes provisions that allow the NYISO to file, on LIPA's behalf, LIPA's TSC for inclusion in the OATT on an informational basis only. FERC limits its review of LIPA's TSC to a comparability review by which it only determines that the rates LIPA is charging are applied to all transmission customers, including LIPA itself, on a comparable basis. See "Certain Factors Affecting The Electric Utility Industry – Overview of Federal Regulatory Framework" in this Part 2.

On February 1, 2005, the NYISO introduced Standard Market Design 2 ("SMD2"), a highly flexible technological foundation which has put the New York energy markets on a common computing platform, resulting in economic and scheduling consistency across the markets, as well as advanced market concepts such as a two-settlement system for reserves and regulation services. SMD2 allows for a more efficient real-time unit commitment process and economic signals that indicate where and when shortage conditions exist. SMD2 also includes advanced system operating tools that allow for forward-looking evaluations and sophisticated tools that assist the operator in responding to emergency conditions. In addition, SMD2 provides: (a) improved consistency between the DAM and real-time markets; (b) real-time automated power mitigation in New York City; (c) greater market efficiency; and (d) a two-settlement system for ancillary services.

At the time NYISO was created, the New York State Reliability Council, LLC ("NYSRC") was also created. The NYSRC determines the reliability rules that the NYISO and all market participants must operate under and monitors the NYISO's compliance with the reliability rules.

FERC Seams Resolution Process

While there are no present proposals for combining the NYISO with either PJM Independent System Operator (covering Pennsylvania, New Jersey and Maryland) ("PJM") or ISO-NE, FERC has continued to seek the elimination of existing "seams" that limit the sale of energy and capacity between the respective ISOs. LIPA has worked with other market participants to eliminate or reduce seams between the NYISO, ISO-NE and PJM markets with increasing success. In 2004, FERC approved the elimination of export fees for transactions between NYISO and ISO-NE markets. Efforts to achieve a similar elimination of export fees between PJM and NYISO transactions are ongoing at this time. Further, ISO-NE now allows limited partial de-listing of generating units in its markets and will fully accommodate partial de-listing by the Spring of 2007. Partial de-listing will make additional generation capacity available to the New York markets and bring ISO-NE in parallel to the market mechanisms of NYISO and PJM that already allow partial de-listing. These and other seams reduction efforts will increase coordination between the markets and open up additional resources to Long Island thus reducing Long Island's power supply costs.
Generator Interconnection Rule

FERC has issued final rules requiring all public utilities that own, operate or control transmission facilities to file standard procedures and standard agreements governing interconnection services for "large" generators producing more than 20 MW. (Order No. 2003 & Order No. 2003-A—Large Generator Interconnections) and for "small" generators producing less than 20 MW (Order No. 2006 & Order No. 2006-A—Small Generator Interconnections). These rules apply to "public utilities" as defined under the FPA, including Regional Transmission Organizations ("RTOs") and ISOs such as NYISO. As LIPA is not a "public utility" under the FPA, it is not under a direct compliance obligation. However, as part of its participation in the NYISO, LIPA voluntarily complies with the NYISO's generator interconnection procedures for interconnections at the transmission system level. LIPA continues to administer the interconnection process for all generators connecting to its distribution facilities under its own tariff and procedures. At this time, LIPA is reviewing its own tariff and generator interconnection procedures to include revisions that will be complementary to the NYISO process.

The NYISO OATT now includes Large Generation Interconnection Procedures and a Large Generation Interconnection Agreement consistent with Order Nos. 2003 and 2003-A. On December 8, 2005, the NYISO (together with the New York Transmission Owners other than LIPA and the New York Power Authority ("NYPA")) also filed with FERC standard interconnection procedures and a standard interconnection agreement to cover small generators consistent with Order Nos. 2006 and 2006-A. At this time, FERC has not acted upon the proposed procedures for small generator interconnections into the New York transmission system. Further, on July 20, 2006, FERC issued Order No. 2006-B granting further clarification of its small generator interconnection rules to direct that the Small Generator Interconnection Procedures study agreements include standard legal terms and conditions. The jurisdictional New York Transmission Owners (other than LIPA and NYPA) and NYISO have until October 27, 2006 to file a compliance filing consistent with Order No. 2006-B. LIPA is participating in discussions between the NYISO and the jurisdictional New York Transmission Owners regarding the necessary compliance filing to be made by October 27, 2006.

Fuel Supply

The Energy Manager procures fuel needed for generation by GENCO and certain other non-GENCO generating units pursuant to the EMA. LIPA directly pays for fuel used at the GENCO Generating Facilities. The particular fuel used for generation will depend on generation plant fuel capability, fuel supply and transportation availability, and fuel and fuel transportation cost, subject to environmental constraints. Most of the GENCO steam units can burn either natural gas or residual oil and certain units are required to burn lower sulfur residual oil or natural gas. Natural gas or distillate fuel is burned in the gas turbines.

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

Oil is stored on site or at locations accessible by each generation facility. Existing oil storage capacity plus an active oil management program is employed by the Energy Manager to help LIPA avoid a fuel oil supply disruption at the GENCO facilities and certain other non-GENCO generating units. Conversion of additional generating units to burn natural gas in the future, if economic, will further reduce exposure to potential oil interruptions.

Constellation is responsible for the fuel requirements of NMP2.
RATES AND CHARGES

The Act

The Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Authority; payments in lieu of taxes; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable; and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution. For a description of the Rate Covenant that is contained in the Resolution and which was adopted by the Authority pursuant to the Act, see "Security and Sources of Payment for the Bonds – Rate Covenant" in this Part 2.

Authority to Set Electric Rates

Under current State law, the Authority is empowered to set rates for electric service in the Service Area without being required by law to obtain the approval of the PSC or any other State regulatory body. However, the Authority agreed, in connection with the approval of the LIPA/LILCO Merger by the PACB, that it would not impose any permanent increase, nor extend or reestablish any portion of a temporary rate increase, in average customer rates over a 12-month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. See "Modification to the FPPCA Mechanism" in this Part 2 for a description of a PSC Order declining to review the appropriateness of LIPA's recovery of fuel and purchased power costs through LIPA's Fuel and Purchased Power Cost Adjustment clause. Legislation was introduced in the State Senate and the State Assembly in the 2005-2006 session which would amend the Act and the State Public Service Law to require the approval by the PSC of an increase in LIPA's average customer rates exceeding 2.5% over a 12-month period or to extend or reestablish any portion of a temporary rate increase exceeding 2.5% but was not enacted into law. Similar legislation may be introduced in future sessions of the State Legislature. Another of the PACB conditions requires that the Authority reduce average rates within the Service Area by no less than 14% over a ten-year period commencing on the date that LIPA began providing electric service when measured against LILCO's base rates in effect on July 16, 1997 (excluding the impact of the Shoreham Property Tax Settlement Agreement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events). Litigation has been commenced against the Authority challenging its rates. See "Litigation" in this Part 2.

The Projected Operating Results set forth in Appendix B hereto demonstrate that, based on the assumptions set forth therein (including the Authority's interpretation of the PACB conditions) and absent emergency conditions and extraordinary unforeseeable events, including a precipitous rise in oil prices, the Authority is expected to achieve an average rate reduction of no less than 14% over the ten-year period commencing on the date when the Authority began providing electric service, and that the Authority is not expected to need to increase average customer rates in excess of 2.5% over any 12-month period during the Projection Period. For purposes of determining compliance with the 2.5% and 14% PACB conditions described in the preceding paragraph, the Authority has interpreted the PACB conditions as allowing the exclusion of increases in the cost of electricity paid by the Authority's customers related to the Shoreham Property Tax Settlement Agreement and other pass-through adjustments. The Authority believes that it will be able to satisfy the 14% PACB condition and that the PACB conditions will not prevent the Authority from complying with its obligations under the Act and under the Resolution. If the Authority's interpretation of the PACB conditions were determined to be incorrect, it may influence the timing and size of rate increases implemented by the Authority and/or require (i) the modification of the plan to accelerate retirement of debt (see "Accelerated Debt
Retirement" in this Part 2), (ii) the withdrawal of funds from the Rate Stabilization Fund to avoid or minimize rate increases, or (iii) other action necessary to meet the conditions of the PACB approval.

**Rate Tariffs and Adjustments**

LIPA's base retail electric rates generally reflect traditional rate designs and include fixed customer charges for all customer classes, seasonable energy rates for all customer classes except lighting, and seasonably differentiated demand charges for non-residential customer classes (greater than seven kW). Economic development and load retention incentives are provided to a small number of commercial customers. Miscellaneous service charges, pole attachment charges, and rental rates are also assessed on a monthly basis. In addition, the Authority’s charges include a Fuel and Purchased Power Cost Adjustment ("FPPCA"), a PILOT payments recovery rider, a rider providing for the Shoreham Credits and the Suffolk Surcharge and a rider providing for the RICO Credits. On June 22, 2006, the Board of Trustees approved a revision to LIPA's base schedule of rates to move to the FPPCA substantially all elements of the fuel and purchased power costs currently recovered through the base rates as determined at the time of LIPA's initial tariff. This change, which is effective for all bills issued on and after July 5, 2006, will substantially consolidate fuel and purchased power costs in the FPPCA which will be shown separately in the bills sent to customers but will not otherwise affect the amounts billed to customers.

**Modification to the FPPCA Mechanism**

During 2003, the FPPCA was modified to allow LIPA to recover from customers amounts incurred for fuel and purchased power beyond those included in base rates ("Excess Fuel Costs") in the period incurred, as opposed to a deferral method. This modification was fully implemented on January 1, 2004. As of that date, the FPPCA was set so that LIPA would recover an amount of Excess Fuel Costs necessary to achieve revenue in excess of expenses of $20 million annually as a reserve. In no event, however, would the FPPCA be set at a level that would recover more than LIPA's Excess Fuel Costs. In 2005, the Authority increased the FPPCA by 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8, 2005. These increases were necessary to comply with the modified FPPCA mechanism, in effect during 2004 and 2005, to ensure the $20 million of excess revenue over expenses by year-end.

In connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% annually effective January 1, 2006. Also in December 2005, the Board proposed a modification to the FPPCA, which would increase the reserve target noted above from $20 million annually to $75 million with a "tolerance band". At the start of each calendar year, the FPPCA would be set at a level designed to achieve the targeted reserve of $75 million, with a tolerance band of $50 million above and $50 million below that level. During the year, the Authority would monitor, and if necessary modify, the FPPCA to achieve no less than $25 million and no more than $125 million of reserve. If the reserve is projected to fall below $25 million for the year, the FPPCA would be increased to a level sufficient to produce a reserve of $25 million to $75 million for the year (i.e., the lower half of the tolerance band). If the reserve is projected to exceed $125 million for the year, the FPPCA would be decreased to a level sufficient to produce $75 million to $125 million for the year (i.e., the upper half of the tolerance band). If the projected reserve for the year is between $25 million and $125 million, the FPPCA would not change. The proposed modification to the FPPCA was the subject of public hearings held in March and April 2006 and was approved by the Board of Trustees at its April 27, 2006 meeting.

The Authority expects to use a portion of the savings from the amended MSA and a portion of the funds available to it as a result of the 2006 Settlement Agreement to establish a reserve for the purpose of avoiding any increase in the FPPCA through 2007, absent a world-wide energy crisis.
Litigation has been commenced against the Authority challenging its rates and the FPPCA surcharge. See "Litigation" in this Part 2.

On May 3, 2006, the Authority voluntarily filed two petitions seeking PSC review of LIPA's FPPCA including the appropriateness of its charges to customers and seeking a confirmation that LIPA is treating fuel and purchased power costs properly and similar to other New York electric companies. The first petition sought a declaratory ruling regarding the PSC's interpretation of its rule on escalation clauses to the effect that utilities may automatically recover increased fuel and purchased power and other costs through escalation clauses. The second petition asked the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, also on June 20, 2006, the PSC issued an Order declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. The PSC noted that LIPA is not subject to PSC jurisdiction except in very limited circumstances unrelated to ratemaking, and LIPA's rates, services and practices are not governed by, and need not comply with, the provisions of the Public Service Law and PSC's regulations. In a separate letter to the Authority, the Chairman of the PSC offered technical assistance to the Authority in procuring and overseeing an independent consultant to perform a review of the FPPCA, should the Authority choose to pursue that option. The Authority expects to work with the Department of Public Service to retain an independent consultant to conduct such a review.

To help protect its customers from significant market price fluctuations for the purchase of fuel oil, natural gas and electricity, LIPA uses derivative financial instruments, which are recorded at their market value. Effective with the 2003 modifications to the FPPCA, any unrealized gains and losses derived from these derivatives are deferred as a regulatory asset or regulatory liability until realized, at which time they are included in current period results as a reduction to or as a component of fuel and purchased power. Prior to the 2003 modifications, unrealized gains and losses were included in fuel and purchased power expense, but were not included in the FPPCA calculation until realized.

The Act also requires the Authority to make payments in lieu of taxes, i.e., PILOTs, to municipalities and school districts equal to the property taxes that would have been received by each such jurisdiction from LILCO if the acquisition by the Authority had not occurred, and to make PILOTs for certain State taxes (including gross receipts taxes) and local taxes (including temporary transit station maintenance surcharges charged by the Metropolitan Transportation Authority of New York) which would otherwise have been imposed on LILCO. The PILOT payments recovery rider allows the Authority to recover PILOTs representing these gross receipts taxes and surcharges. All other PILOTs are recovered in the Authority's base rates.

BILLING AND COLLECTIONS

General

At December 31, 2005, the Authority had approximately 1.1 million customers in its service area. Prior to 2003, approximately 40% of the customers received a single bill for both electric service from LIPA and gas service from KeySpan. During 2003, LIPA separated the bills so that customers receive one invoice from LIPA for electric service and a separate bill from KeySpan for gas service. This separation alleviated significant customer confusion and provided LIPA with clearer information with respect to customer payments.
Collections

At the time of the LIPA/LILCO Merger, May 28, 1998, the 12-month revolving write-off of electric accounts amounted to 0.72% of sales on a six month lag basis. Since then, the write-off experience has improved. For the 12-month periods ended December 31, 2001, December 31, 2002, December 31, 2003, December 31, 2004 and December 31, 2005, the rates were 0.48%, 0.35%, 0.35%, 0.44% and 0.57% respectively.

CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY

General

The electric utility industry has been, and in the future will be, affected by a number of factors which will have an impact on the business, operations and financial condition of both public and private electric utilities, including the Authority and LIPA.

One of the most significant of these factors is the efforts on both the national and local levels to restructure the electric utility industry from a heavily regulated monopoly to an industry in which there is open competition for power supply service on both the wholesale and retail level.

In addition, such factors include, among others, (i) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (ii) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (iii) changes in national energy policy, (iv) increasing competition from independent power producers and marketers and brokers, (v) "self generation" by certain industrial and commercial customers, (vi) issues relating to the ability to issue tax exempt obligations, (vii) service restrictions on the ability to sell to nongovernmental entities electricity from generation projects financed with outstanding tax exempt obligations, (viii) changes from projected future load requirements, (ix) increases in costs, and (x) shifts in the availability and relative costs of different fuels. Any of these factors (as well as other factors) could have an effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways.

The Authority cannot predict what effects these factors will have on the business, operations and financial condition of the Authority or LIPA, but the effects could be significant. The following sections of this caption provide brief discussions of certain of these factors. However, these discussions do not purport to be comprehensive or definitive, and these matters are subject to change subsequent to the date of this Official Statement. Extensive information on the electric utility industry is, and is expected to be, available from legislative and regulatory bodies and other sources in the public domain.

Overview of Federal Regulatory Framework

Under Part II of the FPA, "public utilities" are subject to regulation by FERC. A "public utility" includes any person or entity that owns, controls, or operates facilities used for the transmission of electric energy in interstate commerce or for the sale of electric energy at wholesale in interstate commerce. However, under Part II of the FPA a "public utility" does not include a state or any political subdivision of a state, or any agency, authority, or instrumentality of any one or more of the foregoing. As a corporate municipal instrumentality and political subdivision of the State, the Authority, and, indirectly, LIPA, are largely exempt from FERC regulation as "public utilities" under Part II of the FPA. Notwithstanding this exemption, the Authority and LIPA are subject to the authority of FERC to order interconnection of its facilities pursuant to Section 210 of the FPA, and the authority of FERC to order "transmitting utilities" to provide transmission services in accordance with sections 211 and 212 of the FPA as amended by the Energy Policy Act. Further, FERC has stated that it intends to apply the "open
access" principles set forth in Order No. 888 (described below) and its progeny to the maximum extent to consumer-owned and other non-jurisdictional utilities, both with respect to deciding cases brought under sections 210 and 211 of the FPA and by requiring such utilities to agree to provide open access transmission service as a condition to securing transmission service from jurisdictional investor-owned utilities under open access tariffs.

As part of the recently enacted Energy Policy Act of 2005 (the "2005 Energy Policy Act"), Congress amended the FPA to include a new Section 211A which grants FERC limited discretionary authority (but does not mandate the exercise of such authority) over certain non-jurisdictional utilities referred to as "unregulated transmitting utilities." The term "unregulated transmitting utility" is defined as an entity that owns or operates facilities used for wholesale transmission service in interstate commerce and is an otherwise exempt entity under Section 201(f) of the FPA. LIPA meets this definition and will be considered an unregulated transmitting utility should FERC decide to implement the provisions of Section 211A.

Section 211A provides that the Commission may require an unregulated transmitting utility to provide transmission services at rates that are comparable to those it charges itself for such service and on terms and conditions (not relating to rates) that are comparable to those under which the unregulated transmitting utility provides transmission services to itself and that are not unduly discriminatory or preferential. Further, the rate-changing procedures of FPA Sections 205(c) and (d) also would apply to such unregulated transmitting utilities. While FERC now has the discretion to exercise direct jurisdiction over rates and terms of transmission service by unregulated transmitting utilities, FERC may not require a State or municipality to take an action under Section 211A that would violate a private activity bond rule for the purposes of section 141 of the Internal Revenue Code of 1986.

The provisions of Section 211A are not self-executing. Rather, FERC must make a specific ruling to apply the provisions of Section 211A to unregulated transmitting utilities. On September 16, 2005, FERC issued a Notice of Inquiry ("NOI") seeking comments on a number of 2005 Energy Policy Act implementation matters, including whether and, if so, how FERC should implement Section 211A. At this time, FERC has not taken any further action on the NOI or issued a rule or order applying Section 211A to LIPA or any other unregulated transmitting utility. Further, on May 19, 2006, as part of a notice of proposed rulemaking announcing potential modifications to its Order No. 888, pro forma OATT, FERC stated that it would not be issuing a generic rule to implement the new FPA section 211A. Rather, FERC proposes to apply Section 211A on a case-by-case basis.

While FERC may apply the terms of Section 211A to LIPA and other unregulated transmitting utilities on a case-by-case basis, it is unclear whether such application will fundamentally change LIPA's provision of wholesale transmission service. LIPA already provides open access transmission service to third parties on a comparability basis through its participation in the NYISO. Further, LIPA maintains its own reciprocity OATT, voluntarily complies with FERC's Standards of Conduct and OASIS requirements and ensures comparability in interconnection service to generators.


The Energy Policy Act of 1992 (the "1992 Energy Policy Act") made fundamental changes in the federal regulation of the electric utility industry, particularly in the area of transmission access. The purpose of these changes, in part, was to bring about increased competition in the wholesale electric power supply market. In particular, the 1992 Energy Policy Act provides FERC with the authority, upon application by any person selling electricity, federal power marketing agency, or other power generator, to require a transmitting utility to provide transmission services to the applicant essentially on a cost-of-service basis. Municipally-owned electric utilities are "transmitting utilities" for purposes of these provisions of the 1992 Energy Policy Act. However, the 1992 Energy Policy Act specifically denied
FERC the authority to mandate "retail wheeling," under which a retail customer of one utility could obtain transmission services for the purpose of obtaining power from another utility or non-utility power generator.

Certain FERC Initiatives

On April 24, 1996, FERC issued two final rules that contain significant policy initiatives designed to open the market for generation of electricity to competition. The final rules effect significant changes in the regulation of transmission services provided by "public utilities" (as defined in the FPA) that own, operate or control interstate transmission facilities used to transmit power in interstate commerce ("jurisdictional utilities"). Neither the Authority nor LIPA is a jurisdictional utility as so defined.

One of the final rules, Order No. 888, as modified on rehearing, (i) requires all public utilities to provide open access transmission services on a non-discriminatory basis by requiring all such public utilities to file tariffs that offer other entities seeking use of the interstate transmission system the same transmission services they provide themselves under comparable terms and conditions and (ii) contains a reciprocity provision that requires non-jurisdictional utilities (including municipal and consumer-owned utilities such as LIPA and the Authority) that purchase transmission services under FERC-filed open-access tariffs and that own or control transmission facilities to, in turn, provide open access service to the transmitting utility on rates, terms and conditions that are comparable to the service that the non-jurisdictional utility provides itself. Order No. 888 also includes provisions which, in effect, would permit jurisdictional utilities to recover so-called "stranded costs" for generating and other facilities from wholesale customers of a utility who opt to purchase from other power suppliers.

The rates that LIPA charges for wholesale transmission service, including the calculation of any stranded cost charge, are not subject to direct regulation by FERC under Sections 205 or 206 of the FPA. In 1998 FERC reviewed LIPA's OATT, including its rates for transmission service, and found that the OATT represents an acceptable reciprocity tariff subject to the condition that LIPA adopt a code of conduct and maintain an Open Access Same-time Information System ("OASIS"). While LIPA has retained a reciprocity OATT, transmission service over LIPA's system occurs primarily through the NYISO OATT. As previously described, LIPA's rates for wholesale transmission service are set by the Authority and incorporated for informational purposes into the NYISO OATT. LIPA remains the entity that charges and collects the transmission service charges from customers using its bulk transmission system.

On May 19, 2006, FERC issued a notice of proposed rulemaking ("NOPR") proposing certain changes to open access rules promulgated under Order No. 888 and the Order No. 888 pro forma OATT. The proposal considers modifications to existing provisions of the pro forma OATT as well as the addition of new provisions. Issues addressed in the NOPR include: rollover rights, the scope of point-to-point transmission service, the scope of network transmission service, creditworthiness standards, pricing for both generator and energy imbalances, available transmission capacity ("ATC") calculations, transmission planning, and OASIS information. At this time, it is uncertain whether any of the proposed changes to the pro forma OATT will be adopted or will result in material changes to the treatment of LIPA under the NYISO OATT and/or require modification of LIPA's reciprocity OATT.

While LIPA is not subject to Sections 205 and 206 of the FPA, other provisions of Part II of the FPA apply to its operations. Sections 210 and 211 of the FPA allow for a customer to file applications with the Commission to order a transmitting utility, such as LIPA, to provide interconnection service and/or transmission service under the relevant provisions of Section 210 and 211. FERC has discretion to entertain such an application, but it has noted that when FERC has approved an OATT for comparability purposes for a nonjurisdictional utility the applicant requesting a Section 211 order has the burden to show why service to the applicant under the same terms as available under the OATT is not sufficient and
why a Section 211 order should be granted. Similarly, FERC has held that, where an independent system operator, such as the NYISO, is in operation, a presumption applies that the applicant can gain the necessary transmission service or interconnection service through the ISO or ROT tariff and that an order under Section 210 or 211 is unnecessary.

The other final rule, Order No. 889, as supplemented by later orders, requires standards of conduct for utilities that offer open access transmission services to ensure that transmission owners and their affiliates do not have an unfair competitive advantage in using transmission to sell power. To this end, Order No. 889 (i) requires those utilities to establish an electronic OASIS to share transmission-related information (including information about available capacity) on a real-time basis, and also requires those utilities to obtain information about their transmission systems for their own wholesale power transactions, such as available capacity, in the same way that their competitors do—via an OASIS, and (ii) promulgates standards of conduct to ensure that utilities functionally separate their transmission and wholesale power merchant functions to prevent self-dealing.

Neither the Authority nor LIPA is directly subject to Order Nos. 888 and 889. However, the Authority and LIPA are subject to the reciprocity provision in Order No. 888, described above. Moreover, the Authority has voluntarily filed an OATT that substantially conforms to the provisions of Order No. 888, as modified on rehearing, which FERC had made a condition to FERC's approval of the transfer to the Authority of LILCO's transmission assets. On September 22, 1998 FERC approved LIPA's OATT finding that it is consistent with the compatibility requirements of Order No. 888 as modified on rehearing for an acceptable reciprocity transmission tariff on the condition that LIPA adopt a code of conduct and maintain an OASIS. LIPA's OASIS is in place. LIPA has filed its code of conduct with FERC.

2005 Energy Policy Act

On August 8, 2005, President Bush signed into law the 2005 Energy Policy Act. Among other things, the 2005 Energy Policy Act: (a) authorizes FERC to require "unregulated transmitting utilities" that formerly were exempt from regulation under sections 205 and 206 of the FPA (including the Authority) to provide open access to their transmission systems and to comply with certain rate change provisions of section 205 of the FPA; (b) authorizes FERC to order refunds for certain short-term wholesale sales made by state and municipal power entities (including the Authority) if such sales violate FERC-approved tariffs or FERC rules; (c) allows load serving entities holding certain firm transmission rights to continue to use those rights to serve their customers; (d) provides that an "electric reliability organization" ("ERO") shall develop reliability standards for operation of the transmission grid subject to FERC approval, that compliance with such standards will be mandatory and enforceable by the ERO and FERC, and that the ERO may delegate its authority to regional entities subject to FERC approval; (e) adds to the FPA a prohibition on market manipulation and submission of false information, and expands civil and criminal penalties for violation of the FPA; (f) authorizes FERC to issue construction permits for transmission projects located in "national interest electric transmission corridors" (to be designated by DOE) in circumstances where the applicable state or regional siting agency does not timely authorize a project or imposes unreasonable conditions; (g) eliminates certain ownership restrictions on electric utilities regarding "qualifying facilities" under section 210 of the Public Utility Regulatory Reform Act ("PURPA"), and authorizes FERC to eliminate prospectively the obligation of electric utilities to purchase and sell electricity to such qualifying facilities if certain market condition findings are made by FERC; (h) requires state utility regulatory commissions and "non-regulated electric utilities" (including the Authority) to consider adopting certain standards on net metering, fuel diversity, fossil fuel plant diversity, certain metering and time-based rate schedules and demand response, and interconnection with distributed generation facilities; (i) repeals the Public Utility Holding Company Act ("PUHCA"), effective six months after enactment of the 2005 Energy Policy Act; (j) increases FERC's authority to
review mergers of public utility companies; and (k) directs FERC to establish transmission investment incentives in transmission rate structures for public utilities.


Competition

In New York and many other states, there have been legislative and regulatory actions to promote competition in the supply of power by requiring, among other things, the separation of power supply services and costs from electric transmission and distribution services and costs. As of late 2005, there were 17 states with active competitive restructuring programs and 25 states without active competitive restructuring programs. Six states, including California have delayed or suspended their competitive restructuring programs. Alaska and Hawaii are not included. The trend among public power authorities is quite different. Excluding LIPA, none of the 15 largest public power authorities (by number of customers served) offered competitive restructuring programs to their retail customers. Federal regulation of transmission assets and services has been the focus of increasing action and attention as transmission resources are viewed as the vehicle for delivery of competitively priced generation to wholesale and retail customers. In general, transmission and distribution resources are viewed as an inherently monopoly function that must remain regulated.

The Authority has taken several actions to promote an orderly transition to greater competition in power supply and retail customer choice in the power supply markets in the Service Area. The Authority fosters wholesale competition by offering Open Access Transmission Service to generators that wish to provide power to the NYISO or to other wholesale customers. This service is offered on a comparable basis to the regulated transmission utilities in the State that are also members of the NYISO. Retail choice (sometimes called customer choice, retail wheeling, or retail open access) refers to a process by which retail customers choose among competitive suppliers for electric capacity, energy, and ancillary services. The delivery of capacity and energy is provided by the owner and operator of the local transmission and distribution system. Key issues that have surfaced in the movement to retail choice include the level of rate reductions accompanying the restructuring of individual utilities, recovery of stranded investments, and the timetable and methods for implementation of customer choice.

The Authority adopted a retail choice program (called "Long Island Choice") which is intended to offer electric customers the opportunity to choose an electric energy supplier other than LIPA. The program is available to all customers in LIPA's service territory. As of December 31, 2005, three suppliers were selling electricity to 1,854 commercial and industrial customers in the Service Area representing a total load of 191 MW.

The Authority can make no prediction as to what effect, if any, State or federal law providing for retail and commercial competition will have on its plans for implementing retail competition.

New York State Electric Utility Industry Regulation

General. Legislation is regularly introduced in the New York Legislature, which could affect the operations of the Authority. The Authority is not able to predict which, if any, of such legislation might be enacted into law, what form any of such legislation, if enacted, might take or what impact any of such legislation if enacted might have on the Authority's operations.

Environmental

Electric utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures, which regulate the environmental impact of electric utilities, are subject to change. These changes may arise from continuing legislative, regulatory and judicial action regarding such standards and procedures. Consequently, there is no assurance that the facilities owned or under contract to LIPA will remain subject to the regulations currently in effect, will always be in compliance with future regulations or will always be able to obtain all required operating permits. An inability to comply with environmental standards could result in additional capital expenditures to comply, reduced operating levels or the complete shutdown of individual electric generating units, including NMP2 and other units under contract to LIPA under the PSA, not in compliance.

The United States Environmental Protection Agency ("EPA"), the states and local jurisdictions may issue new regulations governing emissions from many types of power plants. State regulation of electric utility emissions may change significantly. The changes could affect the cost of purchased power from combustion turbines and other types of plants. If enacted, new regulations may change existing cost assumptions for electric utilities. While it is too early to determine if any new provisions will be enacted, in what form, or what their effect will be, any changes may have a material impact on the cost of power generated at affected electric generating units. See also "Environmental Matters" in this Part 2.

Nuclear Plant Matters

The 1992 Energy Policy Act provides, among other things, that utilities with nuclear reactors will contribute an aggregate total of $150 million annually, based upon an assessment, for a period of 15 years, up to a total of $2.25 billion (in 1992 dollars), for the costs of the decommissioning and decontamination of the United States Department of Energy ("DOE") nuclear fuel enrichment facilities.

In accordance with the Nuclear Waste Policy Act of 1982, Niagara Mohawk, as the operator of Nine Mile Point, in August 1995, entered into a contract with DOE, under which DOE, commencing not later than January 31, 1998, would accept and dispose of spent nuclear fuel. However, it appears unlikely that DOE will accept any spent nuclear fuel from Niagara Mohawk (now Constellation) or others before 2010. The contract provides that DOE will be paid a fee quarterly based on nuclear generation and sales of electricity from Nine Mile Point at a specified rate. LIPA's share of such fees, which relate to NMP2 is 18%.

The NRC has adopted decommissioning rules which require reactor operators to certify that sufficient funds will be available for decommissioning the contaminated portion of nuclear plants in the form of prepayments or external sinking funds, either of which must be segregated from the licensee's assets and outside its administrative control, or by the surety of insurance payable to a trust established for decommissioning costs. LILCO established such an external decommissioning trust fund in 1990 to meet these regulatory requirements. The Authority expects that by the expiration of NMP2's operating license in 2026, there will be funds in LIPA's decommissioning trust fund sufficient to meet the current estimated costs for its 18% share of the decommissioning costs of NMP2. If the estimated NMP2 decommissioning costs should increase, based on future site specific studies or NRC regulatory changes, LIPA expects to increase its contributions into the decommissioning trust fund to meet the revised requirements.

The Federal Low-Level Radioactive Waste Policy Act, as amended in 1985, requires states to join compacts or to individually develop their own low-level radioactive waste disposal site. In response to the federal law, the State had decided to develop its own site because of the large volume of such waste
generated in the State, and had committed to develop a plan for the management of the low-level radioactive waste in the State during the interim period until the disposal facility was available. No further action has been taken by those in the State and LIPA cannot predict when, or if, such a facility may be available.

Constellation does not currently have a contract to ship low level radioactive waste ("LLRW") generated at NMP2 to the disposal facility in Barnwell, South Carolina. Rather, Constellation has contracts with both Duratek Inc. and RACE Inc. Under these contracts, the contractors reduce the volume of the LLRW, then ship to various licensed sites (within the U.S.) with which they have contracts.

The NMP2 reactor core consists of 764 fuel assemblies. At each refueling outage, about a third of the oldest fuel assemblies are replaced with fresh assemblies. The used assemblies are stored in the spent fuel pool adjacent to the reactor. The NMP2 spent fuel pool is licensed for the storage of 4,049 fuel assemblies. Based on a 24-month operating cycle, NMP2 could operate into 2012 with existing spent fuel racks. To preserve the ability to off-load an entire core, the limitation on the existing and planned spent fuel racks is 2010. Beyond 2010, provisions must be made to store an additional 2,000 fuel bundles. Dry storage is being considered as a possible option to meet this storage need.

Constellation procures public liability and property insurance for NMP2 and LIPA reimburses Constellation for its 18% share of those costs.

In November 2002, the Terrorism Risk Insurance Act ("TRIA") of 2002 was enacted by the federal government. Under the TRIA, property and casualty insurance companies are required to offer insurance for losses resulting from certified acts of terrorism. The United States Secretary of State and Attorney General determine certified acts of terrorism. The nuclear property and accidental outage insurance programs, as discussed later in this section provide coverage for certified acts of terrorism.

Losses resulting from non-certified acts of terrorism are covered as a common occurrence, meaning that if non-certified terrorist acts occur against one or more commercial nuclear power plants insured by the insurers of NMP2, within a 12-month period, such acts would be treated as one event and the owners of the currently licensed nuclear power plants in the United States would share one full limit of liability (currently $3.24 billion).

The Price-Anderson Amendments Act mandates that nuclear power generators secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $300 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 103 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $100.6 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of $18.1 million, per incident, through assessments of up to $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor.

Constellation participates in the American Nuclear Insurers Master Worker Program that provides coverage for worker tort claims filed for radiation injuries. Effective January 1, 1998, this program was modified to provide coverage to all workers whose nuclear-related employment began on or after the commencement date of reactor operations. Waiving the right to make additional claims under the old policy was a condition for coverage under the new policy. The old and new policies are described below.

Nuclear worker claims reported on or after January 1, 1998 are covered by an insurance policy with an annual industry aggregate limit of $300 million for radiation injury claims against all those insured by this policy.
All nuclear worker claims reported prior to January 1, 1998 are still covered by the old policy. Insured workers under the old policies, with no current operations, are not required to purchase the newer policy described above, and may still make claims against the old policies through 2007. If radiation injury claims under these old policies exceed the policy reserves, all policyholders could be retroactively assessed, with LIPA's share being up to $300,000.

Constellation has also procured $500 million of primary nuclear property insurance and approximately $2.25 billion of additional protection (including decontamination costs) in excess of the primary layer through the Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $3.0 million per loss.

LIPA has obtained insurance coverage from NEIL for the extra expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, coverage would commence twelve weeks after any accidental outage, with reimbursement from NEIL at the rate of approximately $553,000 per week for the purchase of replacement power with a maximum limit of $77.4 million over a three-year period.

ENVIRONMENTAL MATTERS

General

As discussed in "Guarantees and Indemnities" in this Part 2, KeySpan Parties and LIPA Parties have entered into Liabilities Undertaking and Indemnification Agreements which, taken together, will provide, generally, that environmental liabilities will be divided between KeySpan Parties and LIPA Parties on the basis of whether they relate to Transferred Assets or LIPA Assets. In addition, to clarify and supplement these agreements, KeySpan Parties and LIPA Parties have also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the LIPA/LILCO Merger and relating to the business and operations to be conducted by LIPA Parties after the LIPA/LILCO Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan Parties after the LIPA/LILCO Merger (the "Transferred Business").

The Authority and LIPA are subject to a number of federal, State and local environmental laws and regulations governing the installation, operation and maintenance of electric transmission and distribution systems.

Environmental Liabilities

The Liabilities Undertaking and Indemnification Agreements allocate certain liabilities (including environmental liabilities) arising from events occurring prior to the LIPA/LILCO Merger and relating to the Retained Business and to the Transferred Business.

KeySpan Parties are responsible for all environmental liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those formerly operated by LILCO or any of its predecessors, whether or not such MGP Sites relate to the Transferred Business or the Retained Business; all environmental liabilities traceable to the Transferred Business; and certain scheduled environmental liabilities. Certain environmental liabilities that are traceable to GENCO, including liabilities arising from asbestos litigation, may be recovered from LIPA by KeySpan Parties as part of the capacity charge under the PSA. The Authority has established reserves for environmental liabilities, which it believes, based on information currently available to it, are adequate.
LIPA Parties are responsible for all environmental liabilities traceable to the Retained Business (including environmental liabilities discovered in the future which arise from events or circumstances occurring prior to the LIPA/LILCO Merger) and certain scheduled environmental liabilities. Notwithstanding the parties' contractual allocation of environmental liabilities, under certain circumstances LIPA could be liable for environmental costs related to Transferred Assets as the prior owner if a KeySpan Party fails to satisfy such liability.

Environmental Liabilities that existed as of the LIPA/LILCO Merger that are untraceable, including untraceable liabilities that arise out of common plant and/or shared services (whether known or unknown), are allocated 53.6% to LIPA Parties and 46.4% to KeySpan Parties (of which 25.4% is allocable to GENCO). Such liabilities that arise from events or circumstances occurring after the LIPA/LILCO Merger may be recovered by KeySpan Parties to the extent provided for under the PSA and MSA.

For purposes of allocations, an environmental liability is traceable if it can be determined to have resulted from the activities of the Retained Business or the Transferred Business, or a percentage of each, based on available documentation, reasonable inferences, and other reasonable evidence.

For a description of specific actual and potential environmental liabilities of the LIPA Parties and the KeySpan Parties, see "Legal Proceedings" in Note 12 to the Authority's Basic Financial Statements for the years ended December 31, 2005 and 2004, attached hereto as Appendix A.

REGULATION

The operations of the Authority and LIPA are subject to regulation by various State and federal agencies, discussions of which appear in other parts of this Official Statement. The principal agencies having a regulatory impact on the Authority and LIPA and the conduct of their activities are as follows:

New York State

PACB. The Authority is required by the Act to obtain certain approvals of the PACB. The PACB consists of five members appointed by the Governor of the State. One of the members is appointed upon the recommendation of the Majority Leader of the State Senate, one upon the recommendation of the Speaker of the State Assembly, one upon the recommendation of the Minority Leader of the State Senate and one upon the recommendation of the Minority Leader of the State Assembly. The two members of the PACB appointed by the Governor upon the recommendations of the Minority Leaders of the Senate and the Assembly do not vote. The unanimous vote of the voting members of the PACB is required to authorize action by the PACB.

Pursuant to the Act, the Authority may not undertake any "project" without PACB approval. A "project" of the Authority is defined by the Act to mean an action undertaken by the Authority that: (i) causes the Authority to issue bonds, notes or other obligations, or shares in any subsidiary corporation; (ii) significantly modifies the use of an asset valued at more than one million dollars owned by the Authority or involves the sale, lease or other disposition of such an asset; or (iii) commits the Authority to a contract or agreement with a total consideration of greater than one million dollars and does not involve the day-to-day operations of the Authority. The Act provides that the PACB shall only approve a proposed project of the Authority upon the PACB's determination that: (i) the project is financially feasible; (ii) the project does not materially adversely affect overall real property taxes in the Service Area; (iii) the project is anticipated to result generally in lower utility rates; and (iv) the project will not materially adversely affect overall real property taxes or utility rates in other areas of the State.

On July 16, 1997, the PACB adopted a resolution, which approved the execution and delivery of all agreements required for the consummation of the LIPA/LILCO Merger. The PACB made its approval
subject to certain conditions (the "PACB Conditions"), which were accepted by the Authority by a
resolution of the Trustees adopted unanimously on August 21, 1997. Two of those conditions relate to
the establishment of rates, and are described herein under the caption "Rates and Charges – Authority to
Set Electric Rates." Included among the PACB Conditions is a prohibition against LIPA purchasing the
GENCO Generating Facilities at a price greater than book value.

New York State Comptroller. Pursuant to the Act, the Authority must obtain the written approval
of the Comptroller of any private sale of bonds or notes of the Authority and the terms of such sale. By
letter dated July 22, 1999, the Comptroller set forth his determination that pursuant to Section 1020-cc of
the Act (which subjects all Authority contracts to "the provisions of the State Finance Law relating to
contracts made by the State") certain Authority contracts that exceed $15,000 in amount must be
approved by the Comptroller before such contracts become effective. The Authority is submitting
Authority contracts, which are subject to such approval to the Comptroller.

Public Service Commission. The PSC is the principal agency in the State regulating the
generation, transmission, distribution and sale of electric power and energy. It has no statutory
jurisdiction over rates for power generated, transmitted, distributed or sold by the Authority or LIPA but
does regulate the rates of the State's investor-owned utilities and certain municipal systems to which the
Authority or LIPA sells power. The PSC is empowered by the New York Public Service Law to issue
Certificates of Environmental Compatibility and Public Need prior to the construction of power
transmission lines of certain capacities and lengths, including those of LIPA. Under the Act, the
Authority is empowered to set rates for electric service in its Service Area without obtaining the approval
of the PSC or any other State regulatory body. See, however, "Rates and Charges – Authority to Set
Electric Rates" in this Part 2.

State Board on Electric Generation Siting and the Environment. The State Board on Electric
Generation Siting and the Environment (the "State Siting Board") was empowered to issue certificates for
the construction of major electric generating facilities in the State but its authority to do so expired
December 31, 2002, except with respect to applications received prior to that date. Legislation has been
introduced extending the authority of the State Siting Board and expanding its jurisdiction to smaller
facilities. The Authority cannot predict whether such legislation will be enacted or whether, if enacted, it
will affect the scope of authority of the State Siting Board.

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

Federal

Nuclear Regulatory Commission. The NRC regulates the construction and operation of nuclear
power plants. An operating license is required for the operation of any nuclear power plant. In addition,
the NRC prescribes various operating standards and other rules.

Federal Energy Regulatory Commission. FERC regulates the rates, terms and conditions of
(i) the sale for resale of electric power by "public utilities"; and (ii) the provision of transmission service
in interstate commerce by public utilities. Neither the Authority nor LIPA is a "public utility" under the
FPA and therefore, FERC does not exercise direct jurisdiction over rates for service over LIPA's facilities
under either FPA Sections 205 or 206. Although the rates, terms and conditions under which the
Authority provides transmission service are not currently subject to general FERC jurisdiction, FERC
may order the Authority to provide transmission service to individual customers meeting the requirements of Sections 211 and 212 of the FPA on rates, terms and conditions comparable to those of the Authority for the Authority's own use of its system. Further, FERC may, in the future, apply the provisions of FPA Section 211A to LIPA, in which case LIPA would become subject to FERC jurisdiction with respect to the provision of wholesale transmission service at rates that are comparable to the rates it charges itself, on terms and conditions that are comparable and not unduly discriminatory or preferential. FERC has not asserted jurisdiction over unregulated transmitting utilities under FPA, Section 211A at this time.

**Environmental Protection Agency.** The EPA is the principal agency of the federal government regulating air, water and land quality. However, with respect to nuclear facilities, the NRC reviews environmental impacts as part of its permit and licensing proceedings. The Authority and LIPA are subject to EPA rules requiring the securing of routine discharge permits for non-radiological emissions and effluents from all Authority and LIPA facilities.

**Department of Energy.** The Economic Regulatory Administration of DOE is authorized to issue Presidential permits for international transmission interconnections.

**United States Army Corps of Engineers.** The United States Army Corps of Engineers is authorized to approve construction undertaken in connection with a power plant or transmission line, which affects navigation, involves dredging or filling in navigable waters, or involves crossing of navigable streams.

**Other Jurisdictions**

The regulatory procedures of neighboring states such as Connecticut and New Jersey impact the ability of LIPA to obtain additional power supplies through the construction of new cables which extend into such jurisdictions.

**LITIGATION**

**The Offered Securities**

There is no litigation pending or threatened in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Offered Securities or questioning the creation, organization or existence of the Authority, the title to office of the Trustees or officers of the Authority, the validity or enforceability of the Resolution, Financing Agreement, the pledge of the Trust Estate, the proceedings for the authorization, execution, authentication and delivery of the Offered Securities or the validity of the Offered Securities.

**Rate Litigation**

Lawsuits have been commenced as class actions challenging the steps LIPA has taken to increase its rates to reflect increases in its fuel costs. Among other allegations, the Plaintiffs contend that such increases violate certain conditions imposed on LIPA by the New York State Public Authorities Control Board in 1997. The lawsuits also repeat several criticisms directed at LIPA in a report issued by the New York State Comptroller in December 2005 which, among other things, took issue with the methodology used by LIPA in applying its FPPCA and criticized the increases in rates which have resulted from application of the FPPCA. LIPA believes that its rate structure, including the FPPCA, complies with applicable legal requirements and that the methodology it uses to calculate the FPPCA is correct. Plaintiffs seek injunctive relief and an unspecified amount of damages on behalf of themselves and other class members. LIPA will vigorously contest these cases and expects to prevail. If the Authority does
not prevail in this litigation, it may influence the timing and size of rate increases implemented by the Authority and/or require (i) the modification of the plan to accelerate the retirement of debt, (ii) the withdrawal of funds from the Rate Stabilization Fund to avoid or minimize rate increases or (iii) other action necessary to meet any required conditions. The lawsuits have been consolidated into one action. On May 17, 2006, LIPA filed a motion to dismiss the consolidated lawsuit. Plaintiffs' brief in opposition to the motion to dismiss was filed on June 16, 2006 and LIPA's reply brief was filed on June 30, 2006. Oral argument on the motion took place on July 10, 2006 and the court reserved decision on the motion.

Other Litigation

LIPA is involved in numerous actions arising from the ordinary conduct of its business both prior to and subsequent to the LIPA/LILCO Merger including environmental claims brought by governments and individual plaintiffs alleging that LIPA is responsible for all or a portion of the clean-up costs or personal injuries or damages as a result of the alleged use, release or deposit of hazardous substances including asbestos. While LIPA cannot presently predict the costs of such pending claims, or additional similar claims which may arise in the future, LIPA believes that such litigation, in the aggregate, will not have a material adverse effect on the business or the affairs of the Authority or LIPA. See "Legal Proceedings" in note 12 to the Authority's Basic Financial Statements for the years ended December 31, 2005 and 2004, attached hereto as Appendix A and "Environmental Matters – Environmental Liabilities" in this Part 2 for a description of certain litigation in which LIPA is involved.

AGREEMENT OF NEW YORK STATE

In the Act, the State pledges to and agrees with the holders of any obligations issued under the Act and the parties to any contracts with the Authority that the State will not limit or alter the rights vested in the Authority until such obligations together with the interest thereon are fully met and discharged and/or such contracts are fully performed on the part of the Authority, provided that nothing therein contained shall preclude such limitation or alteration if and when adequate provision shall be made by law for the protection of the holders of such obligations of the Authority, or those entering into such contracts with the Authority. The Authority, as agent for the State, is authorized to include such pledge and agreement by the State in all agreements with the holders of such obligations and in all such contracts. The Authority has included such pledge in the Resolution.

CONTINUING DISCLOSURE UNDERTAKINGS FOR THE OFFERED SECURITIES

Pursuant to the Continuing Disclosure Certificate dated as of the date of the closing of the sale of the Offered Securities (the "Continuing Disclosure Certificate"), a form of which is attached hereto as Appendix G, the Authority will provide for the benefit of the holders of the Offered Securities certain financial information and operating data relating to the Authority by the dates specified in the Continuing Disclosure Undertaking (the "Annual Report"), and provide notices of the occurrence of certain enumerated events with respect to the Offered Securities, if material. The Annual Report will be filed by or on behalf of the Authority with each Nationally Recognized Municipal Securities Information Repository and with the State Information Depository, if any, established by the State. The notices of such material events would be filed by or on behalf of the Authority with each Nationally Recognized Municipal Securities Information Repository or with the Municipal Securities Rulemaking Board, with such State Information Depository, if any, and with the Trustee. The specific nature of the information to be contained in the Annual Report and the notices of material events is set forth in the Form of the Continuing Disclosure Certificate which is included in its entirety in Appendix G hereto. The Authority's undertakings in the Continuing Disclosure Certificate are being made in order to assist the Underwriters in complying with Securities and Exchange Commission Rule 15c2-12.
ADDITIONAL INFORMATION

Certain of the corporations mentioned in this Official Statement, including KeySpan and certain of the KeySpan Subs and Constellation Energy Group, the parent of Constellation Nuclear L.L.C., the operator of NMP2, are subject to the information and reporting requirements of the Securities Exchange Act of 1934, as amended, and are required to file reports and other information with the Securities and Exchange Commission (the "Commission"). Such reports and other information are available for inspection at the public reference facilities of the Commission located in Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of this material may also be obtained by mail, upon payment of the Commission's prescribed fees, by writing to the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such material may also be obtained from the website that the Commission maintains at http://www.sec.gov. Reports and other information concerning these corporations should also be available for inspection at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005. None of the above-mentioned additional information regarding any of these corporations is part of this Official Statement, and neither the Authority nor the Underwriters take any responsibility for the accuracy or completeness thereof.

LEGALITY FOR INVESTMENT

The Act provides that the Offered Securities will be legal investments for public officers and bodies of the State and all municipalities, insurance companies and associations and other persons carrying on an insurance business, banks, bankers, trust companies, savings banks and savings associations, including savings and loan associations, building and loan associations, investment companies, and other persons carrying on a banking business, all trusts, estates and guardianships, and all other persons whatsoever who are now or may hereafter be authorized to invest in bonds or other obligations of the State, or may properly and legally invest funds, including capital in their control or belonging to them. Under the Act, the Offered Securities are also securities which may be deposited with and may be received by all public officers and bodies of the State and all municipalities for any purpose for which the deposit of bonds or other obligations of the State is now or may hereafter be authorized.
Appendix A

Basic Financial Statements of the Authority
LONG ISLAND POWER AUTHORITY
(A Component Unit of The State of New York)

Basic Financial Statements

December 31, 2005 and 2004

(With Independent Auditors’ Report Thereon)
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</tbody>
</table>

## Section 2

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<th>Description</th>
<th>Page</th>
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<td>Accordance with <em>Government Auditing Standards</em></td>
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Independent Auditors’ Report

The Board of Trustees
Long Island Power Authority:

We have audited the balance sheets, statements of revenues, expenses, and changes in net assets, and statements of cash flows of the Long Island Power Authority (Authority), a component unit of the State of New York, as of and for the years then ended December 31, 2005 and 2004, which collectively comprise the Authority’s basic financial statements. These financial statements are the responsibility of the Authority’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued a report dated March 23, 2006 on our consideration of the Authority’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope and of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.
The accompanying management’s discussion and analysis on pages 3 through 12 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 23, 2006
Overview of the Financial Statements

This report consists of three parts: management’s discussion and analysis, the basic financial statements, and the notes to the financial statements.

The financial statements provide summary information about the Authority’s overall financial condition. The notes provide explanation and more details about the contents of the financial statements.

The Authority is considered a special-purpose government engaged in business-type activities and follows financial reporting for enterprise funds. The Authority’s financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Authority has elected to comply with all authoritative pronouncements applicable to nongovernmental entities (i.e. pronouncements of the Financial Accounting Standards Board) that do not conflict with GASB pronouncements.
The following is a summary of the Authority’s financial information for 2005, 2004, and 2003 (thousands of dollars):

### Balance Sheet Summary

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td><strong>Assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
</tr>
<tr>
<td>Cash, cash equivalents and investments</td>
<td>$470,880</td>
</tr>
<tr>
<td>Other current assets</td>
<td>$501,018</td>
</tr>
<tr>
<td>Noncurrent assets:</td>
<td></td>
</tr>
<tr>
<td>Utility plant, net</td>
<td>4,004,646</td>
</tr>
<tr>
<td>Promissory notes receivable</td>
<td>155,425</td>
</tr>
<tr>
<td>Nonutility property and other investments</td>
<td>464,334</td>
</tr>
<tr>
<td>Deferred charges</td>
<td>173,828</td>
</tr>
<tr>
<td>Regulatory assets</td>
<td>859,513</td>
</tr>
<tr>
<td>Acquisition adjustment, net</td>
<td>3,079,939</td>
</tr>
<tr>
<td><strong>Total assets:</strong></td>
<td>$9,709,583</td>
</tr>
<tr>
<td><strong>Liabilities and net assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$1,100,126</td>
</tr>
<tr>
<td>Noncurrent liabilities:</td>
<td></td>
</tr>
<tr>
<td>Long-term debt</td>
<td>6,686,136</td>
</tr>
<tr>
<td>Capital lease obligation</td>
<td>1,097,055</td>
</tr>
<tr>
<td>Other noncurrent liabilities</td>
<td>774,646</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>9,657,963</td>
</tr>
<tr>
<td>Net assets (deficit):</td>
<td></td>
</tr>
<tr>
<td>Capital assets net of related debt</td>
<td>(475,991)</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>527,611</td>
</tr>
<tr>
<td><strong>Total net assets (deficit)</strong></td>
<td>51,620</td>
</tr>
<tr>
<td><strong>Total liabilities and net assets</strong></td>
<td>$9,709,583</td>
</tr>
</tbody>
</table>
LONG ISLAND POWER AUTHORITY  
(A Component Unit of The State of New York)  
Management’s Discussion and Analysis  
Years ended December 31, 2005 and 2004

Summary of Revenues, Expenses, and Changes in Net Assets

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td>Electric revenue</td>
<td>$3,281,186</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
</tr>
<tr>
<td>Operations – fuel and purchased power</td>
<td>1,758,533</td>
</tr>
<tr>
<td>Operations and maintenance</td>
<td>723,774</td>
</tr>
<tr>
<td>General and administrative</td>
<td>43,567</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>237,863</td>
</tr>
<tr>
<td>Payments in lieu of taxes</td>
<td>222,609</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>2,986,346</td>
</tr>
<tr>
<td>Operating income</td>
<td>294,840</td>
</tr>
<tr>
<td>Other income, net</td>
<td>57,518</td>
</tr>
<tr>
<td>Interest charges</td>
<td>(332,358)</td>
</tr>
<tr>
<td>Change in net assets</td>
<td>20,000</td>
</tr>
<tr>
<td>Change in net assets before cumulative effect of change in accounting principle</td>
<td>20,000</td>
</tr>
<tr>
<td>Cumulative effect of change in accounting principle</td>
<td>—</td>
</tr>
<tr>
<td>Change in net assets</td>
<td>20,000</td>
</tr>
<tr>
<td>Net assets (deficit) – beginning of year</td>
<td>31,620</td>
</tr>
<tr>
<td>Net assets – end of year</td>
<td>$51,620</td>
</tr>
</tbody>
</table>

Excess of Revenues over Expenses

The revenues in excess of expenses for the twelve months ended December 31, 2005, 2004, and 2003 were $20 million.

Revenue

Revenue for the twelve months ended December 31, 2005, increased approximately $427 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately $378 million, the positive effects of weather, load growth and sales mix totaling approximately $49 million, and higher other miscellaneous revenue of approximately $5 million primarily due to service fees initiated during 2005. These increases were partially offset by the impact of having one less day of sales in 2005 as 2004 was a leap year, estimated to be approximately $5 million.
LONG ISLAND POWER AUTHORITY  
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Years ended December 31, 2005 and 2004

Revenue for the year ended December 31, 2004, increased approximately $270 million when compared to the similar period in 2003. The increase is attributable to higher recoveries of excess fuel costs totaling approximately $239 million, the positive effects of weather, load growth and sales mix totaling approximately $25 million and the impact of the August 2003 blackout which caused a revenue loss in 2003 estimated at $7 million. These positive impacts were partially offset by lower nonsystem revenue of approximately $1 million.

Fuel and Purchased Power Costs

LIPA’s tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment (“FPPCA”). The FPPCA was modified by the Board in 2003 to allow LIPA to recover in the period incurred fuel and purchased power costs beyond those included in base rates (“Excess Fuel Costs”). As a result of this modification, the FPPCA is designed to recover a sufficient amount of Excess Fuel Costs to allow the Authority to earn $20 million of excess revenue over expenses each year as a reserve. If fuel prices change such that LIPA would exceed or fail to meet that financial target, the FPPCA will be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA in 2004 by an annual rate of 4.5% of base revenues in February, and by an additional annual rate of 5.0% and 1.0% in June and October, respectively. In 2005, the Authority increased the FPPCA by 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8, as a result of the increasing fuel and purchased power costs. In December 2005, the Authority proposed to its Board a modified FPPCA to allow the Authority to earn $75 million of excess revenue over expenses each year with a variance of $50 million above or below such amount in each year. The proposed modification to the 2006 FPPCA was subject to a public hearing held in March 2006 and must be approved by the Board following such hearing prior to becoming effective. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% effective January 1, 2006.

Fuel and purchased power costs for the twelve months ended December 31, 2005, increased approximately $371 million as compared to the same period in 2004. This increase is primarily attributable to increased commodity costs totaling $330 million and higher sales volumes totaling approximately $24 million. Also the Authority partially offset fuel and purchased power costs by applying customer credits totaling $20 million whereas in the similar period of 2004, customer credits totaled $36 million.

Fuel and purchased power costs for the twelve months ended December 31, 2004 increased approximately $310 million as compared to the same period in 2003. However, due to the accounting mechanism of the FPPCA, prior year recoveries and deferrals comprise approximately $216 million of this variation. After eliminating these mechanisms, the increase is attributable to commodity costs totaling approximately $88 million and higher sales volumes totaling approximately $6 million.

Operations and Maintenance Expense (O&M)

O&M increased approximately $32 million for the twelve month period ended December 31, 2005, compared to the similar period in 2004 due to higher PSA costs totaling approximately $21 million (due primarily to agreed upon increased capacity charges totaling $14 million and the 2004 Utility Plant true-up totaling approximately $4 million), higher storm reserve accruals totaling approximately $7 million, higher MSA costs totaling approximately $7 million, higher bad debt expense of approximately $5 million, higher clean energy expenses totaling approximately $4 million, and various other items totaling approximately $2 million.

(Continued)
LONG ISLAND POWER AUTHORITY
(A Component Unit of The State of New York)

Management’s Discussion and Analysis

Years ended December 31, 2005 and 2004

These increases were partially offset by the absence in 2005 of any costs associated with renting temporary emergency stand-by generators whereas in 2004 LIPA incurred approximately $14 million.

O&M decreased approximately $42 million for the year ended December 31, 2004, compared to the similar period in 2003 primarily due to lower MSA costs totaling approximately $19 million, lower clean energy expenses totaling approximately $9 million, one-time recognition in 2003, of LIPA’s $5 million contribution to the Shoreham bill credits as required by the Shoreham Property Tax Settlement Agreement (LIPA had no such funding in 2004), lower storm cost reserve accruals totaling approximately $12 million and lower costs associated with renting temporary emergency stand-by generators totaling approximately $1 million. Partially offsetting these decreases was increased customer accounts expenses of approximately $2 million, and $2 million related to the settlement of the Cross Sound Cable dispute.

General and Administrative Expenses (G&A)

General and administrative expenses increased for the year ended December 31, 2005 approximately $3 million due to the costs associated with the strategic assessment to evaluate LIPA’s long-term organizational and business options, other various consulting costs and increased salary and benefit expenses.

General and administrative expenses decreased for the year ended December 31, 2004, approximately $4 million due primarily to decreased consulting costs related to forensic auditing services of approximately $3 million. The remaining decrease is due to lower insurance costs totaling approximately $1 million.

Depreciation and Amortization

For the year ended December 31, 2005, depreciation and amortization increased approximately $9 million due to higher utility plant balances in 2005 when compared to 2004.

For the year ended December 31, 2004, depreciation and amortization decreased approximately $1 million. During 2003, an adjustment totaling approximately $6 million was recognized in conjunction with the adoption of the accounting for asset retirement obligations. Partially offsetting that decrease of $6 million is higher utility plant balances in 2004 when compared to 2003 resulting in approximately $5 million higher depreciation expense.

Payments in Lieu of Taxes

For the year ended December 31, 2005, payments in lieu of taxes (PILOTs) increased approximately $7 million due to increased property and school taxes.

For the year ended December 31, 2004, PILOTs increased approximately $2 million due to increased property taxes totaling approximately $6 million. This increase was partially offset by decreased revenue taxes (due to lower tax rates) totaling approximately $4 million.
Other Income, Net

For the year ended December 31, 2005, other income increased approximately $10 million due to higher earnings on investment balances which includes amounts held as collateral from various counterparties, totaling approximately $9 million and higher sales of emissions credits totaling approximately $6 million. These increases were partially offset by lower interest income related to New York Independent System Operator (NYISO) prior month’s re-bills totaling approximately $5 million.

For the year ended December 31, 2004, other income decreased approximately $7 million. This decrease was the result of lower investment income of approximately $2 million due to lower investment balances, and lower emissions credit income totaling approximately $9 million. These decreases were partially offset by interest received on New York Independent System Operator (NYISO) prior months’ re-bills totaling approximately $3 million and higher carrying charges of approximately $1 million on the Shoreham property tax settlement regulatory asset.

Interest Charges and Credits

For the year ended December 31, 2005, interest charges and credits increased approximately $16 million due to increased interest expense on long term debt due primarily to higher interest rates on variable rate debt combined with slightly higher average debt balances outstanding in 2005 when compared to 2004. Additionally during 2005, the Authority incurred interest expense on amounts held as collateral from various counterparties which is offset with increased “other income” earned on amounts held as collateral.

For the year ended December 31, 2004, interest charges and credits decreased approximately $2 million resulting from lower carrying charge expenses on deferred credits and lower deferred loss amortizations totaling approximately $7 million. This decrease was partially offset by higher interest on long term debt totaling approximately $3 million, due to higher average debt outstanding, and further offset by lower credits from allowance for borrowed funds used during construction (AFC) of approximately $2 million, due to lower construction work in progress balances in 2004 compared to 2003.

Cash, Cash Equivalents, and Investments

The Authority’s cash, cash equivalents, and investments totaled approximately $471 million, $413 million, and $418 million at December 31, 2005, 2004, and 2003, respectively. The increase from 2004 to 2005 is primarily the result of counterparty collateral held by LIPA. The decrease from 2003 to 2004 is primarily the result of higher fuel and purchased power costs. The Authority has maintained a $250 million balance in its Rate Stabilization Fund. The Authority also has the ability to issue up to $200 million of commercial paper notes, $100 million of which is outstanding as of December 31, 2005 and 2004.
Capital Assets

During 2005 two new natural gas fired generating facilities were constructed on Long Island by separate entities, with a combined capacity of 160 MW. Each of these facilities began supplying capacity and energy to LIPA in accordance with the terms of the Power Purchase Agreements (PPA’s) negotiated in 2004. Under the terms of these agreements, LIPA receives 100% of the output from the newly constructed generating unit for a term of 20 years. These PPAs qualify for capitalization under FASB Emerging Issues Task Force Issue No. 01-08 Determining Whether an Arrangement is a Lease and SFAS No. 13, Accounting for Leases, and have been included in both Utility Plant and Capital Lease Obligations.

During 2004 two generating facilities were constructed on Long Island by two separate entities with a combined capacity of approximately 96MW. Each of these facilities began supplying capacity and energy to LIPA in accordance with the terms of the PPA’s negotiated in 2003. Under the terms of one of those agreements, LIPA receives 100% of the output from the facility for a term of 13 years. The agreement contains two optional renewal periods of five years each. This PPA qualifies for capitalization under FASB Emerging Issues Task Force Issue No. 01-08 Determining Whether an Arrangement is a Lease and SFAS No. 13, Accounting for Leases, and has been included in both Utility Plant and Capital Lease Obligations. The other PPA provides LIPA with 10MW of the capacity and energy for a period of 30 years. This PPA did not qualify for capitalization and is being reported as an executory contract.

Costs incurred under the PPAs are includible in fuel and purchased power costs in the period incurred, in accordance with the FPPCA provisions of the Authority Tariff for Electric Service.

For additional information on power purchase agreements, see footnote 11 of notes to basic financial statements.

The Authority also continued its program of strategic investment in transmission and distribution (T&D) upgrades to improve reliability and to enhance capacity needed to meet growing customer demands. For the years ended December 31, 2005 and 2004, T&D capital improvements totaled $215 million and $204 million, respectively. These improvements included the replacement or upgrade of transformer banks and circuit breakers, new substations, enhanced transmission lines and upgraded command and control equipment.

Regulatory Assets

Regulatory assets decreased approximately $41 million from December 31, 2004 to December 31, 2005. The decrease is the result of (i) the scheduled recovery of approximately $37 million, representing a portion of the 2003 deferred Excess Fuel Costs scheduled to be recovered over a ten-year period which began January 1, 2004, in accordance with LIPA’s tariff (ii) the scheduled recovery of approximately $36 million related to the Shoreham Property Tax Settlement Agreement through a surcharge on billings for electric service to customers residing in Suffolk County (the Shoreham surcharge), which began in June 2003 (as discussed in greater detail in note 3 of notes to basic financial statements); (iii) partially offset by the additional carrying charges on the Shoreham Property Tax Settlement Agreement related credits totaling approximately $32 million.
Regulatory assets decreased approximately $57 million from December 31, 2003 to December 31, 2004. The decrease is the result of (i) the scheduled recovery of a portion of the 2003 deferred Excess Fuel Costs totaling approximately $36 million, (ii) the decrease in the deferred unrealized losses on LIPA’s fuel hedges totaling approximately $17 million and (iii) the scheduled recovery of approximately $35 million related to the Shoreham Property Tax Settlement; partially offset by the additional carrying charges on the Shoreham Property Tax Settlement Agreement related credits totaling approximately $31 million.

Debt

The Authority’s long-term debt, including current maturities is comprised of the following instruments:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General Revenue Bonds</td>
<td>5,826,115</td>
<td>5,966,549</td>
<td>5,900,544</td>
</tr>
<tr>
<td>Subordinated Revenue Bonds</td>
<td>935,045</td>
<td>962,345</td>
<td>989,645</td>
</tr>
<tr>
<td>Commercial Paper Notes</td>
<td>100,000</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>NYSERDA Notes</td>
<td>155,420</td>
<td>155,420</td>
<td>155,420</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,016,580</strong></td>
<td><strong>7,184,314</strong></td>
<td><strong>7,145,609</strong></td>
</tr>
</tbody>
</table>

During 2005, debt decreased as a result of the scheduled maturities of approximately $194 million, partially offset by the accretion of the capital appreciation bonds totaling $26 million.

During 2004, the Authority issued $200 million Electric System General Revenue Bonds, Series 2004A. The issuance consisted of $33.9 million of Serial bonds and $166.1 million of Term bonds. The Serial bonds have maturities that begin in 2013 and continue each year through 2025. Interest rates on the Serial bonds range from 3.8% to 4.875%. The Term bonds have maturities of $64.9 million in 2029, $12.4 million in 2032, and $88.8 million in 2034. Interest rates on the Term bonds are 5.0% and 5.1%. The purpose of these bonds was to reimburse LIPA’s treasury for capital projects funded previously with cash from operations, and to provide funding for future capital spending.

In addition, debt decreased as a result of the scheduled maturities of approximately $186 million, partially offset by the accretion of the capital appreciation bonds totaling $25 million.
LONG ISLAND POWER AUTHORITY
(A Component Unit of The State of New York)
Management’s Discussion and Analysis
Years ended December 31, 2005 and 2004

Investment Ratings

Below are the Authority’s securities as rated by Standard and Poors Corporation (S&P), Moody’s Investors Service (Moody’s), and Fitch Investors Services, LP (Fitch):

<table>
<thead>
<tr>
<th>Investment ratings</th>
<th>Moody’s</th>
<th>Standard &amp; Poors</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Lien Debt</td>
<td>A3</td>
<td>A-</td>
<td>A-</td>
</tr>
</tbody>
</table>

- Certain Senior and all Subordinated Lien debt and the Commercial Paper notes are supported by either a Letter of Credit (LOC) or are insured. Such debt carries the ratings of the LOC syndicate or insurance company, not that of the Authority.

Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority formed an Executive Risk Management Committee to strengthen executive management oversight for the risk mitigation activities of the Authority. In addition, the Authority retains an external consultant specializing in risk management, energy markets and energy trading to enhance its understanding of these areas.

Whenever the Authority enters into a transaction to mitigate risk, it becomes exposed to an event of nonperformance by the counterparty. To limit its exposure to such risk, the Authority will only enter into derivative transactions with counterparties that have a credit rating of “investment grade” or better. For commodity derivatives the Authority requires collateral for mark to market values above an established credit limit set for each counterparty. At December 31, 2005, the Authority held approximately $232 million of counterparty collateral, included in current liabilities. At December 31, 2004, no such amounts were required to be posted by the Authority’s counterparties.

The goal of the Authority’s risk management program is to reduce the impact that energy price volatility and interest rate fluctuations could have on rates if not mitigated with derivative products.

Fuel and purchased power transactions: – The Authority uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, and electricity. These instruments are recorded at their market value. Any unrealized gains and losses are deferred until realized, in accordance with the modifications to the FPPCA. Upon realization, such gains and losses will be reflected in income and considered in the determination of the FPPCA. At December 31, 2005 and 2004, the Authority had unrealized gains on commodity derivatives of approximately $369 million and $24 million, respectively, based on quoted market prices.
Interest rate transactions: – During 2004, the Authority entered into a basis swap with three counterparties for a notional amount of approximately $1 billion under terms that require LIPA to pay the counterparties the Bond Market Association (BMA) Index in exchange for a fixed percent of LIBOR. This agreement became effective July 1, 2004, and continues through August 15, 2033. Under the terms of the agreement, LIPA received, on June 28, 2004, an up front premium of $35 million which is being amortized as an interest rate modifier over the life of the agreement.

During 2004, the Authority also entered into two fixed-to-floating rate swap agreements, each with a notional amount of approximately $101 million. Under the terms of these identical agreements, LIPA pays a floating rate equal to the BMA index, and receives a fixed rate of interest. The agreements became effective July 1, 2004, and are co-terminus with the underlying securities, the last of which matures September 1, 2016. These agreements are cancelable by the counterparties on July 1, 2007.

In accordance with SFAS No. 133, Accounting for Derivatives and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, and SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, the Authority marks its financial derivatives to market and records unrealized gains and losses. At December 31, 2005 and 2004, the Authority had an unrealized market value loss of approximately $218 million. The Authority received approximately $125 million of upfront premiums related to those transactions which are being amortized as interest rate modifiers. The gains and losses resulting from these market values have been deferred, and will be recognized when realized.

Other Power Supply

The Authority has entered into numerous agreements for capacity and energy necessary to continue to satisfy the increasing energy demand of Long Island, while increasing the diversity of its fuel mix alternatives. During 2005, the Authority began to receive 100% of the output from two newly constructed facilities with total combined capacity of approximately 160MW, which became commercially operational just prior to the summer of 2005. In addition, the construction and installation of a submarine cable to connect Long Island to the power supplies of the PJM Interconnection has progressed on schedule to be commercially operational by the summer of 2007, and the vendor with whom LIPA has engaged to construct and operate a 350MW (LIPA’s allocation is approximately 300MW) combined cycle gas fired facility on Long Island, to be commercially operational by the summer of 2009, are in the permitting and engineering phase of the project. LIPA also entered into an agreement for a 140MW off-shore wind farm with a targeted commercial operation date of 2008.

Contacting the Long Island Power Authority

This financial report is designed to provide our bondholders, customers, and other interested parties with a general overview of the Authority’s finances and to demonstrate its accountability for the funds it receives. If you have any questions about this report or need additional information, contact the Authority at 333 Earle Ovington Blvd., Suite 403, Uniondale, New York 11553, or visit our website at www.lipower.org.
## Balance Sheets

December 31, 2005 and 2004  
(Dollars in thousands)

<table>
<thead>
<tr>
<th>Assets</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 454,414</td>
<td>335,068</td>
</tr>
<tr>
<td>Investments</td>
<td>16,466</td>
<td>77,900</td>
</tr>
<tr>
<td>Accounts receivable (net of allowance for doubtful accounts of $19,485 and $19,635, respectively)</td>
<td>343,673</td>
<td>274,184</td>
</tr>
<tr>
<td>Other accounts receivable</td>
<td>23,902</td>
<td>11,344</td>
</tr>
<tr>
<td>Fuel inventory</td>
<td>104,652</td>
<td>66,948</td>
</tr>
<tr>
<td>Material and supplies inventory</td>
<td>7,365</td>
<td>7,128</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>153</td>
<td>300</td>
</tr>
<tr>
<td>Prepayments and other current assets</td>
<td>21,273</td>
<td>9,732</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>971,898</td>
<td>782,604</td>
</tr>
<tr>
<td><strong>Noncurrent assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utility plant and property and equipment, net</td>
<td>4,004,646</td>
<td>3,540,103</td>
</tr>
<tr>
<td>Promissory notes receivable – KeySpan Energy</td>
<td>155,425</td>
<td>155,425</td>
</tr>
<tr>
<td>Nonutility property and other investments</td>
<td>464,334</td>
<td>120,213</td>
</tr>
<tr>
<td>Deferred loss related to nonfuel derivatives</td>
<td>88,778</td>
<td>86,177</td>
</tr>
<tr>
<td>Deferred charges</td>
<td>85,050</td>
<td>93,972</td>
</tr>
<tr>
<td><strong>Regulatory assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shoreham property tax settlement</td>
<td>568,316</td>
<td>572,101</td>
</tr>
<tr>
<td>Fuel and purchased power costs recoverable</td>
<td>291,197</td>
<td>327,931</td>
</tr>
<tr>
<td><strong>Total regulatory assets</strong></td>
<td>859,513</td>
<td>900,032</td>
</tr>
<tr>
<td><strong>Acquisition adjustment (net of accumulated amortization of $1,015,572 and $902,891, respectively)</strong></td>
<td>3,079,939</td>
<td>3,192,620</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$ 9,709,583</td>
<td>8,871,146</td>
</tr>
</tbody>
</table>

See accompanying notes to basic financial statements.
## Liabilities and Net Assets

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term debt</td>
<td>$100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Current maturities of long-term debt</td>
<td>202,325</td>
<td>193,630</td>
</tr>
<tr>
<td>Current portion of capital lease obligation</td>
<td>121,813</td>
<td>89,552</td>
</tr>
<tr>
<td>Accounts payable and accrued expenses</td>
<td>332,008</td>
<td>275,054</td>
</tr>
<tr>
<td>Accrued payments in lieu of taxes</td>
<td>43,552</td>
<td>38,082</td>
</tr>
<tr>
<td>Accrued interest</td>
<td>44,780</td>
<td>44,465</td>
</tr>
<tr>
<td>Counterparty collateral</td>
<td>232,424</td>
<td>—</td>
</tr>
<tr>
<td>Customer deposits</td>
<td>23,224</td>
<td>24,721</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>1,100,126</td>
<td>765,504</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Noncurrent liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term debt</td>
<td>6,686,136</td>
<td>6,865,277</td>
</tr>
<tr>
<td>Capital lease obligation</td>
<td>1,097,055</td>
<td>772,800</td>
</tr>
<tr>
<td>Asset retirement obligation</td>
<td>81,463</td>
<td>68,320</td>
</tr>
<tr>
<td>Deferred credits</td>
<td>68,601</td>
<td>85,323</td>
</tr>
<tr>
<td>Deferred credits – financial derivatives</td>
<td>222,996</td>
<td>228,126</td>
</tr>
<tr>
<td>Deferred gain – financial derivatives</td>
<td>6,339</td>
<td>10,410</td>
</tr>
<tr>
<td>Regulatory liability – fuel derivatives</td>
<td>368,666</td>
<td>23,675</td>
</tr>
<tr>
<td>Claims and damages</td>
<td>26,581</td>
<td>20,091</td>
</tr>
<tr>
<td><strong>Total noncurrent liabilities</strong></td>
<td>8,557,837</td>
<td>8,074,022</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Commitments and contingencies (note 11)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total noncurrent liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net assets (deficit):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invested in capital assets net of related debt</td>
<td>(475,991)</td>
<td>(634,292)</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>527,611</td>
<td>665,912</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td>51,620</td>
<td>31,620</td>
</tr>
<tr>
<td><strong>Total liabilities and net assets</strong></td>
<td>$9,709,583</td>
<td>8,871,146</td>
</tr>
</tbody>
</table>
LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Statements of Revenues, Expenses, and Changes in Net Assets
Years ended December 31, 2005 and 2004
(Dollars in thousands)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenues – electric sales</td>
<td>$3,281,186</td>
<td>2,853,837</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations – fuel and purchased power</td>
<td>1,758,533</td>
<td>1,386,907</td>
</tr>
<tr>
<td>Operations and maintenance</td>
<td>723,774</td>
<td>691,937</td>
</tr>
<tr>
<td>General and administrative</td>
<td>43,567</td>
<td>40,962</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>237,863</td>
<td>229,316</td>
</tr>
<tr>
<td>Payments in lieu of taxes</td>
<td>222,609</td>
<td>215,312</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>2,986,346</td>
<td>2,564,434</td>
</tr>
<tr>
<td>Operating income</td>
<td>294,840</td>
<td>289,403</td>
</tr>
<tr>
<td>Nonoperating revenues and expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other income, net:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investing income</td>
<td>17,886</td>
<td>7,362</td>
</tr>
<tr>
<td>Carrying charges on regulatory asset</td>
<td>32,345</td>
<td>31,577</td>
</tr>
<tr>
<td>Other</td>
<td>7,287</td>
<td>8,309</td>
</tr>
<tr>
<td>Total other income, net</td>
<td>57,518</td>
<td>47,248</td>
</tr>
<tr>
<td>Interest charges and (credits):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on long-term debt, net</td>
<td>311,391</td>
<td>298,764</td>
</tr>
<tr>
<td>Other interest</td>
<td>23,398</td>
<td>20,110</td>
</tr>
<tr>
<td>Allowance for borrowed funds used during construction</td>
<td>(2,431)</td>
<td>(2,223)</td>
</tr>
<tr>
<td>Total interest charges</td>
<td>332,358</td>
<td>316,651</td>
</tr>
<tr>
<td>Total nonoperating revenues and expenses</td>
<td>(274,840)</td>
<td>(269,403)</td>
</tr>
<tr>
<td>Change in net assets</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Total net assets, beginning of year</td>
<td>31,620</td>
<td>11,620</td>
</tr>
<tr>
<td>Total net assets, end of year</td>
<td>$51,620</td>
<td>31,620</td>
</tr>
</tbody>
</table>

See accompanying notes to basic financial statements.
LONG ISLAND POWER AUTHORITY  
(A Component Unit of the State of New York)  

Statements of Cash Flows  
Years ended December 31, 2005 and 2004  
(Dollars in thousands)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flows from operating activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Received from customers for the system sales, net of refunds</td>
<td>$3,273,787</td>
<td>2,896,658</td>
</tr>
<tr>
<td>Other operating revenues received</td>
<td>26,979</td>
<td>28,750</td>
</tr>
<tr>
<td><strong>Paid to suppliers and employees:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations and maintenance</td>
<td>(745,937)</td>
<td>(781,617)</td>
</tr>
<tr>
<td>Fuel and purchased power</td>
<td>(1,704,529)</td>
<td>(1,398,626)</td>
</tr>
<tr>
<td>Payments in lieu of taxes</td>
<td>(314,511)</td>
<td>(304,004)</td>
</tr>
<tr>
<td>Margin calls on fuel derivative transactions, net</td>
<td>232,424</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net cash provided by operating activities</strong></td>
<td>768,213</td>
<td>441,161</td>
</tr>
<tr>
<td><strong>Investing activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net sales (purchases) of investment securities</td>
<td>61,434</td>
<td>120,992</td>
</tr>
<tr>
<td>Earnings received on investments</td>
<td>17,703</td>
<td>5,773</td>
</tr>
<tr>
<td>Other</td>
<td>2,545</td>
<td>3,371</td>
</tr>
<tr>
<td><strong>Net cash provided by investing activities</strong></td>
<td>81,682</td>
<td>130,136</td>
</tr>
<tr>
<td><strong>Cash flows from capital and related financing activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital and nuclear fuel expenditures</td>
<td>(229,691)</td>
<td>(208,431)</td>
</tr>
<tr>
<td>Swaption proceeds</td>
<td>—</td>
<td>35,000</td>
</tr>
<tr>
<td>Proceeds from the issuance of bonds, net of issuance costs</td>
<td>—</td>
<td>192,806</td>
</tr>
<tr>
<td>Interest paid, net</td>
<td>(307,228)</td>
<td>(288,319)</td>
</tr>
<tr>
<td>Redemption of long-term debt</td>
<td>(193,630)</td>
<td>(186,380)</td>
</tr>
<tr>
<td><strong>Net cash used in capital and related financing activities</strong></td>
<td>(730,549)</td>
<td>(455,324)</td>
</tr>
<tr>
<td><strong>Net increase in cash and cash equivalents</strong></td>
<td>119,346</td>
<td>115,973</td>
</tr>
<tr>
<td>Cash and cash equivalents at beginning of period</td>
<td>335,068</td>
<td>219,095</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at end of period</strong></td>
<td>$454,414</td>
<td>335,068</td>
</tr>
<tr>
<td><strong>Reconciliation to net cash provided by operating activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating income</td>
<td>$294,840</td>
<td>289,403</td>
</tr>
<tr>
<td><strong>Adjustments to reconcile excess of operating income to net cash provided by operating activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>237,863</td>
<td>229,316</td>
</tr>
<tr>
<td>Nuclear fuel burned</td>
<td>5,806</td>
<td>4,951</td>
</tr>
<tr>
<td>Shoreham surcharges (credits), net</td>
<td>36,130</td>
<td>35,136</td>
</tr>
<tr>
<td>Provision for claims and damages</td>
<td>19,824</td>
<td>5,019</td>
</tr>
<tr>
<td>Accretion of asset retirement obligation</td>
<td>6,295</td>
<td>3,868</td>
</tr>
<tr>
<td>Other, net</td>
<td>(13,893)</td>
<td>(41,995)</td>
</tr>
<tr>
<td><strong>Changes in operating assets and liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>(81,897)</td>
<td>(24,818)</td>
</tr>
<tr>
<td>Fuel and material and supplies inventory</td>
<td>(37,941)</td>
<td>(12,295)</td>
</tr>
<tr>
<td>Fuel and purchased power costs recovered related to prior periods</td>
<td>37,034</td>
<td>36,085</td>
</tr>
<tr>
<td>Counterparty collateral</td>
<td>232,424</td>
<td>—</td>
</tr>
<tr>
<td>Accounts payable and accrued expenses</td>
<td>31,728</td>
<td>(83,509)</td>
</tr>
<tr>
<td><strong>Net cash provided by operating activities</strong></td>
<td>$768,213</td>
<td>441,161</td>
</tr>
</tbody>
</table>

See accompanying notes to basic financial statements.
(1) Basis of Presentation

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

The Authority reporting entity is comprised of itself and its operating subsidiary the Long Island Lighting Company, a wholly owned subsidiary of the Authority doing business as LIPA. LIPA has 1 share of $1 par value common stock authorized, issued and outstanding, which is held by the Authority.

As the Authority holds 100% of the common stock of LIPA and substantially controls the operations of LIPA, under Government Accounting Standard Board Statement No. 14, *The Financial Reporting Entity*, LIPA is considered a blended component unit of the Authority and the assets, liabilities and results of operations are consolidated with the operation of the Authority for financial reporting purposes.

The Authority and its blended component unit, LIPA, are referred to collectively, as the “Company” in the financial statements. All significant transactions between the Authority and LIPA have been eliminated.

(2) Nature of Operations

LIPA, as owner of the transmission and distribution system located in the New York State Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways (Service Area), is responsible for supplying electricity to customers within the service area. To assist LIPA in meeting these responsibilities, LIPA contracted with KeySpan Energy Corporation (KeySpan) or its affiliates to provide: operations and management services related to the transmission and distribution system through a management services agreement (MSA); capacity and energy from the fossil fired generating plants of KeySpan, formerly owned by LILCO, through a power supply agreement (PSA); and, energy and fuel management services through an energy management agreement (EMA) (collectively; the Operating Agreements). Through these contracts, LIPA pays KeySpan directly for these services and KeySpan, in turn, pays the salaries of its employees and fees of its contractors and suppliers. In 2005 and 2004, LIPA paid to KeySpan approximately $1.7 billion each year under the operating agreements, which includes all fees under such agreements, reimbursement for various taxes and PILOTS, certain fuel and purchase power costs, capital projects, conservation services, research and development and various other expenditures authorized by the Company.

On February 27, 2006 KeySpan announced a definitive agreement under which KeySpan would be acquired in early 2007 by an affiliate of National Grid plc, a company organized under the laws of England and Wales. The transaction is subject to the approval of the shareholders of both companies and to various regulatory approvals. In the event there is a change of control of KeySpan, the Authority and LIPA would have the option of canceling their contracts with KeySpan and the KeySpan subsidiaries.

The Authority and LIPA are also parties to an Administrative Services Agreement, which describes the terms and conditions under which the Authority provides personnel, personnel-related services, and other services necessary for LIPA to provide service to its customers. As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above.
(3) Summary of Significant Accounting Policies

(a) General

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

The operations of the Company are presented as an enterprise fund following the accrual basis of accounting in order to recognize the flow of economic resources. Under this basis, revenues are recognized in the period which they are earned and expenses are recognized in the period in which they are incurred.

(b) Accounting for the Effects of Rate Regulation

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

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

In order for a rate-regulated entity to continue to apply the provisions of SFAS No. 71, it must continue to meet the following three criteria: (1) the enterprise’s rates for regulated services provided to its customers must be established by an independent third-party regulator or its own governing board empowered by a statute to establish rates that bind customers; (2) the regulated rates must be designed to recover the specific enterprise’s costs of providing the regulated services; and (3) in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the enterprise’s costs can be charged to and collected from customers.

Based upon the Company’s evaluation of the three criteria discussed above in relation to its operations, and the effect of competition on its ability to recover its costs, the Company believes that SFAS No. 71 continues to apply.

If the Company had been unable to continue to apply the provisions of SFAS No. 71, as of December 31, 2005, the Company estimates that approximately $291 million of fuel and purchased power and the acquisition adjustment, totaling approximately $3.1 billion would be considered for impairment.

(Continued)
(c) **Utility Plant and Property and Equipment**

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

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

(d) **Cash and Cash Equivalents and Investments**

Funds held by the Authority are administered in accordance with the Authority’s investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller’s investment guidelines for public authorities. Certain investments and cash and cash equivalents have been designated by the Authority’s Board of Trustees to be used for specific purposes, including rate stabilization, debt service, capital expenditures, and Clean Energy initiatives. Investments’ carrying value is reported at amortized cost, which approximates fair market value.

The Authority adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* for the year ended December 31, 2005.

(e) **Fuel Inventory**

Under the terms of the EMA and various Power Purchase Agreements, LIPA owns the fuel oil used in the generation of electricity at the facilities under contract to LIPA. Fuel inventory represents the value of low sulfur and internal combustion fuels that LIPA had on hand at each year-end in order to meet the demand requirements of these generating stations. Fuel inventory is valued using the weighted average cost method.

(f) **Material and Supplies Inventory**

This represents LIPA’s share of material and supplies inventory needed to support the operation of the Nine Mile Point 2 (NMP2) nuclear power station.
LONG ISLAND POWER AUTHORITY  
(A Component Unit of The State of New York) 

Notes to Basic Financial Statements  
December 31, 2005 and 2004

(g) **Promissory Note Receivable**  
As part of the 1998 Merger, KeySpan issued promissory notes to LIPA of approximately $1.048 billion. As of December 31, 2005 and 2004, approximately $155 million remained outstanding, respectively. The interest rates and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed by LIPA in the merger. KeySpan is required to make principal payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA transfers those amounts to the debt holders in accordance with the original debt repayment schedule.

(h) **Nonutility Property and Other Investments**  
The Authority’s nonutility property and other investments consist of: (i) the fair value of its derivatives totaling approximately $405 million and (ii) its investment in the Nine Mile Point 2 Decommissioning Trust Fund totaling approximately $59 million.

(i) **Deferred Loss Related to Non-Fuel Derivatives**  
The Authority uses financial derivative instruments to manage the impact of interest rates on its customers, earnings and cash flows. Under the provisions of SFAS No. 133, *Accounting for Derivatives and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, the Authority is required to recognize the fair value of all derivative instruments as either an asset or liability on the balance sheet with an offsetting gain or loss recognized. These standards permit the deferral of hedge gains and losses to Other Comprehensive Income, under specific hedge accounting provisions, until the hedged transaction is realized. However, the Authority is a governmental agency and, therefore, its financial statements are prepared in accordance with the provisions of the Governmental Accounting Standards Board, which do not provide for Other Comprehensive Income.

As the Authority is subject to the provisions of SFAS No. 71, all such gains and losses are deferred until realized. Accordingly, the Authority’s balance sheet reflects the inclusion of deferred losses and the deferred gains.

(j) **Deferred Charges**  
Deferred charges represent primarily the unamortized balance of costs incurred to issue long-term debt. Such amounts are amortized to interest expense over the life of the debt issuance to which they relate. Also included in deferred charges are amounts incurred by the Authority related to various energy projects, the amortization of which will be over the period of benefit (the life of the related Power Purchase Agreement).
(k) Regulatory Assets

Shoreham Property Tax Settlement (Settlement)

In January 2000, the Authority reached an agreement with Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District) (collectively, the Suffolk Taxing Jurisdictions) and Nassau County regarding the over assessment of the Shoreham Nuclear Power Station. As required under the terms of the agreement, the Authority was required to issue $457.5 million of rebates and credits to customers over the five-year period which began May 29, 1998. In order to fund such rebates and credits, the Authority used the proceeds from the issuance in May 1998 of its Capital Appreciation Bonds, Series 1998A Electric System General Revenue Bonds totaling approximately $146 million and the issuance in May 2000 of approximately $325 million of Electric System General Revenue Bonds, Series 2000A.

As provided under the Agreement, beginning in June 2003, LIPA’s Suffolk County customers’ bills include a surcharge (the Suffolk Surcharge) to be collected over the succeeding approximate 25 year period to repay the Authority for debt service and issuance costs on the bonds issued by the Authority to fund the Settlement as well as its cost of pre-funding certain rebates and credits.

As future rates will be established at a level sufficient to recover all such costs identified above, LIPA recorded a regulatory asset in accordance with SFAS No. 71. The balance of the Shoreham property tax settlement regulatory asset as of December 31, 2005 and 2004 was approximately $568.3 million and $572.1 million, respectively. The balance represents costs recorded from 1998 through 2004 including rebates and credits issued to customers, costs of administering the program and debt service costs on the Bonds identified above less surcharges collected since May 2003 totaling approximately $90 million.

Fuel and Purchased Power Costs Recoverable

LIPA’s Tariff for Electric Service (“Tariff”) includes a fuel recovery mechanism – the Fuel and Purchased Power Cost Adjustment (FPPCA) – whereby customer bills may be adjusted to reflect changes in the cost of fuel, purchased power and related costs. The FPPCA allows LIPA to recover from customers amounts incurred for fuel and purchased power beyond those included in base rates (Excess Fuel Costs).

Modification to the FPPCA Mechanism

During 2003, the FPPCA was modified to allow LIPA to recover from customers amounts incurred for fuel and purchased power beyond those included in base rates (“Excess Fuel Costs”) in the period incurred, as opposed to a deferral method. This modification was fully implemented on January 1, 2004. As of that date, the FPPCA was set so that LIPA would recover an amount of Excess Fuel Costs necessary to achieve revenue in excess of expenses of $20 million annually as a reserve. In no event, however, would the FPPCA be set at a level that would recover more than LIPA’s Excess Fuel Costs.
Effective with the Board’s adoption of the 2004 budget in mid-February 2004, the FPPCA surcharge was increased by an annual rate of 4.5% and, as a result of the continuing increases in fuel and purchased power costs, the Authority increased the surcharge by an additional annual rate of 5.0% effective June 8, 2004 and by 1.0% effective October 1, 2004. In 2005, the Authority increased the FPPCA by 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8, 2005. These increases were necessary to comply with the modified FPPCA mechanism, in effect during 2004 and 2005.

In December 2005, a modification to the 2006 FPPCA was proposed that would increase the reserve target noted above from $20 million annually to $75 million with a “tolerance band”. At the start of each calendar year, the FPPCA would be set at a level designed to achieve the targeted reserve of $75 million, with a tolerance band of $50 million above and $50 million below that level. During the year, the Authority would monitor, and if necessary modify, the FPPCA to achieve no less than $25 million and no more than $125 million of reserve. If the reserve is projected to fall below $25 million for the year, the FPPCA would be increased to a level sufficient to produce a reserve of $25 million to $75 million for the year (i.e., the lower half of the tolerance band). If the reserve is projected to exceed $125 million for the year, the FPPCA would be decreased to a level sufficient to produce $75 million to $125 million for the year (i.e., the upper half of the tolerance band). If the projected reserve for the year is between $25 million and $125 million, the FPPCA would not change. The proposed modification to the FPPCA was subject to a public hearing held in March 2006 and must be approved by the Board following such hearing prior to becoming effective. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% annually effective January 1, 2006.

To protect its customers from significant market price fluctuations for the purchase of fuel oil, natural gas, and electricity, LIPA uses derivative financial instruments which, are recorded at their market value. Effective with the 2003 modifications to the FPPCA, unrealized gains or losses derived from these derivatives are deferred as a regulatory asset until realized, at which time they are included in current period results as a component of fuel and purchased power.

Accordingly, as of December 31, 2005, the Authority deferred its unrealized gain on fuel derivatives of approximately $369 million.

(1) Acquisition Adjustment

The acquisition adjustment represents the difference between the purchase price paid and the net assets acquired from LILCO and is being amortized and recovered through rates on a straight-line basis using a 35-year life.

(m) Fair Values of Financial Instruments

The Company’s financial instruments approximate their fair market value as of December 31, 2005 and 2004. The fair values of the Company’s long-term debt and derivative instruments are based on quoted market prices.
(n) Capitalized Lease Obligations

Represents the net present value of various contracts for the capacity and/or energy of certain generation and transmission facilities in accordance with Emerging Issues Task Force No. 01-08, Determining if Whether an Arrangement Contains a Lease, and Statement of Financial Accounting Standards (SFAS) No. 13, Accounting for Leases. Upon satisfying the capitalization criteria, the net present value of the contract payments is included in both Utility Plant and Capital Lease Obligations.

As of December 31, 2005, and 2004, the unamortized net present value of the minimum contract payments related to the various contracts totaled approximately $1.2 billion and $862 million, respectively.

As permitted under SFAS No. 71, LIPA recognizes in Fuel and Purchased Power expense an amount equal to the contract payment of the capitalized leases discussed above, as allowed through the ratemaking process. The value of the asset and the obligation are reduced each month so that the balance sheet properly reflects the remaining value of the asset and obligation at each month end.

For a further discussion on the capitalization of capacity and/or energy contracts, see note 11 of notes to basic financial statements.

(o) Deferred Credits

Deferred credits represent amounts received by the Authority, the final disposition of which remains undetermined. Accordingly, the Authority has deferred the recognition of income until such determination is reached. Certain of these amounts may be returned to customers, KeySpan or the Internal Revenue Service.

During 2005 and 2004, amounts determined as due to customers totaling approximately $20 million and $36 million, respectively, were applied against the Excess Fuel Costs.

(p) Claims and Damages

Losses arising from claims against LIPA, including workers’ compensation claims, property damage, and general liability claims are partially self-insured. Storm losses are self-insured by LIPA. Reserves for these claims and damages are based on, among other things, experience, and expected loss. In certain instances, significant portions of extraordinary storm losses may be recoverable from the Federal Emergency Management Agency.

(q) Revenues

Operating revenues are comprised of cycle billings for electric service rendered to customers, based on meter reads, and the accrual of revenues for electric service rendered to customers not billed at month-end. All other revenue not meeting this definition is reported as nonoperating revenue when service is rendered. For the years ended December 31, 2005, and 2004, LIPA received approximately 52% of its revenues from residential sales, 44% from sales to commercial and industrial customers, and the balance from sales to public authorities and municipalities.
(r) **Depreciation**

The provisions for depreciation for utility plant result from the application of straight-line rates by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The average composite depreciation rate is 2.99%.

Leasehold improvements are being amortized over the lesser of the life of the assets or the term of the lease, using the straight-line method. Property and equipment is being depreciated over its estimated useful life using the straight-line method.

The following estimated useful lives and capitalization thresholds are used for utility property:

<table>
<thead>
<tr>
<th>Category</th>
<th>Useful life</th>
<th>Capitalization threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generation-nuclear</td>
<td>37 – 38 years</td>
<td>$ 200</td>
</tr>
<tr>
<td>Transmission and distribution</td>
<td>23 – 46 years</td>
<td>200</td>
</tr>
<tr>
<td>Common</td>
<td>4 – 42 years</td>
<td>200</td>
</tr>
<tr>
<td>Nuclear fuel in process and in reactor</td>
<td>6 years</td>
<td>200</td>
</tr>
<tr>
<td>Generation assets under capital lease</td>
<td>15 – 25 years</td>
<td>—</td>
</tr>
</tbody>
</table>

(s) **Payments-in-Lieu-of-Taxes**

The Company is required to make payments-in-lieu-of-taxes (PILOTS) for all operating taxes previously paid by LILCO, including gross income, gross earnings, property, Metropolitan Transportation Authority and certain taxes related to fuels used in utility operations. In addition, the Authority has entered into various PILOT arrangements for property it owns, upon which merchant generation and transmission is built.

(t) **Allowance for Borrowed Funds Used During Construction**

The allowance for borrowed funds used during construction (AFUDC) is the net cost of borrowed funds used for construction purposes. AFUDC is not an item of current cash income. AFUDC is computed monthly on a portion of construction work in progress, and is shown as a net reduction in interest expense.

(u) **Income Taxes**

The Authority is a political subdivision of the State of New York and, therefore, the Authority and its blended component unit are exempt from Federal, state, and local income taxes.
(v) Asset Retirement Obligation

The Authority adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*. An Asset Retirement Obligation (ARO) exists when there is a legal obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and/or normal operation of the asset. LIPA, as an 18% owner of Nine Mile Point 2 (NMP2) Nuclear Power Station, has a legal obligation associated with its retirement. This obligation is offset by the capitalization of the obligation which is included in “Utility plant and property and equipment, net”. As of December 31, 2005 and 2004, respectively, the asset retirement obligation was approximately $72.4 million and $68.3 million.

Additionally, during 2005, FASB Summary of Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*—an interpretation of SFAS No. 143 was issued. This Interpretation clarifies that the term conditional asset retirement obligation as used in SFAS No. 143, *Accounting for Asset Retirement Obligations*, refers to a 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. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Prior to this interpretation, LIPA did not report an ARO on certain of its utility assets. However, as a result of this interpretation, approximately $3 million has been reclassified from accumulated depreciation, where it has been recorded previously, to the asset retirement obligation. The Company recorded an additional asset retirement obligation of $4 million and increased utility plant, and property and equipment. The required obligation under the standard was approximately $9 million.

(w) Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is assessed by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flow, an impairment charge to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of and assets held for sale are reported at the lower of the carrying amount or fair value less costs to sell, whether reported in continuing operations or in discontinued operations, and are no longer depreciated.

(x) Use of Estimates

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

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

(4) **Risk Management**

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority formed an Executive Risk Management Committee.

*Fuel and purchased power transactions:* The Authority uses derivative financial instruments as detailed in the table below:

### Fuel Derivative Transactions

<table>
<thead>
<tr>
<th>Type of contract</th>
<th>Duration</th>
<th>Volume per month</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Oil contracts (volumes in barrels):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Options</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Put Short</td>
<td>Jan 06 – Dec 08</td>
<td>80,000-600,000</td>
</tr>
<tr>
<td>Call Long</td>
<td>Jan 06 – Dec 08</td>
<td>80,000-600,000</td>
</tr>
<tr>
<td>Swap Long</td>
<td>Jan 06 – Dec 08</td>
<td>20,000-535,000</td>
</tr>
<tr>
<td><strong>Gas transactions (volumes in decatherms):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Put Short</td>
<td>Jan 06 – Dec 08</td>
<td>435,000-3,255,000</td>
</tr>
<tr>
<td>Call Long</td>
<td>Jan 06 – Dec 08</td>
<td>435,000-3,255,000</td>
</tr>
<tr>
<td>Swap Long</td>
<td>Jan 06 – Dec 08</td>
<td>*</td>
</tr>
<tr>
<td><strong>Basis transactions (volumes in decatherms):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Swap Long</td>
<td>Jan 06 – Mar 07</td>
<td>**</td>
</tr>
</tbody>
</table>

* No ownership from January to April 2008

** No ownership from April to October 2006
Interest Rate Transactions: The Authority has entered into several interest rate swap agreements with several counterparties to modify the effective interest rates on outstanding debt as detailed below (thousands of dollars):

<table>
<thead>
<tr>
<th>Notional amount</th>
<th>Effective date</th>
<th>Type of swap</th>
<th>Mark to market</th>
<th>Deferred gain (loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$150,000</td>
<td>11/12/1998</td>
<td>Floating to Fixed</td>
<td>$11,134</td>
<td>(11,134)</td>
</tr>
<tr>
<td>100,000</td>
<td>11/12/1998</td>
<td>Floating to Fixed</td>
<td>(8,168)</td>
<td>(8,168)</td>
</tr>
<tr>
<td>587,225</td>
<td>6/1/2003</td>
<td>Floating to Fixed</td>
<td>(a) (136,285)</td>
<td>(40,257)</td>
</tr>
<tr>
<td>100,995</td>
<td>7/1/2004</td>
<td>Fixed to Floating</td>
<td>(657)</td>
<td>(657)</td>
</tr>
<tr>
<td>100,995</td>
<td>7/1/2004</td>
<td>Fixed to Floating</td>
<td>(b) (619)</td>
<td>(619)</td>
</tr>
<tr>
<td>502,090</td>
<td>7/1/2004</td>
<td>Basis Swap</td>
<td>(c) (30,150)</td>
<td>(13,945)</td>
</tr>
<tr>
<td>251,045</td>
<td>7/1/2004</td>
<td>Basis Swap</td>
<td>(d) (15,165)</td>
<td>(7,062)</td>
</tr>
<tr>
<td>251,045</td>
<td>7/1/2004</td>
<td>Basis Swap</td>
<td>(d) (15,039)</td>
<td>(6,936)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$ (217,217)</td>
<td>(88,778)</td>
</tr>
<tr>
<td>116,000</td>
<td>11/1/2001</td>
<td>Fixed to Floating</td>
<td>$4,623</td>
<td>4,623</td>
</tr>
<tr>
<td>116,000</td>
<td>4/1/2003</td>
<td>Floating to Fixed</td>
<td>(b) (5,779)</td>
<td>1,716</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$ (1,156)</td>
<td>6,339</td>
</tr>
</tbody>
</table>

(a) The Authority received an upfront premium totaling approximately $106 million.
(b) The Authority received an upfront premium totaling approximately $8 million.
(c) The Authority received an upfront premium totaling approximately $17.5 million.
(d) The Authority received an upfront premium totaling approximately $8.75 million.

(5) Rate Matters

Under current New York State law, the Authority is empowered to set rates for electric service in the Service Area without the approval of the New York State Public Service Commission (PSC) or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the 1998 merger of the Authority and LILCO (d/b/a LIPA) by the New York State Public Authorities Control Board (the PACB), that it will not impose any permanent increase, nor extend or re-establish any portion of a temporary rate increase, in average customer rates over a 12-month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. Another of the PACB conditions requires that the Authority reduce average base rates within LIPA’s service area by no less than 14% over a ten year period commencing on the date when LIPA began providing electric service, when measured against LILCO’s base rates in effect on July 16, 1997 (excluding the impact of the Shoreham Property Tax Settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events).

For a further discussion on rate matters, see note 12 of notes to basic financial statements.
The LIPA Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Company; PILOTS; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

LIPA’s tariff includes: (i) the FPPCA, to allow for adjustments to customers’ bills to reflect changes in the cost of fuel and purchased power and related costs; (ii) a PILOTS recovery rider, which allows for rate adjustments to accommodate PILOTS; and (iii) a rider providing for the recovery of costs associated with the Shoreham Property Tax Settlement (credits and rebates).
LONG ISLAND POWER AUTHORITY  
(A Component Unit of The State of New York)  

Notes to Basic Financial Statements  
December 31, 2005 and 2004

(6) **Utility Plant and Property and Equipment**

The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2005 (thousands of dollars):

<table>
<thead>
<tr>
<th></th>
<th>Beginning balance</th>
<th>Additions</th>
<th>Deletions</th>
<th>Ending balance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital assets, not being depreciated:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$ 9,941</td>
<td>2,233</td>
<td>—</td>
<td>12,174</td>
</tr>
<tr>
<td>Retirement work in progress</td>
<td>6,850</td>
<td>15,043</td>
<td>725</td>
<td>21,168</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>73,548</td>
<td>203,477</td>
<td>186,595</td>
<td>90,430</td>
</tr>
<tr>
<td><strong>Total capital assets not being depreciated</strong></td>
<td>90,339</td>
<td>220,753</td>
<td>187,320</td>
<td>123,772</td>
</tr>
<tr>
<td><strong>Capital assets, being depreciated:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generation – nuclear</td>
<td>700,915</td>
<td>2,439</td>
<td>—</td>
<td>703,354</td>
</tr>
<tr>
<td>Transmission and distribution</td>
<td>2,325,845</td>
<td>175,139</td>
<td>9,564</td>
<td>2,491,420</td>
</tr>
<tr>
<td>Common</td>
<td>4,724</td>
<td>12,744</td>
<td>13</td>
<td>17,455</td>
</tr>
<tr>
<td>Nuclear fuel in process and in reactor</td>
<td>46,513</td>
<td>11,174</td>
<td>—</td>
<td>57,687</td>
</tr>
<tr>
<td>Office equipment, furniture, and leasehold improvements</td>
<td>3,307</td>
<td>192</td>
<td>3</td>
<td>3,496</td>
</tr>
<tr>
<td>Generation assets under capital lease</td>
<td>944,398</td>
<td>403,431</td>
<td>—</td>
<td>1,347,829</td>
</tr>
<tr>
<td><strong>Total capital assets being depreciated</strong></td>
<td>4,025,702</td>
<td>605,119</td>
<td>9,580</td>
<td>4,621,241</td>
</tr>
<tr>
<td>Less accumulated depreciation for:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generation – nuclear</td>
<td>132,829</td>
<td>26,404</td>
<td>—</td>
<td>159,233</td>
</tr>
<tr>
<td>Transmission and distribution</td>
<td>320,403</td>
<td>96,880</td>
<td>14,296</td>
<td>402,987</td>
</tr>
<tr>
<td>Common</td>
<td>807</td>
<td>2,347</td>
<td>13</td>
<td>3,141</td>
</tr>
<tr>
<td>Nuclear fuel in process and in reactor</td>
<td>37,656</td>
<td>5,806</td>
<td>—</td>
<td>43,462</td>
</tr>
<tr>
<td>Office equipment, furniture, and leasehold improvements</td>
<td>2,197</td>
<td>386</td>
<td>—</td>
<td>2,583</td>
</tr>
<tr>
<td>Generation assets under capital lease</td>
<td>82,046</td>
<td>46,915</td>
<td>—</td>
<td>128,961</td>
</tr>
<tr>
<td><strong>Total accumulated depreciation</strong></td>
<td>575,938</td>
<td>178,738</td>
<td>14,309</td>
<td>740,367</td>
</tr>
<tr>
<td><strong>Net value of capital assets, being depreciated</strong></td>
<td>3,449,764</td>
<td>426,381</td>
<td>(4,729)</td>
<td>3,880,874</td>
</tr>
<tr>
<td><strong>Net value of all capital assets</strong></td>
<td>$ 3,540,103</td>
<td>647,134</td>
<td>182,591</td>
<td>4,004,646</td>
</tr>
</tbody>
</table>

In 2005, depreciation expense related to capital assets was approximately $125 million.
The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2004 (thousands of dollars):

<table>
<thead>
<tr>
<th></th>
<th>Beginning balance</th>
<th>Additions</th>
<th>Deletions</th>
<th>Ending balance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital assets, not being depreciated:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$ 9,833</td>
<td>108</td>
<td>—</td>
<td>9,941</td>
</tr>
<tr>
<td>Retirement work in progress</td>
<td>6,860</td>
<td>16,003</td>
<td>16,013</td>
<td>6,850</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>29,806</td>
<td>184,786</td>
<td>141,044</td>
<td>73,548</td>
</tr>
<tr>
<td><strong>Total capital assets not being depreciated</strong></td>
<td>46,499</td>
<td>200,897</td>
<td>157,057</td>
<td>90,339</td>
</tr>
<tr>
<td><strong>Capital assets, being depreciated:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generation – nuclear</td>
<td>693,183</td>
<td>7,732</td>
<td>—</td>
<td>700,915</td>
</tr>
<tr>
<td>Transmission and distribution</td>
<td>2,207,033</td>
<td>132,546</td>
<td>13,734</td>
<td>2,325,845</td>
</tr>
<tr>
<td>Common</td>
<td>4,440</td>
<td>766</td>
<td>482</td>
<td>4,724</td>
</tr>
<tr>
<td>Nuclear fuel in process and in reactor</td>
<td>37,142</td>
<td>9,371</td>
<td>—</td>
<td>46,513</td>
</tr>
<tr>
<td>Office equipment, furniture, and leasehold improvements</td>
<td>2,920</td>
<td>387</td>
<td>—</td>
<td>3,307</td>
</tr>
<tr>
<td>Generation assets under capital lease</td>
<td>844,914</td>
<td>99,484</td>
<td>—</td>
<td>944,398</td>
</tr>
<tr>
<td><strong>Total capital assets being depreciated</strong></td>
<td>3,789,632</td>
<td>250,286</td>
<td>14,216</td>
<td>4,025,702</td>
</tr>
<tr>
<td><strong>Less accumulated depreciation for:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generation – nuclear</td>
<td>106,657</td>
<td>26,172</td>
<td>—</td>
<td>132,829</td>
</tr>
<tr>
<td>Transmission and distribution</td>
<td>260,665</td>
<td>89,466</td>
<td>29,728</td>
<td>320,403</td>
</tr>
<tr>
<td>Common</td>
<td>653</td>
<td>655</td>
<td>501</td>
<td>807</td>
</tr>
<tr>
<td>Nuclear fuel in process and in reactor</td>
<td>32,705</td>
<td>4,951</td>
<td>—</td>
<td>37,656</td>
</tr>
<tr>
<td>Office equipment, furniture, and leasehold improvements</td>
<td>1,853</td>
<td>344</td>
<td>—</td>
<td>2,197</td>
</tr>
<tr>
<td>Generation assets under capital lease</td>
<td>43,211</td>
<td>38,835</td>
<td>—</td>
<td>82,046</td>
</tr>
<tr>
<td><strong>Total accumulated depreciation</strong></td>
<td>445,744</td>
<td>160,423</td>
<td>30,229</td>
<td>575,938</td>
</tr>
<tr>
<td><strong>Net value of capital assets, being depreciated</strong></td>
<td>3,343,888</td>
<td>89,863</td>
<td>(16,013)</td>
<td>3,449,764</td>
</tr>
<tr>
<td><strong>Net value of all capital assets</strong></td>
<td>$ 3,390,387</td>
<td>290,760</td>
<td>141,044</td>
<td>3,540,103</td>
</tr>
</tbody>
</table>

In 2004, depreciation expense related to capital assets was approximately $116.6 million.
LONG ISLAND POWER AUTHORITY  
(A Component Unit of The State of New York)

Notes to Basic Financial Statements  
December 31, 2005 and 2004

(7) Nine Mile Point Nuclear Power Station, Unit 2 (NMP2)

LIPA has an undivided 18% interest in Nine Mile Point 2 Nuclear Power Station (NMP2), located in Scriba, New York, operated by Constellation Nuclear LLC (Constellation).

LIPA’s share of the rated capability of NMP2 is approximately 207 megawatts (MW). LIPA’s net utility plant investment, excluding nuclear fuel, was approximately $544 million and $568 million as of December 31, 2005 and 2004, respectively. Generation from NMP2 and operating expenses incurred by NMP2 are shared by LIPA at its 18% ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

LIPA has an operating agreement for NMP2 with Constellation, which provides for a management committee comprised of one representative from each co-tenant. Constellation controls the operating and maintenance decisions of NMP2 in its role as operator. LIPA and Constellation have joint approval rights for the annual business plan, the annual budget and material changes to the budget. In addition to its involvement through the management committee, LIPA employs on-site nuclear oversight personnel to provide additional support to protect LIPA’s interests.

Nuclear Plant Decommissioning

LIPA is making provisions for decommissioning costs for NMP2 based on a site-specific study performed in 1995, as updated by LIPA’s engineering consultants. LIPA’s share of the total decommissioning costs for both the contaminated and noncontaminated portions is estimated to be approximately $72 million as of December 31, 2005, and is included in the balance sheet as a component of the asset retirement obligation. LIPA maintains a trust fund for its share of the decommissioning costs of NMP2, which as of December 31, 2005 and 2004, had an approximate value of $59.0 million and $54.1 million, respectively. Through continued deposits and investment returns being maintained within these trusts, the Company believes that the value of these trusts in 2046 will be sufficient to meet the Company’s decommissioning obligations.

NMP2 Radioactive Waste

Constellation has contracted with the U.S. Department of Energy (DOE) for disposal of high-level radioactive waste (spent fuel) from NMP2. Despite a court order reaffirming the DOE’s obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. LIPA has been advised by Constellation that the NMP2 spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If additional DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required. LIPA reimburses Constellation for its 18% share of the cost under the contract at a rate of $1.00 per megawatt hour of net generation, less a factor to account for transmission line losses. Such costs are included in the cost of fuel and purchased power.

Nuclear Plant Insurance

Constellation procures public liability and property insurance for NMP2 and LIPA reimburses Constellation for its 18% share of those costs.
In November 2002, the Terrorism Risk Insurance Act (TRIA) of 2002 was enacted by the federal government. Under the TRIA, property and casualty insurance companies are required to offer insurance for losses resulting from Certified acts of terrorism. The United States Secretary of State and Attorney General determine certified acts of terrorism. The nuclear property and accidental outage insurance programs, as discussed later in this section provide coverage for Certified acts of terrorism.

Losses resulting from noncertified acts of terrorism are covered as a common occurrence, meaning that if noncertified terrorist acts occur against one or more commercial nuclear power plants insured by the insurer’s of NMP2, within a 12-month period, such acts would be treated as one event and the owners of the currently licensed nuclear power plants in the United States would share one full limit of liability (currently $3.24 billion).

The Price-Anderson Amendments Act mandates that nuclear power generators secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $300 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this “secondary financial protection” subjects each of the 104 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $100.6 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA’s interest in NMP2 could expose it to a maximum potential loss of $18.1 million, per incident, through assessments of up to $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor.

Constellation participates in the American Nuclear Insurers Master Worker Program that provides coverage for worker tort claims filed for radiation injuries. Effective January 1, 1998, this program was modified to provide coverage to all workers whose nuclear-related employment began on or after the commencement date of reactor operations. Waiving the right to make additional claims under the old policy was a condition for coverage under the new policy. The old and new policies are described below:

Nuclear worker claims reported on or after January 1, 1998 are covered by an insurance policy with an annual industry aggregate limit of $300 million for radiation injury claims against all those insured by this policy.

All nuclear worker claims reported prior to January 1, 1998 are still covered by the old policy. Insureds under the old policies, with no current operations, are not required to purchase the newer policy described above, and may still make claims against the old policies through 2007. If radiation injury claims under these old policies exceed the policy reserves, all policyholders could be retroactively assessed, with LIPA’s share being up to $300,000.

Constellation has also procured $500 million of primary nuclear property insurance and additional protection (including decontamination costs) of $1.25 billion of stand-alone excess property insurance and a $1.0 billion shared excess policy for Nine Mile Point through the Nuclear Electric Insurance Limited (NEIL). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses at other member facilities exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $3.1 million per loss.
LIPA has obtained insurance coverage from NEIL for the expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, coverage would commence twelve weeks after any accidental outage, with reimbursement from NEIL at the rate of approximately $630,000 per week for the first 52 weeks, reduced to $504,000 per week for an additional 110 weeks for the purchase of replacement power, with a maximum limit of $88.2 million over a three-year period.

**NMP2 License Renewal**

In May 2004, Constellation submitted an application to extend the licensed life of NMP2 by 20 years. If successful, this would extend the license dates to the year 2046. The current review cycle history of the Nuclear Regulatory Commission (NRC) indicates that approval could be expected by the end of 2006.

To maximize its options, LIPA has agreed to fund a pro rata share of the license renewal costs up to the point of approval by the NRC. At the point of approval, LIPA will then have an option to participate in the extended license.

**(8) Cash, and Cash Equivalents and Investments**

The Authority and LIPA each have distinct investment policies to manage the risks associated with each of their investment objectives.

**Authority**

The Authority’s investments are managed by an external investment manager and consist of two accounts; the Operating Fund and the Rate Stabilization Fund. The Operating Fund is managed to meet the liquidity needs of the Authority and the Rate Stabilization Fund is managed to maximize the return on investment. The Authority must maintain a minimum balance of $150 million in the Rate Stabilization Fund as required by the Authority’s bond covenants, however, the Authority has set an informal policy of maintaining a minimum balance of $250 million. Additionally, the Authority is required to maintain compensating balances of $1.2 million.

The Authority’s investment policy places limits on investments by issuer and by security type and addresses various risks described below. The Board of Trustees of the Authority may also specifically authorize, as it deems appropriate, other investments that are consistent with the Authority’s investment objective. The Authority reviews its investment policy on an annual basis to ensure continued effectiveness.

**Investment Risks**

**Credit Risk**

The Authority’s permissible investments and related minimum credit ratings include U.S. Treasury and Federal Agency obligations (AAA), repurchase agreements (A-1), bankers’ acceptances (AA- or Aa3), commercial paper (A1 or P-1), corporate notes (AA- or Aa3), master notes (AA- or Aa3) and asset backed securities (AAA), certificates of deposit (AA- or Aa3), mutual funds (AAAm or AAAm-G), investment contracts (AA- or Aa3, municipal obligations (AA- or Aa3), and variable rate notes (no credit rating limit). The Authority’s investment policy prohibits investments involving complex derivatives, reverse repurchase agreements, and short selling and arbitrage related investment activity.
Concentration of Credit Risk

To address this risk, the Authority’s investment policies have established limits such that no more than 5% of the investment portfolio may be invested in the securities of any one issuer with the exception of U.S. Treasury Obligations (100% maximum), each Federal agency (35%), repurchase agreements counterparties (less of 10% or $50 million), mutual funds (25% maximum) and investment contracts (10%).

Custodial Credit Risk

The Authority believes that custodial credit risk related to its deposits and investments to be minimal as its guidelines stipulate that deposits and investments be held by a third-party custodian who may not otherwise be a counter-party to the transactions, and that all securities are held in the name of the Authority and that will be free and clear of any lien.

Custodial credit risk for deposits is the risk that in the event of a bank failure, the Authority’s deposits may not be returned. The Authority’s policy to address this risk requires that the custodian or depository bank have a long term credit rating of Aa3/AA. Custodians or depository banks not meeting this credit rating are required to provide collateral.

As of December 31, 2005 and 2004, the Authority had deposits of $24.6 million and $25.2 million respectively, of which approximately $12.8 million and $0.8 million were not collateralized or were uninsured. Uncollateralized balances were primarily the result of amounts temporarily held pending investment or disbursement. Collateral on the remaining deposits is held in the name of the Authority and range from 102% to 105% of the deposit balances.

Interest Rate Risk

The Authority’s policy states that all investments have maturities of 12 months or less, generally. Investment maturities may exceed 12 months provided that the maturity does not exceed the expected disbursement date of those funds, the total average portfolio maturity is one year or less and no individual maturity exceeds three years, with the exception of U.S. Government obligations and investment contracts. The duration of the Authority’s investment maturities are detailed in the chart below.
As of December 31, 2005 and 2004 the Authority had the following investments and maturities (amounts in thousands):

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Fair value</th>
<th>Percent of portfolio</th>
<th>2005</th>
<th>Investment Maturities</th>
<th>2004</th>
<th>Investment Maturities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Less than 3 months</td>
<td></td>
<td>Less than 3 months</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3 months to 1 year</td>
<td></td>
<td>3 months to 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1 to 3 years</td>
<td></td>
<td>1 to 3 years</td>
</tr>
<tr>
<td>U.S. Treasury obligations</td>
<td>$9,451</td>
<td>2%</td>
<td></td>
<td>$—</td>
<td></td>
<td>$9,451</td>
</tr>
<tr>
<td>Short term discount notes:</td>
<td></td>
<td></td>
<td></td>
<td>$—</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>$267,087</td>
<td>33%</td>
<td></td>
<td>$267,087</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Federal agencies</td>
<td>$153,916</td>
<td>57%</td>
<td></td>
<td>$153,916</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Master notes/money markets</td>
<td>$15,728</td>
<td>3%</td>
<td></td>
<td>$15,728</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Cash &amp; collateralized deposits</td>
<td>$24,698</td>
<td>5%</td>
<td></td>
<td>$24,698</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$470,880</td>
<td>100%</td>
<td></td>
<td>$461,429</td>
<td></td>
<td>$9,451</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Fair value</th>
<th>Percent of portfolio</th>
<th>2005</th>
<th>Investment Maturities</th>
<th>2004</th>
<th>Investment Maturities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Less than 3 months</td>
<td></td>
<td>Less than 3 months</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3 months to 1 year</td>
<td></td>
<td>3 months to 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1 to 3 years</td>
<td></td>
<td>1 to 3 years</td>
</tr>
<tr>
<td>U.S. Treasury obligations</td>
<td>$60,000</td>
<td>15%</td>
<td></td>
<td>$10,040</td>
<td></td>
<td>$49,960</td>
</tr>
<tr>
<td>Variable rate Federal agency</td>
<td>$9,994</td>
<td>2%</td>
<td></td>
<td>$9,994</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>obligations</td>
<td></td>
<td></td>
<td></td>
<td>$—</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Variable rate corporate bonds</td>
<td>$19,998</td>
<td>5%</td>
<td></td>
<td>$9,998</td>
<td></td>
<td>$10,000</td>
</tr>
<tr>
<td>Short term discount notes:</td>
<td></td>
<td></td>
<td></td>
<td>$—</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>$255,472</td>
<td>62%</td>
<td></td>
<td>$255,472</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Federal agencies</td>
<td>$38,030</td>
<td>9%</td>
<td></td>
<td>$30,123</td>
<td></td>
<td>$7,907</td>
</tr>
<tr>
<td>Master notes/money markets</td>
<td>$4,316</td>
<td>1%</td>
<td></td>
<td>$4,316</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td>Cash &amp; collateralized deposits</td>
<td>$25,158</td>
<td>6%</td>
<td></td>
<td>$25,158</td>
<td></td>
<td>$—</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$412,968</td>
<td>100%</td>
<td></td>
<td>$345,101</td>
<td></td>
<td>$57,867</td>
</tr>
</tbody>
</table>

(b) **LIPA**

LIPA maintains a separate investment policy applicable to the long term investments in the Nuclear Decommissioning Trust (NDT) which is held to meet LIPA’s obligation with respect to the eventual decommission of LIPA’s 18% interest in the Nine Mile Point 2 nuclear facility. LIPA guidelines detail permissible investments and portfolio restrictions. LIPA reviews it investment policy on an annual basis, or as required, to ensure continued effectiveness.
Investment Risks

Credit Risk

LIPA’s guidelines minimize the risk by limiting permissible investments to include; obligations of the U.S. Government and its Agencies, corporate or other obligations with an A or better rating, mortgage obligations rated AA or higher, commercial paper with a rating of A1 or P1, certificates of deposit, Eurodollar certificates of deposit and bankers acceptances of domestic banks with A+ rating or better, short term money market investment accounts that conform to the aforementioned permissible investments, portfolio funds of securities designed to replicate the overall market measured by the S&P 500 Index, and futures contracts on the S&P 500 Index in the futures markets. The Board of Trustees authorized the use of equity investments as permissible vehicle within this portfolio in 2004 and limited the maximum exposure to 35%. The Nuclear Decommissioning Trust investment portfolio must be rebalanced quarterly at plus or minus 5% for equity investments. Fixed income securities held in the portfolio must maintain an average credit rating of AA or better with no more than 30% of the portfolio invested in notes and bonds rated A and no more than 20% of the portfolio invested in municipal securities.

Concentration of Credit Risk

To address this risk, LIPA’s investment policies have established limits such that more than 5% of the portfolio may be invested in the securities of any one issuer with the exception of U.S. Government and its agencies securities. In addition, no more than 25% of the portfolio may be invested in securities of issuers in the same industry.

Custodial Credit Risk

LIPA does not have a policy relative to custodial credit risk of its deposits, however, as a practical matter, LIPA defers to the policies of the Authority, as discussed above. LIPA’s deposits at December 31, 2004 were fully collateralized.

Interest Rate Risk

Due to the long term nature of the NDT asset, interest rate risk is managed to track the Lehman Brothers Government/Credit Bond Index. The portfolio’s duration is required to fall within a range of 20% below the duration of the index and 10% above the duration of the index.
As of December 31, 2005 and 2004 LIPA had the following investments (amounts in thousands):

<table>
<thead>
<tr>
<th>Investment type</th>
<th>2005 Fair value</th>
<th>Percent of portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate notes and bonds</td>
<td>$25,606</td>
<td>43%</td>
</tr>
<tr>
<td>Mortgage obligations</td>
<td>121</td>
<td>—</td>
</tr>
<tr>
<td>U.S. Government and its agencies obligations</td>
<td>22,430</td>
<td>38%</td>
</tr>
<tr>
<td>Money market</td>
<td>105</td>
<td>—</td>
</tr>
<tr>
<td>Equity securities</td>
<td>11,668</td>
<td>19%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$59,930</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment type</th>
<th>2004 Fair value</th>
<th>Percent of portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate notes and bonds</td>
<td>$22,379</td>
<td>41%</td>
</tr>
<tr>
<td>Mortgage obligations</td>
<td>149</td>
<td>—</td>
</tr>
<tr>
<td>U.S. Government and its agencies obligations</td>
<td>17,955</td>
<td>33%</td>
</tr>
<tr>
<td>Money market</td>
<td>10,308</td>
<td>19%</td>
</tr>
<tr>
<td>Deposits</td>
<td>3,293</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$54,084</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The overall duration of the three individual accounts averaged 4.6 and 4.5 years at December 31, 2005 and 2004, respectively, and is within the limits described by LIPA’s investment guidelines.

### (9) Long-Term and Short-Term Debt

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

The Bonds are secured by a Trust Estate as pledged under the Authority’s Bond Resolution (the Resolution). The Trust Estate consists principally of the revenues generated by the operation of LIPA’s transmission and distribution system and has been pledged by LIPA to the Authority.
The Company’s bond and note indebtedness and other long-term liabilities as of December 31, 2005 are comprised of the following obligations (thousands of dollars):

<table>
<thead>
<tr>
<th>Authority debt: Electric system general revenue bonds:</th>
<th>Beginning balance</th>
<th>Accretion/retirements/retirements</th>
<th>Ending balance</th>
<th>Due within one year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Series 1998A</td>
<td>$2,157,793</td>
<td>7,962</td>
<td>2,092,925</td>
<td>75,810</td>
</tr>
<tr>
<td>Series 1998B</td>
<td>711,580</td>
<td>—</td>
<td>711,580</td>
<td>—</td>
</tr>
<tr>
<td>Series 2000A</td>
<td>309,071</td>
<td>17,934</td>
<td>327,005</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001A</td>
<td>300,000</td>
<td>—</td>
<td>300,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001B-K</td>
<td>500,000</td>
<td>—</td>
<td>500,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001L-P</td>
<td>316,000</td>
<td>—</td>
<td>316,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003A</td>
<td>86,900</td>
<td>—</td>
<td>67,400</td>
<td>13,930</td>
</tr>
<tr>
<td>Series 2003B</td>
<td>474,600</td>
<td>—</td>
<td>400,600</td>
<td>112,585</td>
</tr>
<tr>
<td>Series 2003C</td>
<td>323,380</td>
<td>—</td>
<td>323,380</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003D-O</td>
<td>587,225</td>
<td>—</td>
<td>587,225</td>
<td>—</td>
</tr>
<tr>
<td>Series 2004A</td>
<td>200,000</td>
<td>—</td>
<td>200,000</td>
<td>—</td>
</tr>
<tr>
<td><strong>Subtotal – bonds</strong></td>
<td><strong>5,966,549</strong></td>
<td><strong>25,896</strong></td>
<td><strong>5,826,115</strong></td>
<td><strong>202,325</strong></td>
</tr>
<tr>
<td>Electric system subordinate revenue bonds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Series 1-3</td>
<td>525,000</td>
<td>—</td>
<td>525,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 7</td>
<td>250,000</td>
<td>—</td>
<td>250,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 8</td>
<td>187,345</td>
<td>27,300</td>
<td>160,045</td>
<td>—</td>
</tr>
<tr>
<td><strong>Subtotal – bonds net</strong></td>
<td><strong>962,345</strong></td>
<td><strong>27,300</strong></td>
<td><strong>935,045</strong></td>
<td><strong>—</strong></td>
</tr>
<tr>
<td>LIPA Debt:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NYSERDA notes</td>
<td>155,420</td>
<td>—</td>
<td>155,420</td>
<td>—</td>
</tr>
<tr>
<td><strong>Subtotal – debt</strong></td>
<td><strong>155,420</strong></td>
<td>—</td>
<td><strong>155,420</strong></td>
<td><strong>—</strong></td>
</tr>
<tr>
<td><strong>Net unamortized discounts/premiums</strong> and deferred amortization**</td>
<td>(25,407)</td>
<td>(2,712)</td>
<td>—</td>
<td>(28,119)</td>
</tr>
<tr>
<td><strong>Total bonds and notes net of unamortized discounts/premiums</strong></td>
<td><strong>7,058,907</strong></td>
<td><strong>23,184</strong></td>
<td><strong>193,630</strong></td>
<td><strong>6,888,461</strong></td>
</tr>
<tr>
<td>Other long-term liabilities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred credits</td>
<td>$85,323</td>
<td>5,433</td>
<td>68,601</td>
<td>—</td>
</tr>
<tr>
<td>Claims and damages</td>
<td>20,091</td>
<td>17,264</td>
<td>26,581</td>
<td>—</td>
</tr>
<tr>
<td>Capital lease obligation</td>
<td>862,352</td>
<td>403,431</td>
<td>1,218,868</td>
<td>121,813</td>
</tr>
<tr>
<td><strong>Total other long-term liabilities</strong></td>
<td><strong>967,766</strong></td>
<td><strong>426,128</strong></td>
<td><strong>1,314,050</strong></td>
<td><strong>121,813</strong></td>
</tr>
</tbody>
</table>

Additions to the Series 2000A and Series 1998A bonds represent the current accretion on the capital appreciation bonds.
The Company’s bond and note indebtedness and other long-term liabilities as of December 31, 2004 are comprised of the following obligations (thousands of dollars):

<table>
<thead>
<tr>
<th>Authority debt:</th>
<th>Beginning balance</th>
<th>Accretion/ additions</th>
<th>Retirements/ refundings</th>
<th>Ending balance</th>
<th>Due within one year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric system general revenue bonds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Series 1998A</td>
<td>$2,219,636</td>
<td>8,137</td>
<td>69,980</td>
<td>2,157,793</td>
<td>166,330</td>
</tr>
<tr>
<td>Series 1998B</td>
<td>744,205</td>
<td>—</td>
<td>32,625</td>
<td>711,580</td>
<td>—</td>
</tr>
<tr>
<td>Series 2000A</td>
<td>292,123</td>
<td>16,948</td>
<td>—</td>
<td>309,071</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001A</td>
<td>300,000</td>
<td>—</td>
<td>—</td>
<td>300,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001B-K</td>
<td>500,000</td>
<td>—</td>
<td>—</td>
<td>500,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2001L-P</td>
<td>316,000</td>
<td>—</td>
<td>—</td>
<td>316,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003A</td>
<td>106,400</td>
<td>—</td>
<td>19,500</td>
<td>86,900</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003B</td>
<td>511,575</td>
<td>—</td>
<td>36,975</td>
<td>474,600</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003C</td>
<td>323,380</td>
<td>—</td>
<td>—</td>
<td>323,380</td>
<td>—</td>
</tr>
<tr>
<td>Series 2003D-O</td>
<td>587,225</td>
<td>—</td>
<td>—</td>
<td>587,225</td>
<td>—</td>
</tr>
<tr>
<td>Series 2004A</td>
<td>—</td>
<td>200,000</td>
<td>—</td>
<td>200,000</td>
<td>—</td>
</tr>
<tr>
<td>Subtotal – bonds</td>
<td>5,900,544</td>
<td>225,085</td>
<td>159,080</td>
<td>5,966,549</td>
<td>166,330</td>
</tr>
<tr>
<td>Electric system subordinate revenue bonds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Series 1-3</td>
<td>525,000</td>
<td>—</td>
<td>—</td>
<td>525,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 7</td>
<td>250,000</td>
<td>—</td>
<td>—</td>
<td>250,000</td>
<td>—</td>
</tr>
<tr>
<td>Series 8</td>
<td>214,645</td>
<td>—</td>
<td>27,300</td>
<td>187,345</td>
<td>27,300</td>
</tr>
<tr>
<td>Subtotal – bonds net</td>
<td>989,645</td>
<td>—</td>
<td>27,300</td>
<td>962,345</td>
<td>27,300</td>
</tr>
<tr>
<td>LIPA Debt:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NYSERDA notes</td>
<td>155,420</td>
<td>—</td>
<td>—</td>
<td>155,420</td>
<td>—</td>
</tr>
<tr>
<td>Subtotal – debt</td>
<td>155,420</td>
<td>—</td>
<td>—</td>
<td>155,420</td>
<td>—</td>
</tr>
<tr>
<td>Net unamortized discounts/premiums and deferred amortization</td>
<td>(23,286)</td>
<td>(2,488)</td>
<td>(367)</td>
<td>(25,407)</td>
<td>—</td>
</tr>
<tr>
<td>Total bonds and notes net of unamortized discounts/ premiums</td>
<td>$7,022,323</td>
<td>222,597</td>
<td>186,013</td>
<td>7,058,907</td>
<td>193,630</td>
</tr>
<tr>
<td>Other long-term liabilities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred credits</td>
<td>$130,196</td>
<td>5,105</td>
<td>49,978</td>
<td>85,323</td>
<td>—</td>
</tr>
<tr>
<td>Claims and damages</td>
<td>21,481</td>
<td>5,019</td>
<td>6,409</td>
<td>20,091</td>
<td>—</td>
</tr>
<tr>
<td>Capital lease obligation</td>
<td>801,703</td>
<td>99,484</td>
<td>38,835</td>
<td>862,352</td>
<td>89,552</td>
</tr>
<tr>
<td>Total other long-term liabilities</td>
<td>$953,380</td>
<td>109,608</td>
<td>95,222</td>
<td>967,766</td>
<td>89,552</td>
</tr>
</tbody>
</table>

Additions to the Series 2000A and Series 1998A bonds represent the current accretion on the capital appreciation bonds.
The Company’s schedule of capitalization for the years ended December 31, 2005 and 2004 is as follows (thousands of dollars):

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Interest rate</th>
<th>Series</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric system general revenue bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Serial bonds</td>
<td>Annually to 2016</td>
<td>4.250% to 6.000% a 1998 A</td>
<td>$678,450</td>
</tr>
<tr>
<td>Term bonds</td>
<td>December 1, 2018 to 2029</td>
<td>5.000% to 5.750% a 1998 A</td>
<td>$1,263,350</td>
</tr>
<tr>
<td>Capital appreciation bonds</td>
<td>December 1, 2003 to 2028</td>
<td>4.400% to 5.300% a 1998 A</td>
<td>151,125</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>Annually to 2016</td>
<td>4.000% to 5.250% a 1998 B</td>
<td>654,435</td>
</tr>
<tr>
<td>Term bonds</td>
<td>April 1, 2018</td>
<td>4.750% a 1998 B</td>
<td>57,145</td>
</tr>
<tr>
<td>Capital appreciation bonds</td>
<td>June 1, 2005 to 2029</td>
<td>5.000% to 5.950% a 2000 A</td>
<td>327,005</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>September 1, 2013 to 2021</td>
<td>4.600% to 5.375% a 2001 A</td>
<td>21,960</td>
</tr>
<tr>
<td>Term bonds</td>
<td>September 1, 2025 to 2029</td>
<td>5.000% to 5.375% a 2001 A</td>
<td>278,040</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.250% b 2001 B</td>
<td>75,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.200% b 2001 C</td>
<td>25,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.200% b 2001 D</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.300% b 2001 E</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.150% b 2001 F</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.050% b 2001 G</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.150% b 2001 H</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.150% b 2001 I</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.150% b 2001 J</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>2.950% b 2001 K</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>5.375% a 2001 L</td>
<td>116,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.100% b 2001 M</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.100% b 2001 N</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.200% b 2001 O</td>
<td>50,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.200% b 2001 P</td>
<td>50,000</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>June 1, 2004 to 2009</td>
<td>3.00% to 5.00% a 2003 A</td>
<td>67,400</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>December 1, 2003 to 2014</td>
<td>3.00% to 5.25% a 2003 B</td>
<td>400,600</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>September 1, 2013 to 2028</td>
<td>4.25% to 5.50% a 2003 C</td>
<td>137,860</td>
</tr>
<tr>
<td>Term bonds</td>
<td>September 1, 2027 to 2033</td>
<td>5.00% to 5.25% a 2003 C</td>
<td>185,520</td>
</tr>
<tr>
<td>Term bonds</td>
<td>December 1, 2029</td>
<td>3.36% to 3.52% c 2003 D-H</td>
<td>293,625</td>
</tr>
<tr>
<td>Term bonds</td>
<td>December 1, 2029</td>
<td>2.85% to 3.25% b 2003 I-O</td>
<td>293,600</td>
</tr>
<tr>
<td>Serial bonds</td>
<td>September 1, 2013 to 2025</td>
<td>3.80% to 4.875% a 2004 A</td>
<td>33,900</td>
</tr>
<tr>
<td>Term bonds</td>
<td>September 1, 2029 to 2034</td>
<td>5.00% to 5.10% a 2004 A</td>
<td>166,100</td>
</tr>
<tr>
<td>Electric system subordinated revenue bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue bonds</td>
<td>May 1, 2033</td>
<td>3.36% to 3.56% c Series 1A-3A</td>
<td>275,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>May 1, 2033</td>
<td>3.65% to 3.72% d Series 1B-3B</td>
<td>250,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>April 1, 2025</td>
<td>4.210% a Series 7</td>
<td>250,000</td>
</tr>
<tr>
<td>Term bonds</td>
<td>April 1, 2009 to 2012</td>
<td>4.000% to 5.250% a Series 8</td>
<td>160,045</td>
</tr>
<tr>
<td>Total general and subordinated revenue bonds</td>
<td></td>
<td></td>
<td>6,761,160</td>
</tr>
<tr>
<td>Commercial paper notes</td>
<td></td>
<td>2.90% to 3.08% b CP-1</td>
<td>100,000</td>
</tr>
</tbody>
</table>
NYSERDA Financing notes:

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Interest rate</th>
<th>Series</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1, 2016</td>
<td>5.150%</td>
<td>a 1985 A,B</td>
<td>$108,020</td>
</tr>
<tr>
<td>November 1, 2023</td>
<td>5.300%</td>
<td>a 1993 B</td>
<td>29,600</td>
</tr>
<tr>
<td>October 1, 2024</td>
<td>5.300%</td>
<td>a 1994 A</td>
<td>2,600</td>
</tr>
<tr>
<td>August 1, 2025</td>
<td>5.300%</td>
<td>a 1995 A</td>
<td>15,200</td>
</tr>
</tbody>
</table>

Total NYSERDA financing notes 155,420

Unamortized premium and deferred amortization (28,119)

Total long-term debt 6,988,461

Less current maturities 202,325

Long-term debt 6,786,136

Net assets 51,620

Total capitalization $6,837,756

a – Fixed rate
b – Variable rate (rate presented is as of December 31, 2005); Auction rate mode reset at rates as determined by auction agent.
c – Variable rate (rate presented is as of December 31, 2005); Weekly interest rate mode reset at rates as determined by remarketing agent.
d – Variable rate (rate presented is as of December 31, 2005); Daily reset rate mode as determined by remarketing agent.

The debt service requirements for the Company’s bonds as of December 31, 2005 are as follows (thousands of dollars):

<table>
<thead>
<tr>
<th>Due</th>
<th>Principal</th>
<th>Interest</th>
<th>Net swap payments</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$202,325</td>
<td>298,724</td>
<td>10,467</td>
<td>511,516</td>
</tr>
<tr>
<td>2007</td>
<td>214,420</td>
<td>288,452</td>
<td>10,467</td>
<td>513,339</td>
</tr>
<tr>
<td>2008</td>
<td>225,955</td>
<td>277,590</td>
<td>10,467</td>
<td>514,012</td>
</tr>
<tr>
<td>2009</td>
<td>240,730</td>
<td>267,230</td>
<td>10,467</td>
<td>518,427</td>
</tr>
<tr>
<td>2010</td>
<td>224,295</td>
<td>256,334</td>
<td>10,467</td>
<td>491,096</td>
</tr>
<tr>
<td>2011-2015</td>
<td>1,061,410</td>
<td>1,133,370</td>
<td>53,972</td>
<td>2,248,752</td>
</tr>
<tr>
<td>2016-2020</td>
<td>1,143,430</td>
<td>921,245</td>
<td>55,829</td>
<td>2,120,504</td>
</tr>
<tr>
<td>2021-2025</td>
<td>1,309,390</td>
<td>698,463</td>
<td>50,771</td>
<td>2,058,624</td>
</tr>
<tr>
<td>2026-2030</td>
<td>1,610,155</td>
<td>424,073</td>
<td>28,879</td>
<td>2,063,107</td>
</tr>
<tr>
<td>2031-2035</td>
<td>1,183,810</td>
<td>95,403</td>
<td>—</td>
<td>1,279,213</td>
</tr>
<tr>
<td></td>
<td>7,415,920</td>
<td>4,660,884</td>
<td>241,786</td>
<td>12,318,590</td>
</tr>
</tbody>
</table>

Unamortized discounts/premiums (28,119)

Unaccreted interest on CABs (499,340)

Total $6,888,461 4,660,884 241,786 11,791,131

(Continued)
Future debt service is calculated using rates in effect at December 31, 2005 for variable rate bonds. The net swap payment amounts were calculated by subtracting the future variable rate interest payments subject to swap agreements from the synthetic fixed rate amount intended to be achieved by the swap agreements.

**Electric System General Revenue Bonds**

**Series 2004A**

The Authority issued Series 2004A Electric System General Revenue Bonds totaling $200 million for various capital projects and to reimburse the Authority for capital expenditures funded with cash from operations. Series 2004A is comprised of Serial Bonds and Term Bonds with maturities beginning September 1, 2013 and continuing through 2034 and pays interest at a fixed rate every March 1 and September 1.

**Electric System Subordinated Revenue Bonds**

**Series 8 (SubSeries A-H)**

This Series is comprised of Current Interest Bonds issued as follows (thousands of dollars):

<table>
<thead>
<tr>
<th>This series is comprised of subseries</th>
<th>Mandatory purchase date (April 1)</th>
<th>Maturity (April 1)</th>
<th>Principal outstanding</th>
<th>Interest rate to mandatory purchase date</th>
</tr>
</thead>
<tbody>
<tr>
<td>8A</td>
<td>2009</td>
<td>$23,360</td>
<td>5.25%</td>
<td></td>
</tr>
<tr>
<td>8A</td>
<td>2009</td>
<td>$2,500</td>
<td>4.13</td>
<td></td>
</tr>
<tr>
<td>8B</td>
<td>2009</td>
<td>$17,160</td>
<td>4.30</td>
<td></td>
</tr>
<tr>
<td>8B</td>
<td>2009</td>
<td>$10,000</td>
<td>5.25</td>
<td></td>
</tr>
<tr>
<td>8C</td>
<td>2010</td>
<td>$25,225</td>
<td>5.00</td>
<td></td>
</tr>
<tr>
<td>8F</td>
<td>2006</td>
<td>2011</td>
<td>$27,300</td>
<td>5.00</td>
</tr>
<tr>
<td>8G</td>
<td>2007</td>
<td>2012</td>
<td>$27,300</td>
<td>5.00</td>
</tr>
<tr>
<td>8H</td>
<td>2008</td>
<td>2012</td>
<td>$27,200</td>
<td>5.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$160,045</td>
<td></td>
</tr>
</tbody>
</table>

Prior to the mandatory purchase date, the Authority determines to either purchase the Subseries or have such Subseries remarke ted. Remarked securities would become due at the maturity date or an earlier date as determined by the remarketing. The original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing. Principal, interest, and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy.

During the years ended December 31, 2005 and 2004, the Authority redeemed its SubSeries 8D and 8E Bonds, respectively, each totaling $27.3 million. SubSeries 8A through 8C bonds were remarke ted and are in the Fixed Rate Mode, and pay interest on April 1 and October 1 of each year. The Authority intends to remarket its SubSeries 8F Bonds on the mandatory purchase date of April 1, 2006.
Commercial Paper Notes

The Authority’s Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 through CP-3 (Notes) up to a maximum amount of $200 million. The aggregate principal amount of the Notes outstanding at any time may not exceed $200 million. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement, expiring on June 15, 2006. The Notes do not have maturity dates of longer than 270 days from their date of issuance and as Notes mature, the Authority continually replaces them with additional Notes.

During 2005, the Authority issued an additional $50 million of Commercial Paper Notes to reimburse the Authority’s treasury for capital projects. As of December 31, 2005, the Authority redeemed all of this issuance. As of December 31, 2005 and 2004, the Authority had Notes outstanding totaling $100 million.

The Company’s short-term indebtedness as of December 31, 2005 and 2004 is comprised of the following obligations (thousands of dollars):

<table>
<thead>
<tr>
<th></th>
<th>Beginning balance</th>
<th>Issuances</th>
<th>Retirements</th>
<th>Ending balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term debt – CP-1</td>
<td>$ 100,000</td>
<td>—</td>
<td>—</td>
<td>100,000</td>
</tr>
<tr>
<td>Short term debt – CP-2</td>
<td>—</td>
<td>50,000</td>
<td>(50,000)</td>
<td>—</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 100,000</strong></td>
<td><strong>50,000</strong></td>
<td><strong>(50,000)</strong></td>
<td><strong>100,000</strong></td>
</tr>
</tbody>
</table>
Fair Values of Long-Term Debt

The fair values of the Company’s long-term debt as of December 31, 2005 and 2004 were as follows (thousands of dollars):

<table>
<thead>
<tr>
<th>Debt Instrument</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 1998 A</td>
<td>$2,209,940</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 1998 B</td>
<td>736,457</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2000 A</td>
<td>389,732</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2001 A</td>
<td>314,299</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2001 B</td>
<td>500,000</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2001 L</td>
<td>322,162</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2003 A</td>
<td>69,327</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2003 B</td>
<td>423,017</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2003 C</td>
<td>340,891</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2003 D</td>
<td>587,225</td>
</tr>
<tr>
<td>Electric System General Revenue Bonds, Series 2004 A</td>
<td>207,989</td>
</tr>
<tr>
<td>Electric System Subordinated Revenue Bonds, Series 1-3</td>
<td>525,000</td>
</tr>
<tr>
<td>Electric System Subordinated Revenue Bonds, Series 7</td>
<td>250,000</td>
</tr>
<tr>
<td>Electric System Subordinated Revenue Bonds, Series 8</td>
<td>165,337</td>
</tr>
<tr>
<td>Electric System Commercial Paper Notes, CP-1</td>
<td>100,000</td>
</tr>
<tr>
<td>NYSERDA Notes</td>
<td>155,420</td>
</tr>
<tr>
<td>Total</td>
<td>$7,296,796</td>
</tr>
</tbody>
</table>

(10) Retirement Plans

The Authority participates in the New York State Employees’ Retirement System (the System), which is a cost-sharing, multi-employer, and public employee retirement system. The plan benefits are provided under the provisions of the New York State Retirement and Social Security Law that are guaranteed by the State Constitution and may be amended only by the State Legislature. For full time employees, membership in and annual contributions to the System are required by the New York State Retirement and Social Security Law. The System offers plans and benefits related to years of service and final average salary, and, effective July 17, 1998; all benefits generally vest after five years of accredited service.
Members of the System with less than “10 years of service or 10 years of membership” contribute 3% of their gross salaries and the Authority pays the balance of the annual contributions for these employees. Effective October 1, 2000, members of the System with at least 10 years of service or membership no longer contribute 3% of their gross salaries. The Authority pays the entire amount of the annual contributions of these employees.

Under this plan, the Authority’s required contributions and payments made to the System were approximately $1.3 million, $867,000, and $426,000, for the years ended December 31, 2005, 2004, and 2003, respectively. Contributions are made in accordance with funding requirements determined by the actuary of the System using the aggregate cost method.

The State of New York and the various local governmental units and agencies which participate in the Retirement System are jointly represented, and it is not possible to determine the actuarial computed value of benefits for the Authority on a separate basis. The New York State Employees’ Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement Systems, 110 State Street, Albany, New York 12244.

(11) Commitments and Contingencies

(a) Power Supply Agreement

The PSA provides for the sales to LIPA by KeySpan of all of the capacity and, to the extent necessary, energy from the oil and gas-fire generating plants on Long Island formerly owned by LILCO. Such sales of capacity and energy are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission (FERC). The rates may be modified in accordance with the terms of the PSA for: i) agreed upon labor and expense indices applied to the base year; ii) a return of and return on net capital additions, which require approval by the Authority; and iii) reasonably incurred expenses that are outside of the control of KeySpan. The PSA rates were reset in 2004, and, in accordance with the agreement, will be reset again in 2009. Between 2004 and 2009, the rates will be adjusted annually in accordance with the formula established in the PSA. The annual capacity charge in 2005, was approximately $316 million, and the variable charge remained unchanged at $0.90/Mwh.

The PSA provides incentives and penalties for up to $4 million annually, to maintain the output capability of the facilities, as measured by annual industry-standard tests of operating capability, and to maintain/or make capital improvements which benefit plant availability. The performance incentives averaged approximately $4 million in 2005 and 2004.

(b) Purchased Power and Transmission Agreements

LIPA has contracts with numerous Independent Power Producers (IPPs) and the New York Power Authority (NYPA) for electric generating capacity. Under the terms of the 2004 amended agreement with NYPA, which will expire in April 2020, LIPA may purchase up to 100% of the electric energy produced at the NYPA facility located within LIPA’s service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed nonenergy payments associated with operating and maintaining the plant.
With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs if they fail to deliver energy.

LIPA also has a contract with NYPA for firm transmission (wheeling) capacity in connection with a transmission cable that was constructed, in part, for the benefit of LIPA. With the inception of the New York Independent System Operator (NYISO) on November 18, 1999, this contract was provided with “grandfathered rights” status. Grandfathered rights allow the contract parties to continue business as they did prior to the implementation of the NYISO. That is, the concept of firm physical transmission service continues. LIPA was provided with the opportunity to convert its grandfathered rights for Existing Transmission Agreements (ETAs) into Transmission Congestion Contracts (TCCs). TCCs provide an alternative to physical transmission reservations, which were required to move energy from point A to point B prior to the NYISO. Under the rules of the NYISO, energy can be moved from point A to point B without a transmission reservation however, the entity moving such energy is required to pay a tolling fee to the owner of the TCC. This tolling fee is called transmission congestion and is set by the NYISO.

Although LIPA has converted its ETA’s into TCCs, LIPA will continue to pay all transmission charges per the ETAs, which expire in 2020. In return, LIPA has the right to receive revenues from congestion charges. All such charges and revenue associated with the TCCs are considered components of or reductions to fuel and purchased power costs, and as such are included in the FPPCA calculation.

In addition, in 2000, the Company entered into a lease for a submarine cable running between Connecticut and Long Island whereby LIPA would be entitled to up to 330 megawatts of transmission capacity. The cable was not able to obtain an operating license, as it had been determined that several sections of the cable were not buried to depths required by its permits. During 2003, the Department of Energy (DOE) issued an emergency order allowing the cable to operate. Because the cable owner has not been able to obtain an operating license, the Authority was under no obligation to remit payments to the owner based on the 2000 lease agreement. As a result, LIPA entered into an interim agreement with the cable owner which established LIPA’s ability to pay for 330 megawatts of capacity at a discounted rate from the original lease agreement during the term of the emergency order. In May 2004, the DOE lifted the emergency order.
To resolve the outstanding issues associated with the cable, among other things, LIPA entered into a June 24, 2004, Settlement Agreement with certain Connecticut regulators, the cable owner and others. The Settlement Agreement provided for the immediate re-energization and operation of the cable subject to certain conditions, such as the cable meeting the depth requirements under its Connecticut permits. LIPA and the cable owner have negotiated the terms of a Bridge Agreement, which allows LIPA to utilize the cable during the period June 27, 2004 (when the cable was energized pursuant to the Settlement Agreement) to July 1, 2007, which is the new target date for initial commercial operation of the cable. Under the Bridge Agreement, LIPA may purchase 330 MW of firm transmission capacity at a discount from the rate contained in the original lease agreement. LIPA also entered into an amendment to the original agreement with the cable owner extending the original term of the agreement from 20 to 25 years, at the same rate set in the original agreement.

As provided by LIPA’s tariff, the costs of all of the facilities noted above will be includable in the calculation of Fuel and Purchased Power Cost. As such, these costs will be recoverable through the FPPCA.

The following table represents LIPA’s commitments under purchased power and transmission contracts (thousands of dollars):

<table>
<thead>
<tr>
<th></th>
<th>PPA</th>
<th>Firm transmission</th>
<th>IPPs*</th>
<th>Total business*</th>
</tr>
</thead>
<tbody>
<tr>
<td>For the years ended:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>$34,474</td>
<td>45,033</td>
<td>168,900</td>
<td>248,407</td>
</tr>
<tr>
<td>2007</td>
<td>34,992</td>
<td>47,160</td>
<td>154,300</td>
<td>236,452</td>
</tr>
<tr>
<td>2008</td>
<td>35,528</td>
<td>48,866</td>
<td>147,400</td>
<td>231,794</td>
</tr>
<tr>
<td>2009</td>
<td>36,083</td>
<td>45,331</td>
<td>121,000</td>
<td>202,414</td>
</tr>
<tr>
<td>2010</td>
<td>36,656</td>
<td>45,878</td>
<td>62,400</td>
<td>144,934</td>
</tr>
<tr>
<td>2011 through 2015</td>
<td>173,395</td>
<td>235,507</td>
<td>281,700</td>
<td>690,602</td>
</tr>
<tr>
<td>2016 through 2020</td>
<td>170,195</td>
<td>246,631</td>
<td>12,600</td>
<td>429,426</td>
</tr>
<tr>
<td>2021 through 2025</td>
<td>—</td>
<td>179,991</td>
<td>—</td>
<td>179,991</td>
</tr>
<tr>
<td>2026 through 2030</td>
<td>—</td>
<td>186,278</td>
<td>—</td>
<td>186,278</td>
</tr>
<tr>
<td>2031 through 2035</td>
<td>—</td>
<td>89,415</td>
<td>—</td>
<td>89,415</td>
</tr>
<tr>
<td>Total</td>
<td>$521,323</td>
<td>1,170,090</td>
<td>948,300</td>
<td>2,639,713</td>
</tr>
</tbody>
</table>

* Assumes full performance by NYPA and the IPPs.
(c) Additional Power Supplies

Purchase Power Agreements

The Company has entered into Power Purchase Agreements (PPA’s) with several private companies to develop and operate 17 generating units at sites throughout Long Island. All of the PPA’s but one provide for 100% of the capacity, totaling approximately 735 MWs (and energy if needed), for the term of each contract, which vary in duration from three to 25 years from contract initiation date. The remaining contract provides the Company with capacity and/or energy of up to 10MW, and is for a term of 30 years.

In accordance with the provisions of FASB Emerging Issues Task Force Issue No. 01-8, Determining Whether an Arrangements a Lease and SFAS No. 13, Accounting for Leases, 14 of the generating units, have been accounted for as capitalized lease obligations, whereas the remaining units, are accounted for as operating leases.

The following table represents LIPA’s minimum payments under its capacity and/or energy contracts (thousands of dollars):

<table>
<thead>
<tr>
<th>Minimum lease/rental payments:</th>
<th>Capital</th>
<th>Operating</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$121,813</td>
<td>13,613</td>
</tr>
<tr>
<td>2007</td>
<td>121,380</td>
<td>13,639</td>
</tr>
<tr>
<td>2008</td>
<td>119,954</td>
<td>11,686</td>
</tr>
<tr>
<td>2009</td>
<td>119,108</td>
<td>1,813</td>
</tr>
<tr>
<td>2010</td>
<td>118,577</td>
<td>1,818</td>
</tr>
<tr>
<td>2011 through 2015</td>
<td>596,305</td>
<td>9,182</td>
</tr>
<tr>
<td>2016 through 2020</td>
<td>442,191</td>
<td>9,342</td>
</tr>
<tr>
<td>2021 through 2025</td>
<td>233,522</td>
<td>9,519</td>
</tr>
<tr>
<td>2026 through 2030</td>
<td>17,101</td>
<td>9,715</td>
</tr>
<tr>
<td>2031 through 2035</td>
<td>—</td>
<td>6,594</td>
</tr>
<tr>
<td>Total</td>
<td>1,889,951</td>
<td>86,921</td>
</tr>
</tbody>
</table>

Less imputed interest

<table>
<thead>
<tr>
<th>Net present value</th>
<th>$1,218,868</th>
<th>86,921</th>
</tr>
</thead>
</table>
(d) **Office Lease**

The Authority entered into a noncancelable office lease agreement through January 31, 2011. The future minimum payments under the lease are as follows (thousands of dollars):

<table>
<thead>
<tr>
<th>Year ended December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$ 1,338</td>
</tr>
<tr>
<td>2007</td>
<td>1,388</td>
</tr>
<tr>
<td>2008</td>
<td>1,440</td>
</tr>
<tr>
<td>2009</td>
<td>1,494</td>
</tr>
<tr>
<td>2010</td>
<td>1,550</td>
</tr>
<tr>
<td>2011</td>
<td>129</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 7,339</td>
</tr>
</tbody>
</table>

Rental expense for the office lease amounted to approximately $1.4 million for the years ended December 31, 2005 and 2004.

(e) **Insurance Programs**

The Authority’s insurance program is comprised of a combination of policies from major insurance companies, self-insurance and contractual transfer of liability, including naming the Authority as an additional insured and indemnification.

The Authority has purchased insurance from the State of New York to provide against claims arising from workers’ compensation. Liability related to construction projects and similar risks is transferred through contractual indemnification and compliance with Authority insurance requirements. The Authority also has various insurance coverages on its interest in Nine Mile Point Nuclear Power Station, Unit 2 as disclosed in detail in footnote 7.

The Authority is self insured for property damage to its transmission and distribution system and up to $3 million for general liability, including automobile liability. The Authority purchased commercially available excess general liability insurance for claims above the $3 million self insurance provision.
(12) Legal Proceedings

(a) Authority to Set Rates

Lawsuits have been commenced as class actions, and additional lawsuits threatened, challenging the steps LIPA has taken to increase its rates to reflect increases in its fuel costs. Among other allegations, the Plaintiffs contend that such increases violate certain conditions imposed on LIPA by the New York State Public Authorities Control Board in 1997. These lawsuits also repeat several criticisms directed at LIPA in a report issued by the New York State Comptroller in December 2005 which, among other things, took issue with the methodology used by LIPA in applying its FPPCA and criticized the increases in rates which have resulted from application of the FPPCA. LIPA believes that its rate structure, including the FPPCA, complies with applicable legal requirements and that the methodology it uses to calculate the FPPCA is correct. Plaintiffs seek injunctive relief and an unspecified amount of damages on behalf of themselves and other class members. LIPA will vigorously contest these cases and expects to prevail. If the Authority does not prevail in this litigation, it may influence the timing and size of rate increases implemented by the Authority and/or require (i) the modification of the plan to accelerate retirement of debt (ii) the withdrawal of funds from the Rate Stabilization Fund to avoid or minimize rate increases, or (iii) other action necessary to meet any required conditions.

(b) Environmental

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

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

Environmental liabilities that existed as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan, as provided for in the Merger.
(c) Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables – The Connecticut Department of Environmental Protection (DEP) and the New York State Department of Environmental Conservation (DEC) separately have issued Administrative Consent Orders (ACOs) in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound that LIPA owns jointly with the Connecticut Light and Power Company (CL&P) (the “1385 Cable”). The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Pursuant to the June 24, 2004 Settlement Agreement (as referenced above) LIPA and CL&P agreed to undertake good faith negotiations on all contracts and other arrangements necessary for the removal and replacement of the 1385 Cable and to complete such negotiations no later than October 1, 2004. LIPA and CL&P further agreed to develop and implement a plan for such replacement on a schedule approved by the Commissioner of DEP. LIPA and CL&P have completed such negotiations, entered into two agreements with Northeast Utilities Service Company (NUSCO) relating to the use and replacement of the 1385 Cable, and submitted an implementation plan for such replacement, which was approved by the DEP. Replacement of the 1385 Cable is being procured by NUSCO on behalf of both LIPA and CL&P, and is expected to be completed in 2008.

In November 2002, a work boat, owned and operated by a third party, dragged its anchor, causing extensive damage to four of the seven cables of the 1385 cable and the release of a minimal amount of dielectric cable fluid into the Long Island Sound. The work boat had been at the cable site working as part of a large natural gas pipeline project. Temporary repairs were promptly carried out (the cable ends were capped) and permanent repairs completed in June 2003. Litigation arising from the incident commenced in December 2002 and in that litigation LIPA and CL&P aggressively pursued the owner of the work boat as well as the other parties involved in the natural gas pipeline project and who were involved in this incident. As a result of a voluntary mediation in February 2005, LIPA, CL&P and their insurance underwriters reached a settlement agreement with the owner of the work boat and the other parties, which was completed in April 2005.

The same natural gas pipeline project also resulted in another anchor drag incident in February 2003, which damaged the Y-49 Cable, a facility owned by NYPA but maintained by LIPA as the primary user. Here, a large barge involved in the project dragged its anchor resulting in the damage to one of the four cables of this facility. Temporary repairs (cable was capped) were completed within ten days and permanent repairs were done by September 2003. Litigation arising from the incident commenced in August 2003. LIPA, as well as NYPA and its property damage insurer are actively engaged in litigation against the barge owner as well as the other parties involved in the incident.
Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA has conducted studies and monitoring activities in connection with this herbicide and is currently working cooperatively with the DEC and others in this matter. Results of these studies, and discussion with the regulatory agencies, have indicated that the environmental impact of this contamination is minimal and remediation work has been completed. However, pending the final conclusion of agency action on this matter, the liability, if any, resulting from the use of this herbicide cannot yet be determined. Nevertheless, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

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

Metal Bank – In December 1997, the EPA issued its Record of Decision (ROD), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present cost of the selected remedy for the site is $17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 Potential Responsible Parties (PRPs), including LIPA, for the remedial design and for remedial action at the site. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability equal to its estimated cost representing its estimated share of the additional cost to remediate this site. The liability phase of the case was tried in the fall of 2002, which resulted in a finding of liability against Metal Bank in January 2003. At a March, 2003 conference before the federal judge, the court ordered that the second stage trial (determination of the final remedy) be held on November 1, 2003. In May, 2003, the Metal Bank parties filed for Federal Bankruptcy protection under Chapter 11, resulting in a reorganization plan that obligated the emerging entity to fund $13.25 million of the final remedy with no further obligation. In 2003, all the parties (EPA, the PRPs, and the two Schorsch brothers [owners who were adjudicated liable early 2003 along with the Metal Bank parties]) entered into nonbinding mediation of two issues: (i) the scope of the remedy, and (ii) whether and how much the Schorsch brothers are prepared to contribute. As a result of that mediation, a final global settlement was negotiated, which did not require any monetary payment from the PRPs, but required the collective payment of $9.6 million from the Schorsch brothers. In 2005, Final Consent Decrees were published for public comment, the public hearing was held, and the Federal Judge is expected to shortly approve the Decrees, making all the settlement terms final, and formally ending the litigation. Shortly, the Utilities Group (of which LIPA is a party) expects to submit to the EPA for its approval the Final Remedial Design Plan, and approval is expected in the first half of 2006. As a result of the entry of the Consent Decrees, the Utilities Group should be paid approximately $4 million by the defendant Schorsch brothers, which the Utilities Group intends to retain as a reserve should a contingency arise and the $13.25 million (funding of which is now ready to begin) by the Metal Bank successor in bankruptcy for the remedial work be insufficient. Based on the above, the Utilities Group expects remediation work to commence in 2006.
PCB Treatment Inc. – LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCE Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing Polychlorinated Biphenyls (PCBs). According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order and investigated environmental conditions at these properties. The work required under this consent order has been completed, and the PRPs, including LIPA, recently signed a second consent order that obligates them to clean up and restore the two contaminated properties. LIPA has been determined to be responsible for less than 1% of the materials that were shipped to this site. Although LIPA is currently unable to determine its precise liability for costs to remediate these sites, LIPA does not believe that this liability will have a material adverse effect on its financial position, cash flows or results of operations.

Environmental Matters Which May be Recoverable from LIPA by KeySpan Through the PSA

Asharoken. In March 1996, the Village of Asharoken (the Village) filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company). Although the Village’s negligence claims were dismissed, the causes of action sounding in nuisance remain at issue. Specifically, the Village seeks injunctive relief based upon allegations that the design and construction of the Northport Power Plant upset the littoral drift of sand in the area, thereby causing beach erosion. In a related matter, certain individual residents of the Village commenced an action in New York Supreme Court Suffolk County seeking similar relief (Sbarro v. Long Island Lighting Company). The cases were tried jointly before a judge without a jury. The trial was completed in December 2002 and the parties filed post-trial briefs in March 2003. Since that time, the judge passed away and the case has been reassigned. The parties have agreed that the new judge can decide the case on the existing and supplemental record in lieu of a new trial. Liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

Asbestos Proceedings

Litigation is pending in State Court against LIPA, LILCO, KeySpan and various other defendants, involving thousands of plaintiffs seeking damages for personal injuries or wrongful death allegedly caused by exposure to asbestos. The cases for which LIPA may have financial responsibility involve employees of various contractors and subcontractors engaged in the construction or renovation of one or more of LILCO’s six major power plants. These cases include extraordinarily large damage claims, which have historically proven to be excessive. The actual aggregate amount paid to plaintiffs alleging exposure to asbestos at LILCO power plants over the years has not been material to LIPA. Due to the nature of how these cases are litigated, it is difficult to determine how many of the remaining cases that have been filed (or of those that will be filed in the future) involve plaintiffs who were exposed to asbestos at any of the LILCO power plants. Based upon experience, it is likely that LIPA will have financial responsibility in a significantly smaller percentage of cases than are currently pending (or which will be filed in the future) involving plaintiffs who allege exposure to asbestos at any of the LILCO power plants.
Environmental Matters Which are Currently Untraceable for Which LIPA Could Have Responsibility

*Other Superfund Sites.* The Attorney General is in negotiations with LIPA and other parties to achieve settlements at two of three municipal landfills where LILCO allegedly disposed of hazardous substances. The landfills are located in Towns of North Hempstead (the Port Washington Landfill) and Southampton, (the North Sea Landfill). The other municipal landfill where LILCO allegedly disposed of hazardous substances is in the Town of Huntington (the East Northport Landfill). All three landfills have been remediated and the Attorney General is seeking to recover the monies spent by the State in remediating the sites. The East Northport Landfill site was settled with the parties, resulting in an Order on Consent issued by the Attorney General on October 29, 2004. LIPA’s share of the settlement was $173,800. The other two sites are still open and the subject of tolling agreements to extend the statute of limitations so that the State does not have to initiate litigation in order to achieve settlements with the various parties. LIPA’s share of alleged liability at each site has not been established. LIPA was also served with a Request for Information by the Attorney General seeking information related to LILCO’s activities at the Babylon Landfill Site in the Town of Babylon between 1946 and 1992. LIPA has responded to that request even though the statute of limitations has run against the Attorney General for seeking recovery against LIPA. The other potentially responsible parties who have signed tolling agreements could, however, bring an action against LIPA if they are sued by the Attorney General.

*Other Matters*

*East End Property Company #1, LLC, et al. v. Richard M. Kessel and The Long Island Power Authority, et al.* In January 2006 litigation was commenced against the Authority, among others, contending that certain actions taken by it in connection with the power purchase agreement the Authority entered into with Caithness Long Island LLC (“Caithness”), the proposed construction by Caithness of a power plant in Brookhaven and the possible extension of the Iroquois Pipeline to the plant violate State environmental laws and other State laws and regulations. Plaintiff seeks, among other things, to annul actions the Authority has taken in connection with the power purchase agreement, to enjoin any action taken in furtherance of such agreement and to declare actions taken by the Authority in connection with the extension of the Iroquois Pipeline to be void. The Authority will file its answer to the complaint on March 1, 2006 and will vigorously contest this litigation.

LIPA may from time to time become a party to various legal proceedings arising in the ordinary course of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material effect on the financial position, results of operations or cash flows of LIPA.
LONG ISLAND POWER AUTHORITY
(A Component Unit of The State of New York)

Notes to Basic Financial Statements

December 31, 2005 and 2004

Future Environmental Compliance Obligations

LIPA, through its contractual obligations to KeySpan under the PSA and the MSA, is subject to the cost of compliance with various current and potential future environmental regulations as promulgated by the federal government and by state and local governments with respect to environmental matters, such as emission of air pollutants, cooling water for generation, the handling and disposal of toxic substances and hazardous and solid wastes, and the handling and use of chemical products. Electric utility companies generally use or generate a range of pollutants, potentially hazardous products and by-products that are the focus of such regulation. LIPA is also subject to state laws regarding environmental approval and certification of proposed major transmission facilities.

From time to time environmental laws, regulations and compliance programs may require changes in KeySpan’s operations and facilities, and may increase the cost of energy delivery service. These costs may be reduced in the future, dependent on a capacity ramp down right that is available to LIPA beginning in 2008, the same time period where several compliance obligations occur. Historically, rate recovery has been authorized for environmental compliance costs.

The Clean Air Act Amendments of 1990 (1990 Amendments) limit emissions of sulfur dioxide (SO2) and nitrogen oxides (NOx). The U.S. Environmental Protection Agency (EPA) allocates annual sulfur dioxide emissions allowances to each of the PSA units based historical output. NOx are regulated on a regional level through the Ozone Transportation Commission, and are also controlled through allowance allocations. The PSA units are expected to continue to achieve cost effective compliance with these emission control requirements through capital expenditures, the use of natural gas fuel, and the purchase of emission allowances when necessary. LIPA may be required to purchase additional allowances above the PSA unit allocations based on changes in fuel prices. Future requirements of the 1990 Amendments may require further reduction of SO2 and NOx emissions, as well as new limits on mercury and nickel emissions. However, specific control requirements have not been determined by the EPA, and the costs, if any cannot be estimated at this time.

In 2003 the State of New York promulgated separate regulations that would further limit SO2 and NOx beginning in 2004. The PSA units are expected to comply with the NOx requirements without additional material expenditures, and utilize lower sulfur fuel to meet the SO2 regulations at an approximate cost of $20 million annually from 2005 through 2007. Further fuel sulfur reductions may be required in 2008 and beyond. In 2005, seven Northeast states signed a Memorandum of Understanding called the Regional Greenhouse Gas Initiative (RGGI) for the purpose of capping and then reducing greenhouse gas emissions from power plants. Several similar initiatives are also being considered at the federal level. It is not possible at this time to predict the nature of the requirements that may be imposed, nor their potential operational or financial impacts but the ability of the major PSA units to burn lower CO2 emitting natural gas provides compliance flexibility for these units.
In March 2005, the Federal Clean Air Interstate Rule was promulgated, requiring further reduction of SO2 and NOx emissions. Depending on the outcome of one or more legal challenges, compliance requirements for NOx reduction would begin in 2009, and could require capital expenditures for emission control equipment on the order of $25 million to $35 million from 2006-2009. SO2 reductions if required are expected to be achieved through the use of lower sulfur fuels or the surrender of excess emission allowances. Another rule issued in March of 2005, the Clean Air Mercury Rule (CAMR) set new limits for mercury emissions from coal fueled plants. These do not apply to the PSA units, The rule making process considered, but ultimately did not determine to regulate, Nickel emissions from oil fired units which would have affected some PSA units. Some aspects of CAMR are being litigated. Accordingly, it can not be determined whether EPA’s decision not to regulate nickel will be sustained or whether any future compliance obligations will be imposed.

LIPA and the DEC are parties to a 1998 Consent Order for opacity, for which LIPA pays certain fines for exceeding the opacity limits. While in the past these fines have not been material, the DEC recently issued a draft industry-wide guidance that would increase penalties to as much as much as $1 million per violation.

The Clean Water Act (CWA) requires that electric generating stations hold State Pollutant Discharge Elimination System (SPDES) permits, which reflect water quality considerations for the protection of the environment. Additional capital expenditures may be required by the New York State Department of Environmental Conservation (DEC) upon the periodic renewal of these water discharge permits due to recently promulgated changes in Section 316(b) of the CWA. KeySpan is undertaking the study of the impact of current permit conditions on aquatic resources in consultation with the DEC. The nature and extent of any expenditures cannot be determined until ongoing analysis of the impacts and mitigation discussions with NYSDEC are completed. At this time, compliance estimates range from $20 to $40 million in the 2006-2010 timeframe.

(13) Subsequent Events

Strategic Organization Review

In August 2004, the Authority began an extensive analysis of its organizational structure. The purpose of the review was to decide whether the Authority, as currently organized and governed, was in the best position to provide Long Island with reliable power at the lowest possible cost over the long term. The review also evaluated whether the Authority should exercise its option to acquire the former LILCO on-Island generation consisting of 53 generating units at 13 locations totaling approximately 4,000 megawatts (the “GPRA Option”). In December 2005, the Authority announced that it would remain in its current structure as a governmental authority and retain its public/private partnership model. The Authority also announced that, in connection with this determination, it had reached an agreement in principle with KeySpan to (i) substantially amend the Management Services Agreement between the Authority and KeySpan Electric Services LLC (the “MSA”) and extend its term to December 31, 2013 (ii) settle certain disputes with KeySpan and the KeySpan Subs and (iii) provide the Authority with an option to acquire two of KeySpan’s generating facilities with a combined capacity of 450 megawatts (the Barrett and Far Rockaway plants).
In January, 2006 LIPA entered into definitive agreements to amend the MSA and certain other operating agreements entered into with certain of the KeySpan Subs, subject to certain governmental approvals and other conditions. LIPA also entered into a Settlement Agreement, dated as of January 1, 2006 (the “2006 Settlement Agreement”), with KeySpan and certain of the KeySpan Subs to resolve certain outstanding disputes. LIPA will receive approximately $120 million in payments or credits pursuant to the 2006 Settlement Agreement. LIPA has announced that it will reserve a portion of such amount to allow it to avoid increasing its electric rates through 2007, absent a world-wide energy crisis. In addition, LIPA expects to pay down approximately $25 million of its outstanding debt and provide each residential customer with a one-time refund of $35. LIPA also entered into an option agreement (the “2006 Option Agreement”) with KeySpan Generation LLC (“GENCO”) which provides LIPA with an option (the “2006 Purchase Option”), exercisable not later than December 31, 2006, to acquire the Barrett and Far Rockaway plants from GENCO. In the event that LIPA acquires either or both of such plants, LIPA and KeySpan have agreed that KeySpan, acting through a subsidiary to be designated, will operate and maintain such plants.

Such agreements are subject to approval by the New York State Comptroller and, as to form, by the New York State Attorney General and are also subject to the condition that each of the 2006 Settlement Agreement, the 2006 Option Agreement and the amendment to the Management Services Agreement must become effective or none will become effective. If such agreements become effective, the GPRA Option will expire. However, if such agreements do not become effective, the Authority will have 90 days to exercise the GPRA Option.

On February 27, 2006 KeySpan announced a definitive agreement under which KeySpan would be acquired in early 2007 by an affiliate of National Grid plc, a company organized under the laws of Great Britain. The transaction is subject to the approval of the shareholders of both companies and to various regulatory approvals. The Authority will evaluate the acquisition of KeySpan by National Grid plc and its effect on the Authority’s agreements with KeySpan and the potential benefits to LIPA’s customers of the acquisition. In the event there is a change of control of KeySpan, the Authority and LIPA have the option of canceling their contracts with KeySpan and the KeySpan Subs.

**2006 Bond Issuance**

In March 2006, the Authority issued Series 2006A Electronic System Revenue Bonds totaling approximately $853 million to refund certain outstanding debt and 2006B Electronic System Revenue Bonds totaling approximately $97 million to reimburse LIPA’s treasury for or to fund capital expenditures for system improvements. In addition, the Authority plans to remarket it Series 8F Subordinated Bonds in April 2006.
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

The Board of Trustees
Long Island Power Authority:

We have audited the basic financial statements of the Long Island Power Authority (Authority) as of and for the year ended December 31, 2005, and have issued our report thereon dated March 23, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority’s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority’s basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of Authority management, the Authority’s Board of Trustees, the New York State Division of the Budget and the New York State Office of the State Comptroller and is not intended to be and should not be used by anyone other than those specified parties.

March 23, 2006
Appendix B

Projected Operating Results

Set forth below are projected financial results for LIPA for the years 2006 through 2010. Such projections are based on various assumptions, which are described below.

Statements of Revenues and Expenses
(Thousands of Dollars)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$3,735,331</td>
<td>$3,808,223</td>
<td>$3,884,200</td>
<td>$3,758,642</td>
<td>$3,665,374</td>
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<tr>
<td>Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel and Purchased Power Costs</td>
<td>2,085,748</td>
<td>2,151,977</td>
<td>2,198,400</td>
<td>2,033,334</td>
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<td>Operations and Maintenance Expenses</td>
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<td>768,546</td>
<td>791,257</td>
<td>809,125</td>
<td>833,422</td>
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<td>General and Administrative Expenses</td>
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<td>46,984</td>
<td>48,628</td>
<td>50,330</td>
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<td>Depreciation and Amortization</td>
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<td>253,793</td>
<td>261,704</td>
<td>268,859</td>
<td>275,566</td>
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<td>Revenue Taxes</td>
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<td>59,969</td>
<td>61,100</td>
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<td>59,323</td>
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<td>Payments in Lieu of Taxes (PILOTS)</td>
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<td>185,450</td>
<td>193,967</td>
<td>201,480</td>
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<td>Total Operating Expenses</td>
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<td>3,466,719</td>
<td>3,555,056</td>
<td>3,423,149</td>
<td>3,351,736</td>
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<td>Operating Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Other Income and Deductions</td>
<td>60,891</td>
<td>66,492</td>
<td>70,246</td>
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<td>68,798</td>
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<td>Interest Expense</td>
<td>344,526</td>
<td>332,996</td>
<td>324,390</td>
<td>317,203</td>
<td>307,436</td>
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<td>Excess of Revenues Over Expenses</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$75,000</td>
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Debt Service Coverage Ratios (x):

- Senior Lien Debt: 2.36, 2.42, 2.52, 2.96, 3.02
- Senior Lien and Subordinate Debt: 2.06, 2.12, 2.35, 2.47, 2.68
- Total Debt: 2.03, 2.09, 2.31, 2.43, 2.63
## Statements of Sources and Uses of Funds
(Thousands of Dollars)

### FUNDS PROVIDED FROM:

<table>
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<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
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<tr>
<td><strong>Excess of Revenues Over Expenses</strong></td>
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<td>$ 75,000</td>
<td>$ 75,000</td>
<td>$ 75,000</td>
<td>$ 75,000</td>
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<td><strong>Plus (Minus) Non-Cash Items:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>Amortization of Deferred Shoreham Property Settlement Credits</td>
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<td>35,936</td>
<td>36,725</td>
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<td>Carrying Charges on Deferred Shoreham Property Tax Settlement Costs</td>
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<td>(32,178)</td>
<td>(31,829)</td>
<td>(31,383)</td>
<td>(30,856)</td>
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<td>Deferred Fuel Cost Reconciliation</td>
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<td>NMP2 Amortized Nuclear Fuel Expense</td>
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<td>6,035</td>
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<td>Amortization of Prepaid NMP2 Refueling Outage Costs</td>
<td>3,149</td>
<td>2,340</td>
<td>2,205</td>
<td>2,160</td>
<td>2,025</td>
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<td>Amortization of Prepaid Fuel Hedging Program Costs</td>
<td>13,725</td>
<td>15,555</td>
<td>12,592</td>
<td>11,500</td>
<td>10,000</td>
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<td>Asset Retirement Obligation Accretion - FASB 143</td>
<td>4,345</td>
<td>4,606</td>
<td>4,882</td>
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<td>Amortization of Prepaid Mobile Generating Units</td>
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<td>10,044</td>
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<td>Depreciation and Amortization</td>
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<td>253,793</td>
<td>261,704</td>
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<td>Other</td>
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<td>Debt Service Interest Expense</td>
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<td>Proceeds of Bonds and Notes</td>
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<td>50,000</td>
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<tr>
<td><strong>Total Sources of Funds before Interest Expense</strong></td>
<td><strong>$ 940,272</strong></td>
<td><strong>$ 845,486</strong></td>
<td><strong>$ 798,506</strong></td>
<td><strong>$ 784,651</strong></td>
<td><strong>$ 755,723</strong></td>
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### FUNDS USED FOR:

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<th>2007</th>
<th>2008</th>
<th>2009</th>
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<tr>
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<td>12,000</td>
<td>10,000</td>
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<td>10,000</td>
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<td>Prepaid NMP2 Refueling Outage Costs</td>
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<td>180</td>
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<td>Funding for NMP2 Plant Decommissioning</td>
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<td>4,000</td>
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<tr>
<td>Bank and Related Fees</td>
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<td>Debt Service Payments</td>
<td>540,672</td>
<td>547,500</td>
<td>526,238</td>
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<td>Capital Expenditures</td>
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<td>259,380</td>
<td>243,998</td>
<td>210,600</td>
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<tr>
<td>NMP2 Cash Fuel Expenses Capital Expenditure</td>
<td>1,813</td>
<td>12,514</td>
<td>686</td>
<td>16,795</td>
<td>730</td>
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<tr>
<td>Change in Cash Position Due to Operating, Financing and Investing Activities</td>
<td>92,871</td>
<td>(1,240)</td>
<td>(2,607)</td>
<td>(2,948)</td>
<td>(1,445)</td>
</tr>
<tr>
<td><strong>Total Uses of Funds</strong></td>
<td><strong>$ 940,272</strong></td>
<td><strong>$ 845,486</strong></td>
<td><strong>$ 798,506</strong></td>
<td><strong>$ 784,651</strong></td>
<td><strong>$ 755,723</strong></td>
</tr>
</tbody>
</table>
The projections set forth above were prepared in October 2005 based on the assumptions set forth below. These assumptions were developed prior to the 2006 agreements between the Authority and KeySpan described in Part 2 of this Official Statement and do not include the effects of such agreements.

1. LIPA's load and energy forecast is prepared by KeySpan, under LIPA's supervision, utilizing econometric regression models. These models are based on the relationship between the historical levels of electricity consumption and the variables that are considered to drive consumption including weather, changes in the number of customers, changes in the level of employment, income levels, the size of homes and facilities and the price of electricity. The sales forecast incorporates moderate customer growth through the end of 2010. Employment numbers are based on projections from an independent forecasting company with adjustments made for current or anticipated changes in employment levels and discussions with local economists and regional planners. Jobs are estimated to increase by 51,900 jobs over the Projection Period. The primary employment gains are projected to be in education & health services (about 24,000 jobs) followed by business services (12,200 jobs) and wholesale & retail trade (7,600 jobs). The long slow decline in manufacturing employment on Long Island is projected to moderate, with jobs decreasing by only 800. Income per household is forecasted to increase by 5.2% (0.7% on real terms to exclude the effects of inflation) per year in the Projection Period. 

2. The fuel and purchased power cost projections are prepared by KeySpan utilizing a generation economic dispatch model that considers among other variables, the availability and heat rates of generating resources and delivered fuel prices. The delivered fuel price forecast was also prepared by KeySpan based upon the 10-day average of NYMEX (Henry Hub) ended September 30, 2005 for gas and the SWAPS (NY Harbor) commodity prices for oil dated September 30, 2005.

3. The projections assume that the proposed new power supply sources will be available at the times expected and that current power supply sources will remain available with no significant disruptions.

4. Operating and Administrative costs are projected to increase at an annual rate of approximately 3.5%.

5. The projections assume that electric rates, including the FPPCA, will be set at a level which will produce a reserve of $75 million per year.

6. Capital expenditures are based on continuation of current programs to maintain and/or improve reliability and quality of electric service, provide for new customer growth and provide the upgrades necessary to accommodate new supply sources.

7. The projections assume that the Authority and LIPA stay as currently structured and the GENCO assets are not acquired.
GLOSSARY OF DEFINED TERMS

The following terms, as generally used in Part 1, Part 2 and Appendices D, E and F of this Official Statement, have the respective meanings provided below. These summary definitions do not purport to be complete or definitive and are qualified in their entirety by reference to the Resolution, the Financing Agreement, the MSA, the PSA and the EMA, copies of which are on file with the Trustee and to the Amended and Restated Management Services Agreement (the “Amended and Restated MSA”), a copy of which is on file with the Authority.

“Account” means one of the special accounts created and established pursuant to the Resolution.

“Acquisition Debt” means (A) all Bonds and Subordinated Indebtedness issued for the purposes of providing funds to (i) complete the LIPA/LILCO Merger, (ii) refinance and/or retire any Retained Debt of LIPA, and (iii) pay fees and expenses incurred in conjunction with the foregoing, and (B) all other Outstanding LIPA Unsecured Debt.

“Act” means the Long Island Power Authority Act, being Title One-A of Article 5 (§ 1020 et seq.) of the Public Authorities Law of the State, as amended.

“Administrative Services Agreement” means the Administrative Services Agreement, dated as of May 1, 1998, between the Authority and LIPA, as the same may be amended and supplemented.

“Affiliate” means any person, corporation or other entity directly or indirectly controlling or controlled by another person, corporation or other entity or under direct or indirect common control with such person, corporation or other entity.

“Ancillary Services” means the ancillary services required by NYISO from time to time to enable the NYISO to operate the transmission system in New York State in a secure and reliable manner.

“Annual Report” means the report of certain financial and operating data prepared annually by the Authority as required by and described in the Disclosure Certificate.

“Annual T&D Budget” means such budget as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Process”).

“Applicable Law” means any law, rule, regulation, condition, requirement, guideline, ruling, ordinance or order of or any Legal Entitlement issued by, any Governmental Body and applicable from time to time to the performance of the obligations of the parties to an Agreement.

“Authority Budget” means the annual budget of the Authority, as amended or supplemented, adopted or in effect for a particular Fiscal Year, included as part of the System Budget as provided in the Resolution.

“Authority Obligations” means, collectively, all Bonds and other bonds, notes or other evidences of indebtedness for money borrowed by the Authority, Parity Reimbursement Obligations, Parity Contract Obligations and Subordinated Indebtedness, but shall not include debt of the Authority not secured by the Trust Estate.

“Authorized Representative” means in the case of both the Authority and LIPA, their respective Chairman, Chief Executive Officer, Executive Director, Chief Financial Officer, Controller or Chief Operating Officer, or such other person or persons so designated by resolution of the Authority or LIPA, as the case may be.
“Beneficial Owner” shall have the meaning assigned thereto in Appendix G to this Official Statement.

“Billing Period” means each calendar month in each Contract Year, except that the last Billing Period shall end on the last day of the term of the Agreement.

“Bond Counsel” means (i) Hawkins Delafield & Wood LLP, New York, New York or (ii) any attorney or firm of attorneys of nationally recognized standing in the field of law relating to revenue bonds of municipalities and public agencies, selected by the Authority and reasonably satisfactory to the Trustee.

“Bond Payment Date” means each date on which interest or both a Principal Installment and interest shall be due and payable on any of the Outstanding Bonds or Parity Reimbursement Obligations according to their terms.

“Bondholder”, “Owner” or “Holder” means, when used with reference to a Bond, the person in whose name the Bond is registered on the registry books kept by the Trustee pursuant to the Resolution.

“Bonds” means all bonds, notes or other evidence of indebtedness of the Authority issued pursuant to the Resolution that are on a parity, senior lien basis as to security and source of payment.

“Business Day” means any day other than a Saturday, Sunday or Legal Holiday.

“Capital Costs” as used in the Amended and Restated MSA, means the costs associated with Capital Improvements. Such costs shall include all applicable direct and indirect costs required to be capitalized in accordance with LIPA’s capitalization policy and GAAP, consistently applied. Such costs may also be capitalized in accordance with FERC’s Uniform System of Accounts.

“Capital Lease” means any capital lease or other obligation (other than Bonds, Subordinated Indebtedness, Outstanding LIPA Unsecured Debt, Parity Contract Obligations, Subordinated Contract Obligations, Parity Reimbursement Obligations, Subordinated Reimbursement Obligations, or certain obligations issued for Separately Financed Projects), treated as debt under the accounting principles pursuant to which the books of account of the Authority or LIPA, as the case may be, are kept and audited.

“Capital Improvement” as used in the Amended and Restated MSA, means any repair, replacement, improvement, removal and retirement, alteration and addition to the T&D System which constitutes a capital property unit in accordance with LIPA’s capitalization policy, consistently applied (other than any repair, replacement, improvement, removal and retirement, alteration and addition constituting repair or maintenance of the T&D System) contained in the approved Capital Plan and Budget, including all Public Works Improvements that have an expected useful service life of more than one (1) year from the date of installation.

“Capitalized Interest” means that portion of the proceeds of any Bonds, and interest earnings thereon, used to pay interest on any Bonds.

“Certificate” means (i) a signed document attesting to or acknowledging the matters therein stated or setting forth matters to be determined pursuant to the Resolution or otherwise, (ii) the report of an Accountant as to an audit or compliance called for by the Resolution, or (iii) any report of the Consulting Engineer or Rate Consultant as to any matter called for by the Resolution or the Financing Agreement.

“Change of Control” means (i) the acquisition of beneficial ownership (within the meaning of Rule 13d 3 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the “1934 Act”) of 35% or more of the outstanding shares of securities the holders
of which are generally entitled to vote for the election of directors of the Manager, the Energy Manager or the Guarantor, as the case may be (including securities convertible into, or exchangeable for, such securities or rights to acquire such securities or securities convertible into, or exchangeable for such securities, “Voting Stock”), on a fully diluted basis, by any Person or group of Persons (within the meaning of Section 13 or 14 of the 1934 Act); (ii) any sale, transfer or other disposition of beneficial ownership of 35% or more of the outstanding shares of the Voting Stock, on a fully diluted basis, of the Manager, the Energy Manager or the Guarantor, as the case may be; (iii) any merger, consolidation, combination or similar transaction of the Manager, the Energy Manager or the Guarantor, as the case may be, with or into any other Person, whether or not the Manager, the Energy Manager or the Guarantor, as the case may be, is the surviving entity in any such transaction; (iv) any sale, lease, assignment, transfer or other disposition of the beneficial ownership in 35% or more of the property, business or assets of the Manager, the Energy Manager or the Guarantor, as the case may be; (v) a Person other than the current shareholders of the Manager, the Energy Manager or the Guarantor, as the case may be, obtains, directly or indirectly, the power to direct or cause the direction of the management or policies of the Manager, the Energy Manager or the Guarantor, as the case may be, during any period of 12 consecutive calendar months, when individuals who were directors of the Manager, the Energy Manager or the Guarantor, as the case may be, on the first day of such period cease to constitute a majority of the board of directors of the Manager, the Energy Manager or the Guarantor, as the case may be; or (vii) any liquidation, dissolution or winding up of the Energy Manager or the Guarantor, as the case may be.

“Code” means the Internal Revenue Code of 1986, as amended, or any successor thereto, as the same may be in effect from time to time.

“Common Facilities” has the meaning attributed to that term in the FERC Uniform System of Accounts.

“Construction Fund” means the fund by that name established pursuant to the Resolution.

“Construction Work” means the services to be provided and materials to be supplied by the Manager, relating to the design, procurement, construction, start-up and testing of the Major Capital Improvements and Public Works Improvements.

“Consulting Engineer” means, (i) when such term is used in the Resolution and the Financing Agreement, any independent engineer or firm of engineers of recognized standing selected by the Authority and may include an independent engineer or firm of engineers of recognized standing selected by the Authority or LIPA in one or more other capacities and (ii) when such term is used in the Operating Agreements, a nationally recognized consulting engineer or firm of consulting engineers, having experience with respect to the design, construction, testing, operation and maintenance of electricity transmission and distribution systems, which is designated as the Consulting Engineer for the purposes of the subject Agreement from time to time in writing by LIPA.

“Contract Standards” means the terms, conditions, requirements, methods, techniques, standards and practices of (1) Applicable Law, (2) the System Policies and Procedures, (3) the substantive requirements and standards and guidelines established by the PSC that apply as of May 28, 1998 to the operation and maintenance of the T&D System, except to the extent otherwise directed by LIPA, (4) Prudent Utility Practice, (5) the Performance Guarantees, (6) the Operation and Maintenance Manual, (7) applicable equipment manufacturer’s specifications and reasonable recommendations, (8) applicable Insurance Requirements, and (9) any other term, condition or requirement specifically provided in this Agreement to be observed by the Manager.

“Contract Year”, except as LIPA shall otherwise propose subject to the approval of the Manager, or the Energy Manager, as the case may be, which approval shall not be unreasonably withheld,
means the calendar year commencing on January 1 in any year and ending on December 31 of that year; provided, however, that the first Contract Year shall commence on January 1 prior to the date the Agreement expires or is terminated, whichever is appropriate, and shall end on the last day of the term of the Agreement or the effective date of any termination, whichever is appropriate. Any computation made on the basis of a Contract Year shall be adjusted on a pro rata basis to take into account any Contract Year of less than 365/366 days.

“Cost Incentive Fee” means such fee as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Management Fee, Cost Incentive Fee and Non-cost Performance Incentives and Disincentives”).

“Costs” means costs of any System Improvements or any other purpose related to the System for which bonds, notes or other obligations of the Authority may be issued under the Act or under other applicable State statutory provisions (whether or not also classifiable as an Operating Expense), including but not limited to direct costs, incidental costs (including but not limited to legal, administrative, engineering, consulting and technical services, insurance and financing costs), working capital and reserves deemed necessary or desirable by LIPA and approved by the Authority, and other costs properly attributable thereto including but not limited to the payment of principal, interest, and redemption, tender or purchase price of any (i) obligations issued by the Authority for the payment of any of such costs, (ii) outstanding LIPA Unsecured Debt, (iii) obligations issued to pay Capitalized Interest or (iv) obligations issued to refund any obligations referred to in clauses (i) or (iii) or outstanding LIPA Unsecured Debt referred to in clause (ii); all items of expense directly or indirectly payable or reimbursable and related to the authorization, sale and issuance of Bonds, including but not limited to printing costs, costs of preparation and reproduction of documents, filing and recording fees, initial fees and charges of any Fiduciary, legal fees and charges, fees and disbursements of consultants and professionals, costs of credit ratings, fees and charges for preparation, execution, transportation and safekeeping of Bonds, costs and expenses of refunding, premiums for the insurance of the payment of the Bonds and any other cost, charge or fee in connection with the original issuance of Bonds; termination payments under the PSA or other agreement of the Authority or LIPA for power supply purposes; and termination payments under Financial Contracts.

“Credit Facility” means a letter of credit, revolving credit agreement, surety bond, insurance policy or similar obligation, arrangement or instrument issued by a bank, insurance company or other financial institution which provides for payment of all or a portion of the Principal Installments or interest due on any Bonds including through a reserve or similar fund.

“Debt Service” for any Fiscal Year or part thereof means, as of any date of calculation, the sum of (i) with respect to any Outstanding Bonds, an amount equal to the sum of (a) interest payable during such Fiscal Year or part thereof on such Bonds, except to the extent that such interest is to be paid from amounts representing Capitalized Interest and (b) the Principal Installments of such Bonds payable during such Fiscal Year or part thereof and (ii) with respect to a Parity Reimbursement Obligation, an amount equal to the sum of (a) interest payable during such Fiscal Year or part thereof on such Parity Reimbursement Obligation and (b) the Principal Installments of such Parity Reimbursement Obligation payable during such Fiscal Year or part thereof. Such interest and Principal Installments shall be calculated on the assumption that (x) no such Bonds, or Parity Reimbursement Obligations Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment thereof upon stated maturity or upon mandatory redemption by application of Sinking Fund Installments and (y) variable rate Bonds will bear interest at the greater of (A) the rate or rates which were assumed by LIPA in the Authority Budget for such Fiscal Year to be borne by variable rate Bonds during such Fiscal Year or (B) the average rate or rates borne on variable rate Bonds Outstanding during the twelve calendar months preceding the date of calculation, but at a rate not less than the rate or rates borne thereon as of such date
of calculation; provided, however, that if LIPA has in connection with any variable rate Bonds entered into a Financial Contract which provides that the Authority is to pay to the Qualified Counterparty an amount determined based upon a fixed rate of interest on the Outstanding principal amount of such variable rate Bonds or that the Qualified Counterparty is to pay to the Authority an amount determined based upon the amount by which the rate at which such variable rate Bonds bear interest exceeds a stated rate of interest on all or any portion of such variable rate Bonds, it will be assumed that such variable rate Bond bears interest at the fixed rate of interest to be paid by the Authority or the rate in excess of which the Qualified Counterparty is to make payment to the Authority in accordance with such agreement.

“Debt Service Component”, when used with reference to Supply Contracts with any entity, means that portion of any rates, fees, charges, surcharges or payments for the specific purpose of meeting principal and/or interest on that entity’s obligations directly associated with that contract and payable to such entity regardless of delivery, and the principal and/or interest component of any Capital Lease.

“Debt Service Fund” means the fund by that name established pursuant to the Resolution.

“DEC” means the New York State Department of Environmental Conservation.

“Defeasance Obligations” means obligations of the type described in clause (ii), (iii) or (ix) of the definition of Investment Securities, which are not subject to redemption prior to maturity except at the option of the holder.

“Depositary” means any bank or trust company selected by LIPA or the Authority, as the case may be, as a depository of moneys to be held under the provisions of the Financing Agreement or the Resolution and may include the Trustee.

“Direct Cost Budget” means such budget as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Annual T&D Budget Preparation”).

“Direct Costs” means such costs as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Annual T&D Budget Preparation”).

“Direct DTC Participants” or “Direct Participants” shall have the meaning assigned thereto in Appendix G to this Part 2.

“Disbursement Request” means the written request signed by an Authorized Representative of LIPA and required to be delivered to the Authority pursuant to the Financing Agreement to effect disbursements from the Construction Fund.

“Disclosure Certificate” means the Form of Continuing Disclosure Certificate attached to this Official Statement as an Appendix.

“Electricity” means the electrical energy (real and reactive) and capacity available from the System Power Supply.

“Electricity Customers” means the retail and wholesale customers of LIPA located in the Service Area.

“EMA” or “Energy Management Agreement” means the Energy Management Agreement, dated as of June 26, 1997, between the Energy Manager and LIPA, as amended and supplemented, pursuant to which the Energy Manager, among other things, procures and manages fuel supplies for the GENCO Generating Facilities.
“Encumbrances” means any lien, lease, mortgage, security interest, charge, judgment, judicial award or encumbrance with respect to the T&D System (other than those associated with any retainage holdback on construction materials, supplies and equipment).

“Energy Manager” means the KeySpan Sub that is party to the EMA and that is responsible for providing to LIPA the energy management functions and services required by the EMA.

“Event of Default” means, (i) when such term is used in the Resolution and the Financing Agreement, any event specified in the Resolution as an “Event of Default” (and as summarized in Appendix D under the caption “Event of Default; Remedies Upon Default”) and (ii) when such term is used in the Operating Agreements, such events as defined in the EMA, the MSA or the PSA (and as summarized, with respect to the EMA, in Appendix E, under the caption “Summary of Certain Provisions of the Energy Management Agreement – Term: Events of Default,” and as summarized, with respect to the MSA, in Appendix E, under the caption “Summary of Certain Provisions of the Management Services Agreement – Default, Termination for Cause and Dispute Resolution,” and as summarized, with respect to the PSA, in Appendix E, under the caption “Summary of Certain Provisions of the Power Supply Agreement – Term and Termination”).

“FERC” means the Federal Energy Regulatory Commission.

“Fiduciary” means the Trustee, any Paying Agent, any Depositary, or any Authenticating Agent.

“Financial Contract” means, to the extent from time to time permitted by law, any financial arrangement entered into by the Authority with respect to Bonds or Subordinated Indebtedness, and any financial arrangement entered into by the Authority or LIPA with respect to Outstanding LIPA Unsecured Debt, for the purpose of moderating interest rate fluctuations or any other purpose, (i) which is entered into with an entity that is a Qualified Counterparty at the time the arrangement is entered into, and (ii) which is any of the following, or any combination thereof, or any option with respect thereto: a cap, floor or collar; forward rate; future rate; swap (such swap may be based on an amount equal either to the principal amount of such Bonds or Subordinated Indebtedness, or of such Outstanding LIPA Unsecured Debt, as the case may be; asset, index, price or market-linked transaction or agreement; other exchange or rate protection transaction agreement; or other similar transaction (however designated).

“Financing Agreement” means the Financing Agreement, dated as of May 1, 1998, by and between the Authority and LIPA to provide for their respective duties and obligations relating to the financing and operation of the retail electric business in the Service Area, as the same may be amended or supplemented.

“Firm Gas Supply” means a type of natural gas supply delivered or transported to a City Gate which may not be interrupted except for “force majeure” events. Such gas may be interrupted on the gas distribution system serving LILCO’s existing gas service area whenever its continued delivery would adversely affect the reliability of the gas distribution system serving LILCO’s existing gas service area.

“Fiscal Year” means the twelve-month period commencing on January 1 of each year; provided, however, that the Authority and LIPA may, from time to time, mutually agree on a different twelve-month period as the Fiscal Year, in which case January 1, when with reference to Fiscal Year, shall be construed to mean the first day of the first calendar month of such different Fiscal Year.

“Five-Year Planning Budget” means such budget as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Annual T&D Budget Preparation”).

“Fixed Direct Fee” means such fee as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Service Fee—Formula”).

“Fuel” means the natural gas, oil, kerosene or other fossil fuel used for operating the GENCO Generating Facilities.

“Fuel Management Fee” means such fee as defined in the EMA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—Fuel Management—Fuel Management Fee”).

“Fuel Purchase Performance Incentive/Disincentive” means the incentive payment to or disincentive payment from the Energy Manager calculated in accordance with an appendix to the EMA.

“Fuel Services” means those services required to be furnished and done for and relating to the delivery of Fuel to the GENCO Generating Facilities by the Energy Manager pursuant to the EMA subsequent to May 28, 1998. A reference to “Fuel Services” shall mean “any part and all of the Fuel Services” unless the context otherwise requires.

“Force Majeure” as used in the Amended and Restated MSA, means any act, event or condition, whether affecting the T&D System, the System Power Supply, LIPA, the Manager, or any of LIPA’s subcontractors or the Manager’s Subcontractors to the extent that it materially and adversely affects the ability of either party to perform any obligation under this Agreement (except for payment obligations), if such act, event or condition is beyond the reasonable control and is not also the result of the misconduct or negligent action or omission or failure to exercise reasonable diligence on the part of the party relying thereon as justification for not performing an obligation or complying with any condition required of such party under this Agreement; provided, however, that the contesting in good faith or the failure in good faith to contest such action or inaction shall not be construed as willful or negligent action or a lack of reasonable diligence of either party.

“GENCO” means the KeySpan Sub that is the owner of the generating assets used to supply power and energy under the PSA and that is the party to the PSA responsible to LIPA for furnishing such power and energy.

“GENCO Generating Facilities” or “Generating Facilities” means the electric generating facilities owned by GENCO and under contract at any time with LIPA under the Power Supply Agreement.

“Generation Purchase Option” means the right of LIPA to acquire the GENCO Generating Facilities at fair market value that is granted to LIPA by GENCO under the Generation Purchase Right Agreement.

“Generation Purchase Right Agreement” means the Generation Purchase Right Agreement, dated as of June 26, 1997, as amended and supplemented, by and between GENCO, as seller, and LIPA, as buyer (if the Generation Purchase Option is exercised), and their respective successors and assigns.

“Governmental Body” means any federal, State or local legislative, executive, judicial or other governmental board, agency, authority, commission, administration, court or other body, or any official thereof having jurisdiction with respect to any matter which is a subject of the Agreement other than LIPA.
“Guarantor” means KeySpan and its successors and assigns permitted under the Guaranty Agreement.

“Guaranty Agreement” or “Guaranty” means the Guaranty Agreement entered into at the time of completion of the LIPA/LILCO Merger pursuant to which KeySpan has guaranteed to the Authority payment when due of all amounts payable by the KeySpan Subs under the Operating Agreements and the performance of the covenants and agreements of the KeySpan Subs under the Operating Agreements.

“Incremental Internal Costs” means such costs as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Other Costs”).

“Insurance Requirement” means any rule, regulation, code, or requirement issued by any fire insurance rating bureau or any body having similar functions or by any insurance company which has issued a policy of construction work insurance or operation period insurance under the Agreement, as in effect during the term thereof.

“Investment Securities” means and includes any of the following securities, if and to the extent the same are at the time legal investments by the Authority of the funds to be invested therein and conform to the policies set forth in any investment guidelines adopted by the Authority and in effect at the time of the making of such investment: (i) direct obligations of, or obligations guaranteed as to principal and interest by, any state or direct obligations of any agency, public authority or political subdivision thereof, provided such obligations are rated, at the time of purchase, in one of the three highest Rating Categories by a Rating Agency; (ii) (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are guaranteed by the United States of America, including obligations of any agency thereof or corporation which has been or may be created pursuant to an Act of Congress as an agency or instrumentality of the United States of America to the extent unconditionally guaranteed by the United States of America or (b) any other receipt, certificate or other evidence of an ownership interest in obligations or in specified portions thereof (which may consist of specified portions of the interest thereon) of the character described in subclause (a) of this clause (ii); (iii) obligations of any agency, subdivision, department, division or instrumentality of the United States of America, or obligations fully guaranteed as to interest and principal by any agency, subdivision, department, division or instrumentality of the United States of America; (iv) banker’s acceptances or certificates of deposit issued by a commercial bank with its principal place of business within the State and having capital and surplus of more than $100 million; (v) corporate securities, including commercial paper and fixed income obligations, which are, at the time of purchase, rated by a Rating Agency in one of its three highest Rating Categories for comparable types of obligations; (vi) repurchase agreements or other investment agreements collateralized by securities described in clause (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated “investment grade” by each Rating Agency, provided that (a) a specific written repurchase agreement governs the transaction, (b) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is either a direct member of the Federal Reserve Bank or a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus and undivided profits of not less than $25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (c) the repurchase agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five business days of such valuation, and (d) the fair market value of the collateral securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 102%; (vii) investment agreements or guaranteed investment contracts with any financial institution whose senior long term debt obligations, or whose obligations under such an investment agreement or guaranteed investment contract, are guaranteed
by a financial institution whose senior long term debt obligations, have a rating (at the time such agreement or contract is entered into) in one of the three highest Rating Categories for comparable types of obligations by a Rating Agency; (viii) money market funds rated in one of the three highest Rating Categories for comparable types of obligations by a Rating Agency; (ix) municipal obligations, the payment of principal and redemption price, if any, and interest on which is irrevocably secured by obligations of the type referred to in clauses (i), (ii) or (iii) above and which obligations have been deposited in an escrow arrangement which is irrevocably pledged to the payment of such municipal obligations and which municipal obligations are rated in the highest Rating Category by a Rating Agency, or any other municipal obligation rated in the highest Rating Category by a Rating Agency; (x) obligations of any person or entity which shall be rated at the time of the investment in one of the three highest Rating Categories by a Rating Agency; and (xi) any other investment in which the Authority is permitted to invest under applicable law, notwithstanding any limitations set forth in clauses (i) through (x) above. Obligations of any Fiduciary or an affiliate thereof may be Investment Securities, provided that they otherwise qualify.

“IRS” means the United States Internal Revenue Service.

“KeySpan” means KeySpan Corporation, doing business as KeySpan Energy, and its successors and assigns.

“KeySpan Promissory Notes” means the promissory notes evidencing the obligation of the Promissory Note Obligor to pay the LIPA amounts equal to the principal and interest when due on certain NYSERDA Financing Notes.

“KeySpan Sub” means any particular subsidiary company of KeySpan that is a party to an Operating Agreement or another agreement with LIPA or the Authority.

“Lien” means any and every lien against the T&D System, the T&D System Site, the Construction Work, the Operation and Maintenance Services or against any monies due or to become due from the Subsidiary to the Manager under the Agreement, for or on account of the Construction Work or the Operation and Maintenance Services.

“LILCO” means the Long Island Lighting Company, the publicly-owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger.

“LIPA” means the Long Island Lighting Company as it exists after the LIPA/LILCO Merger as a wholly-owned electric utility subsidiary company of the Authority, and which is conducting its business under the name “LIPA,” and any successor thereto.

“LIPA Budget” means the annual budget of LIPA, as amended or supplemented, adopted or in effect for a particular Fiscal Year as provided in the Financing Agreement.

“LIPA Expenses” means all Operating Expenses incurred by LIPA.

“LIPA General Fund” means the special fund by that name established by LIPA and held by a bank, trust company or banking association designated by LIPA to act as a depository for the general funds of LIPA.

“LIPA Note” means the promissory note or notes of LIPA delivered to the Authority in accordance with the Financing Agreement evidencing the obligation of LIPA to pay to the Authority all amounts necessary to pay Authority Obligations.

“LIPA Retained Assets” means the assets of LILCO retained by LIPA on May 28, 1998.
“LIPA Unsecured Debt Fund” means the fund established in accordance with the Resolution for payment of the principal of and interest on Outstanding LIPA Unsecured Debt, subject to the provisions of the Resolution.

“LIPA/LILCO Merger” means (i) the merger which took place on May 28, 1998 and which resulted in LILCO (doing business as LIPA) becoming the wholly-owned electric utility subsidiary of the Authority.


“Loss-and-Expense” means any and all losses, liabilities, obligations, damages, delays, fines, penalties, judgments, deposits, costs, claims, demands, charges, assessments, taxes, or expenses, including all Fees-And-Costs.

“Major Capital Improvement” means any repair, replacement, improvement, alteration or addition to the T&D System or any part thereof (other than any repair, replacement, improvement, alteration or addition constituting routine maintenance of the T&D System) contained in the Major Capital Plan and Budget and that has a useful life at least equal to three years.

“Major Capital Improvement Cost” means the cost of any Major Capital Improvement which the Manager reasonably incurs and substantiates under the Agreement including, without limitation, expenditures for material, equipment, incremental labor, and services supplied by architects, engineers and Subcontractors, and expenses related to managing and administering the Major Capital Improvement. “Major Capital Improvement Cost” shall not include amounts for an allowance for overhead, profit, or contingency.

“Major Capital Plan and Budget” means such plan and budget as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Major Capital Improvements—Major Capital Plan and Budget”).

“Management Fee” means such fee as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Annual T&D Budget and Five Year Planning Budget Process—Direct Cost Budget”).

“Manager” means the KeySpan Sub that is party to the MSA and that, under the MSA, operates and maintains the T&D System for LIPA.

“Manager Fault” means any breach, failure of compliance, or nonperformance by the Manager with its obligations under the MSA or any negligence or willful misconduct by the Manager under the MSA.

“Manager Indemnified Parties” means the Manager and its Affiliates and their respective officers, directors, Subcontractors and employees.

“Monthly Fuel Payment” means such payment as defined in the EMA (and as summarized in this Appendix E, under the caption “Summary of Certain Provisions of the Energy Management Agreement—Fuel Management—Monthly Fuel Payment”).

“Monthly System Power Supply Management Fee” means such fee as defined in the EMA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—System Power Supply Management—System Power Supply Management Fee”).

“Moody’s” means Moody’s Investors Service and its successors and their assigns.
“MSA” or “Management Services Agreement” means the Management Services Agreement, dated as of June 26, 1997, between the Manager and LIPA, as amended and supplemented, pursuant to which the Manager operates and maintains the T&D System.

“Nine Mile Point” means the two-unit nuclear power station located on Lake Ontario near the Town of Scriba, New York.

“NMP2” means Unit 2 of Nine Mile Point.

“NYISO” means the New York Independent System Operator and any successor thereto.

“NYPAA” means the Power Authority of the State of New York.

“NYSERDA” means New York State Energy Research and Development Authority, a public benefit corporation of the State, which issued bonds to finance for LILCO certain pollution control facilities and facilities for the local furnishing of electricity and to which LILCO issued its NYSERDA Financing Notes to evidence its obligation to repay such bonds.

“NYSERDA Financing Notes” means the notes of LILCO supporting the bonds issued on behalf of LILCO by NYSERDA retained by LIPA. Such NYSERDA Financing Notes constitute a portion of the Retained Debt.

“Off-System Sales” means the sale of electric capacity and/or energy to wholesale or retail customers located outside the Service Area.

“Operating Agreements” means, collectively, the EMA, the MSA and the PSA.

“Operating Assets” means the T&D System and all of the assets of the Manager used in the operation and maintenance of the T&D System and the performance of the Manager’s obligations under the MSA.

“Operating Expense Fund” means the fund by that name established pursuant to the Resolution.

“Operating Expenses” means any and all current expenses of maintaining, repairing, operating and managing the System, including but not limited to the costs of supplies, fuel, fuel assemblies and components required for the operation of the System (including but not limited to any payments made under Supply Contracts other than the Debt Service Component thereof); payments relating to fuel or electricity hedging instruments; all payments under any System Agreements; all salaries, administrative, general, commercial, architectural, engineering, advertising, public notices, auditing, billing, collection and enforcement and legal expenses; insurance and surety bond premiums; consultants’ fees and charges; payments to pension, retirement, health and hospitalization funds; any taxes which may lawfully be imposed on the System or the income or operation thereof or of LIPA; costs of public hearings; ordinary and current rentals of equipment or other property; lease payments for real property or interests therein; expenses of maintenance and repair (including replacements); expenses, liabilities and compensation of the Trustee or any other Fiduciary or Depositary; to the extent provided by by-law, agreement or other instrument of the Authority or LIPA, indemnification of Fiduciaries, Trustees, officers and employees of the Authority, directors, officers and employees of LIPA, and others and premiums for insurance related thereto; reasonable reserves for operation, maintenance and repair and for self-insurance; and all other expenses necessary, incidental or convenient for the efficient operation of the System; all costs and expenses associated with or arising out of the research, development (including feasibility and other studies, including but not limited to resource planning and studies and reports relating to demand side management) and/or implementation of any project, facility, system, task or measure related to the System including but not limited to demand side management programs, deemed desirable or necessary by the Authority or LIPA; all other costs and expenses arising out of or in connection with the conduct of LIPA’s business or necessary, incidental or convenient for the efficient operation of LIPA; and all
expenses necessary, incidental or convenient for the efficient operation of the Authority and the performance of the obligations of the Authority under the Administrative Services Agreement. Notwithstanding the foregoing, Operating Expenses shall not include (i) any costs and expenses attributable to a Separately Financed Project, (ii) any costs or expenses for new construction or for reconstruction other than restoration of any part of the System to the condition of serviceability thereof when new, (iii) the Debt Service Component of any Supply Contract, (iv) to the extent so specified by the Authority, any incentive payments payable by LIPA under any System Agreement, (v) any payments payable by LIPA under any other agreement the terms of which specify that the same shall not constitute an Operating Expense under the Resolution, (vi) any allowance for depreciation, (vii) payment under any Capital Leases, or (viii) any PILOTs.

“Operation and Maintenance Services” means the services to be provided and materials to be supplied by the Manager pursuant to the MSA during the Operation Period, except Construction Work. Operation and Maintenance Services shall include, without limitation, the employment and furnishing of all labor, materials, equipment, supplies, tools, storage, transfer, transportation, insurance, delivery and other items and services necessary in order for the Manager to perform its routine operation and maintenance obligations under the MSA, as well as all related administrative, accounting, record-keeping, notification and similar services relating to such obligations.

“Operation Period” means the period commencing on May 28, 1998 and ending on the date the MSA expires in accordance with its terms, or if earlier, on the MSA’s Termination Date.

“Option Securities” means bonds, notes or other evidences of indebtedness which by their terms may be tendered by and at the option of the Holder thereof for purchase or payment by or on behalf of the Authority prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Holder thereof.

“Other Costs” means such costs as defined in the MSA (and as summarized in this Appendix E, under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Annual T&D Budget and Five Year Planning Budget Process—Other Costs”).

“Outstanding” when used with reference to Parity Reimbursement Obligations, shall have the meaning given to such term in the agreement creating such Parity Reimbursement Obligations, and, when used with reference to Bonds, means, as of any date, all Bonds theretofore or thereupon being authenticated and delivered under the Resolution except: (a) any Bonds canceled by the Trustee at or prior to such date; (b) any Bonds the principal and Redemption Price, if any, of and interest on which have been paid in accordance with the terms thereof; (c) any Bonds in lieu of or in substitution for which other Bonds have been authenticated and delivered pursuant to the Resolution; and (d) any Bonds deemed to have been paid as provided in the Resolution.

“Outstanding LIPA Unsecured Debt” means (i) any indebtedness of LIPA outstanding as of the LIPA/LILCO Merger, as described therein, consisting of (a) “Bonds” as defined in the Indenture, dated as of November 1, 1986, between LILCO and State Street Bank and Trust Company, as successor trustee, or as defined in the Indenture, dated as of November 1, 1992, between LILCO and Chemical Bank, as trustee, in each case as amended and supplemented, and (b) the NYSERDA Financing Notes, and (ii) Financial Contracts related to Outstanding LIPA Unsecured Debt and (iii) any reimbursement obligation relating to any letter of credit or other credit support for any indebtedness referred to in (i)(a) or (b) above.

“Parent” means KeySpan, and its successors and assigns.
“Parity Contract Obligation” means the obligation of the Authority or LIPA to pay the Debt Service Component of Supply Contracts from Revenues and secured by a pledge of and lien on the Trust Estate on a parity with the Bonds.

“Parity Contract Obligations Fund” means the fund by that name established pursuant to the Resolution from which amounts shall be applied for the payment of Parity Contract Obligations in accordance with the Resolution.

“Parity Obligations” means, collectively, all Parity Contract Obligations and Parity Reimbursement Obligations.

“Parity Reimbursement Obligation” shall have the meaning assigned thereto under the heading “Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness” in Appendix D.

“Paying Agent” means any paying agent for any Bonds, and its successor or successors and any other person which may at any time be substituted in its place pursuant to the Resolution.

“Performance Guarantees” means the minimum reliability standard, the minimum worker safety standard and the minimum customer service standard, all as established pursuant to appendices to the MSA.

“PILOTs” means any payment in lieu of taxes due and owing by the Authority or LIPA in accordance with the Act or other applicable law.

“PILOTs Fund” means the fund by that name established by the Resolution, and used to make payments to the State or any municipality or other political subdivision of the State, which shall be entitled to receive PILOTs under the Act, subject to the provisions of the Resolution.

“Power and Energy” means the electrical energy and capacity available from the System Power Supply.

“Prevalent Utility Services” means, at any time, those services, programs, practices and procedures provided or adopted at such time by 50 percent or more of the investor-owned electric utilities within the NYISO with respect to the provisions of electric transmission and distribution services and associated customer service and, with respect to underground transmission facilities (138kV and higher) only, those services, programs, practices and procedures provided or adopted at such time by 50 percent or more of the utilities with at least 50 miles of underground transmission facilities and which are members of the NPCC.

“Prime Rate” means the rate announced by Citibank, N.A. from time to time at its principal office as its prime lending rate for domestic commercial loans, the Prime Rate to change when and as such prime lending rate changes.

“Principal Installment” means, as of any date of calculation and with respect to any Outstanding Bonds, (i) the principal amount of such Bonds (including (x) any amount designated in, or determined pursuant to, the applicable Supplemental Resolution, as the “principal amount” with respect to any Bonds which do not pay full current interest for all or any part of their term and (y) the principal amount of any Parity Reimbursement Obligation) due on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance of any Sinking Fund Installments due on a certain future date for such Bonds, or (iii) if such future dates coincide as to different Bonds, the sum of such principal amount of Bonds and of such unsatisfied balance of Sinking Fund Installments due on such future date.
“Promissory Note Obligor” means KeySpan and one or more of its subsidiaries that are obligated to make payments to LIPA under the Promissory Notes.

“Property Tax Settlement”, as used in the Resolution, means the Authority’s program of rebates and credits to System customers in respect of the amounts otherwise payable by the Suffolk Taxing Jurisdictions as refunds of taxes and payments in lieu of taxes relating to Shoreham.

“Prudent Utility Practice” at a particular time means any of the practices, methods, and acts (including but not limited to the practices, methods and acts engaged in or approved by a significant portion of the electrical utility industry prior thereto), which, in the exercise of reasonable judgment in light of the facts and the characteristics of the T&D System, the Service Area, System Power Supply (and, insofar as the delivery of Fuel Service may require, the gas distribution and transmission system serving gas service area formerly served by Long Island Lighting Company and prevailing regulations or regulatory policies applicable to such gas distribution and transmission system), known at the time the decision was made, would have been expected to accomplish the desired result at the lowest reasonable cost consistent with reliability, safety and expedition and good customer relations. Prudent Utility Practice is not intended to be limited to the optimum practice, method or act, to the exclusion of all others, but rather to be a spectrum of possible practices, methods or acts.

“PSA” or “Power Supply Agreement” means the Power Supply Agreement, dated as of June 26, 1997, between GENCO and LIPA, as amended and supplemented, pursuant to which LIPA purchases all the capacity from the GENCO Generating Facilities and, to the extent requested by LIPA, the associated energy.

“PSC” means the New York State Public Service Commission.

“Public Works Improvement Costs” means the cost of any Public Works Improvement which the Manager reasonably incurs and substantiates under the Agreement including, without limitation, expenditures for material, equipment, incremental labor and services supplied by architects, engineers and Subcontractors, and expenses related to managing and administering the Public Works Improvements. “Public Works Improvement Costs” shall not include amounts for an allowance for overhead, profit or contingency.

“Public Works Improvements” means Major Capital Improvements performed as a result of requirements or requests of a Governmental Body.

“Qualified Counterparty” means an entity (i) whose senior long term debt obligations, other senior unsecured long term obligations, financial program rating, counterparty rating or claims paying ability are rated (at the time the subject Financial Contract is entered into) in any of the three highest Rating Categories from a nationally recognized statistical rating organization, (ii) whose payment obligations under a Financial Contract are guaranteed by an entity whose senior long term debt obligations, other senior unsecured long term obligations, financial program rating, counterparty rating or claims paying ability, are rated (at the time the subject Financial Contract is entered into) in any of the three highest Rating Categories from a nationally recognized statistical rating organization, or (iii) whose obligation, if any, to make payment to the Authority upon the termination of the subject Financial Contract is fully collateralized by Investment Securities of the type described in clause (ii) of the definition of Investment Securities; provided, however, that such obligation shall be deemed to be fully collateralized if the Investment Securities shall have a market value, determined periodically in accordance with the Financial Contract, that is not less than 102% of any termination payment.

“Rate Consultant” means the independent accountant or firm of independent accountants, or a management consultant or firm of management consultants, or independent engineer or firm of independent engineers which, in any case, shall be of recognized standing in the field of electric transmission and distribution system consulting selected by the Authority.
“Rate Covenant” means the covenants by the Authority in the Resolution to establish and maintain System fees, rates, rents, charges and surcharges.

“Rate Stabilization Fund” means the fund by that name established by the Resolution, and used for any lawful purpose of the Authority or LIPA, including but not limited to making any deposits required by the Resolution to any Fund or Account, in accordance with the Resolution.

“Rating Agency” means each of Fitch, Moody’s, and S&P, and their respective successors and assigns, in each case and at any time only if the same is then maintaining a rating on any Bonds at the request of the Authority.

“Rating Category” means a general rating category of an applicable Rating Agency or nationally recognized statistical rating organization without regard to any refinement or gradation of such rating by a numerical modifier or otherwise.

“Redemption Price” means, when used with respect to a Bond or portion thereof, the principal amount thereof plus the applicable premium, if any, payable upon either optional or mandatory redemption thereof pursuant to the Resolution.

“Refunding Bond” means any Bond authenticated and delivered on original issuance pursuant to the Resolution for the purpose of refunding any Outstanding Bonds, or thereafter authenticated and delivered pursuant to the Resolution in lieu of or substitution for such Bond.

“Reimbursement Obligation” shall have the meaning provided under the heading “Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness” in Appendix D.

“Reliability Council” means the separate not-for-profit corporation which will establish safety and reliability standards for all entities, including the NYISO, engaging in electric power transactions on the NYISO’s transmission system.

“Required Deposits” means the amount, if any, payable into the Operating Expense Fund, the Debt Service Fund, the Parity Contract Obligations Fund, the Subordinated Indebtedness Fund, LIPA Unsecured Debt Fund and the PILOTs Fund, but in each case only to the extent such payments are required to be made from Revenues.

“Resolution” means the Electric System General Revenue Bond Resolution, of the Authority, as the same may be amended or supplemented by a Supplemental Resolution or Resolutions.

“Retained Debt” means the indebtedness of LILCO retained by LIPA after the completion of the LIPA/LILCO Merger consisting of the outstanding unsecured debentures of LILCO retained by LIPA and the outstanding NYSERDA Financing Notes.

“Revenue Bonds” means any bonds, notes or other obligations issued or secured under the Resolution, the Subordinated Resolution or any other bond resolutions to be adopted by the Authority.

“Revenue Fund” means the fund into which Revenues are deposited by the Authority or by LIPA, unless required by the Resolution to be deposited to any other Fund or Account, in accordance with the Resolution or the Financing Agreement.

“Revenues” means all revenues, rates, fees, charges, surcharges, rents, proceeds from the sale of LIPA Assets, proceeds of insurance, and other income and receipts, as derived in cash, directly or indirectly from any of LIPA’s operations, by or for the account of the Authority or LIPA, including but not limited to (i) all payments received by the Authority or LIPA with respect to the Promissory Notes, (ii) any guaranty of performance under any System Agreement and (iii) all dividends received by the Authority as a result of ownership of any stock or other evidences of an equity interest in LIPA; provided,
however, that Revenues shall not include (a) any Transition Charge, (b) any of the foregoing attributable directly or indirectly to the ownership or operation of any Separately Financed Project, or (c) any federal or State grant moneys the receipt of which is conditioned upon their expenditure for a particular purpose unless the Authority determines that such grant moneys shall constitute Revenues. Notwithstanding the foregoing, Revenues also shall not include any amounts, or amounts from any sources, as may be specified from time to time by a Supplemental Resolution; provided, however that at the time such Supplemental Resolution becomes effective the tests set forth in paragraph (e)(B) under the heading “Conditions Precedent to Delivery of Bonds” shall be satisfied without regard to either (i) such amounts or (ii) paragraph (e)(D) under the same heading.


“Separately Financed Project” means any such project financed by revenues or other income derived solely from the ownership or operation of such project or from other funds withdrawn from the Revenue Fund in accordance with the Resolution.

“Service Area” or “LIPA Service Area” means the Counties of Suffolk and Nassau and that portion of the County of Queens known as the Rockaways constituting LILCO’s electric franchise area as of the effective date of the Act. “Service Area” does not include the Nassau County Villages of Freeport and Rockville Centre, and the Suffolk County Village of Greenport.

“Service Fee” means such fee as defined in the MSA (and as summarized in this Appendix E, under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Service Fee”).

“Shoreham” means the Shoreham Nuclear Power Station located at Shoreham, Long Island.

“Shoreham Credits” means credits to the bills of System ratepayers arising from the settlement of the Shoreham Property Tax Litigation, in each of the five years of 1998-2003 in Nassau County and the Rockaways in the aggregate amount of $50 million per year and in Suffolk County in the aggregate amount of $30 million per year.

“Sinking Fund Installment” means, as of any particular date of calculation, the amount required, as of such date of calculation, to be paid by the Authority on a future date for the retirement of Outstanding Bonds which are stated to mature subsequent to such future date, but does not include any amount payable by the Authority by reason only of the maturity of a Bond.

“State” means the State of New York.

“Subcontract” means an agreement between the Manager or the Energy Manager and a Subcontractor, or between two Subcontractors, as applicable.

“Subcontractor” means every person (other than employees of the Manager or the Energy Manager) employed or engaged by the Manager or the Energy Manager or any person directly or indirectly in privity with the Manager or the Energy Manager (including every sub-subcontractor of whatever tier) for any portion of the services or the materials, supplies, or equipment to be provided by the Manager or the Energy Manager under the MSA or the EMA.

“Subordinated Contract Obligation” shall mean the Debt Service Component of a Supply Contract that does not constitute a Parity Contract Obligation.

“Subordinated Credit Facility” or “Subordinated Reimbursement Obligation” means a letter of credit, revolving credit agreement, standby purchase agreement, surety bond, insurance policy or similar obligation, arrangement or instrument issued by a bank, insurance company or other financial
institution which (i) provides for payment of all or a portion of the principal of or interest on any
Subordinated Indebtedness, (ii) provides funds for the purchase of any Bonds or Subordinated
Indebtedness, or any portion of any thereof, or (iii) secures the payment by the Authority of its obligations
under a Financial Contract relating to Bonds or Subordinated Indebtedness.

“Subordinated Indebtedness” means any bond, note or other evidence of indebtedness issued
by LIPA in furtherance of its corporate purposes under the Act and secured by a pledge of the Trust
Estate subordinate to the pledge thereof made by the Resolution in favor of the Bonds and Parity
Obligations and otherwise as provided by the Resolution. Subordinated Indebtedness shall include, but
shall not be limited to, Option Securities, Reimbursement Obligations other than Parity Reimbursement
Obligations, and Financial Contracts to the extent provided by the Resolution.

“Subordinated Indebtedness Fund” means the fund established in accordance with the
Resolution for payment of the principal and redemption price of and interest on Subordinated
Indebtedness, subject to the provisions of the Resolution.

“Subordinated Resolution” means the Authority’s Electric System General Subordinated
Revenue Bond Resolution, as amended and supplemented.

“Subsidiary Fault” means any breach, failure of compliance, or nonperformance by the
Subsidiary with its obligations under an Agreement or any negligence or willful misconduct by the
Subsidiary under an Agreement (whether or not attributable to any officer, trustee, member, agent,
employee, representative, contractor, subcontractor of any tier, or independent contractor of the
Subsidiary other than the Manager or Energy Manager and its Subcontractors) that materially and
adversely affects the Manager’s or Energy Manager’s performance or the Manager’s or Energy
Manager’s rights or obligations under the Agreement.

“Suffolk Taxing Jurisdictions” means, collectively, Suffolk County, the Town of Brookhaven,
the Shoreham-Wading River Central School District, the Wading River Fire District, and the Shoreham-
Wading River Library District.

“Supplemental Resolution” means a resolution of the Authority authorizing the issuance of a
Series of Bonds or otherwise amending or supplementing the Resolution, adopted in accordance with the
Resolution.

“Supply Contract” means any contract of the Authority or LIPA with another entity for fuel,
energy or power.

“System” means the Retained Assets and any System Improvements, but shall not include any
Separately Financed Projects.

“System Agreements” means any agreements relating to the operation or maintenance of the
System, the supply of power and energy to the System, and the provision of transmission and distribution
services and capacity for the System, including, but not limited to, the MSA, EMA and PSA.

“System Budget” means the combined Authority Budget and LIPA Budget, as amended or
supplemented, adopted or in effect for a particular Fiscal Year, as provided in the Resolution and in the
Financing Agreement.

“System Improvement” means any project, facility, system, equipment, or material related to or
necessary or desirable in connection with the generation, production, transportation, transmission,
distribution, delivery, storage, conservation, purchase or use of energy or fuel, whether owned jointly or
singly by LIPA, including any capacity or output in which LIPA has an interest, heretofore or hereafter
authorized by the Act or by other applicable State statutory provisions, including but not limited to
demand side management programs; provided, however, that the term “System Improvement” shall not include any Separately Financed Project.

“System Manager” shall mean, collectively, the Manager and the Energy Manager.

“System Policies and Procedures” means the policies and procedures adopted from time to time by the Subsidiary with respect to the T&D System and the System Power Supply in accordance with Applicable Law and Prudent Utility Practice.

“System Power Supply” means the electrical capacity and energy from all power supply sources owned by or under contract to LIPA, including, but not limited to, the Existing Power Supply Agreements, the Power Supply Agreement, LIPA’s rights and interests with respect to the NMP2 power plant, LIPA’s interest in any future generating facilities, spot market capacity and energy purchases made by the Energy Manager on behalf of LIPA, and any load control programs or energy efficiency measure adopted by LIPA.

“System Power Supply Management Fee” means such fee as defined in the EMA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—System Power Supply Management—System Power Supply Management Compensation—System Power Supply Management Fee”).


“System Power Supply Services” means any or all of the services required to be furnished and done for and relating to the administration and management of System Power Supply pursuant to the Power Supply Agreement.

“T&D System” means the electric transmission and distribution system located in the Service Area which provides the means for transmitting and distributing electricity.

“T&D System Site” means the real property and interests therein upon which the components of the T&D System are and will be located.

“Termination Date”, as appropriate, means such date as defined in the EMA, the MSA or the PSA (and as summarized, with respect to the EMA, in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—Term; Events of Default—Procedure for Termination by Cause,” and as summarized, with respect to the MSA, in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Default, Termination for Cause and Dispute Resolution—Termination for Cause,” and as summarized, with respect to the PSA, in Appendix E under the caption “Summary of Certain Provisions of the Power Supply Agreement—Term and Termination—Procedure for Termination for Cause”).


“Total Cost” means the sum of the actual Direct Costs and the actual Third Party Costs.
“Transition Charge” means any rates, fees, charges or surcharges relating to the System or the customers thereof established by irrevocable rate order or other action or instrument, and applicable to or by the Authority or LIPA, in conjunction with the issuance of debt or other securities under a separate resolution, indenture or similar instrument (other than the Resolution) to the extent such rates, fees, charges or surcharges are pledged or otherwise encumbered or conveyed as security for such debt or other securities.

“Trust Estate” means collectively: (i) all payments received by the Authority from LIPA under the Financing Agreement, and all rights to collect and receive the same; (ii) all Revenues and all right, title and interest of the Authority in and to the Revenues, including all rights of the Authority to collect and receive the same, including but not limited to (a) all payments received by the Authority with respect to the Promissory Notes and all right, title and interest of the Authority in and to the Promissory Notes, including all rights of the Authority to collect and receive amounts payable thereunder and (b) any dividends received by the Authority as a result of ownership of any common or preferred stock or other evidences or an equity interest of the Authority in LIPA, and all rights to receive the same; (iii) the proceeds of sale of Bonds until expended for the purposes authorized by the Resolution; (iv) all Funds, Accounts and subaccounts established by the Resolution, including securities credited thereto and investment earnings thereon; and (v) all funds, moneys and securities and any and all other rights and interests in property, whether tangible or intangible, from time to time hereafter by delivery or by writing of any kind conveyed, mortgaged, pledged, assigned or transferred as and for additional security under the Resolution for the Bonds by the Authority, or by anyone on its behalf, or with its written consent, to the Trustee, which is authorized by the Resolution to receive any and all such property at any and all times, and to hold and apply the same subject to the terms of the Resolution.

“Trustee” means, (i) when such term is used in the Resolution and the Financing Agreement, The Bank of New York as successor to United States Trust Company of New York, New York, New York, as Trustee, and its successor or successors and any other person which may at any time be substituted in its place pursuant to the Resolution and (ii) when such term is used in the Operating Agreements, the trustee acting under the Resolution, the Subordinated Resolution or any other bond resolutions to be adopted by the Authority for the benefit of the holders of the Revenue Bonds.

“Uncontrollable Circumstance” means any act, event or condition, whether affecting the T&D System, the System Power Supply, LIPA, the Manager, or any of LIPA’s subcontractors or the Manager’s Subcontractors to the extent that it materially and adversely affects the ability of either party to perform any obligation under the Agreement (except for payment obligations), if such act, event or condition is beyond the reasonable control and is not also the result of the misconduct or negligent action or omission or failure to exercise reasonable diligence on the part of the party relying thereon as justification for not performing an obligation or complying with any condition required of such party under the Agreement; provided, however, that the contesting in good faith or the failure in good faith to contest such action or inaction shall not be construed as willful or negligent action or a lack of reasonable diligence of either party. None of the following acts or conditions shall constitute Uncontrollable Circumstances:

(a) general economic conditions, interest or inflation rates, or currency fluctuations or exchange rates;

(b) the financial condition of LIPA, the Manager, the Guarantor, any of their Affiliates or any Subcontractor;

(c) the consequences of error, neglect or omissions by the Manager, the Guarantor, any Subcontractor, any of their Affiliates or any other person in the performance of any work under the Agreement;
(d) any increase for any reason in premiums charged by the Manager’s insurers or the insurance markets generally for the construction work insurance or operating period insurance, each as required by the Agreement;

(e) the failure of the Manager to secure patents or licenses in connection with the technology necessary to perform its obligations under the Agreement;

(f) equipment malfunction or failure;

(g) union work rules, requirements or demands which have the effect of increasing the number of employees employed at the T&D System, reducing the operating flexibility of the Manager or otherwise increase the cost to the Manager of operating and maintaining the T&D System;

(h) any impact of prevailing wage laws on the Manager’s operation and maintenance costs with respect to wages and benefits;

(i) the failure of any Subcontractor or supplier to furnish labor, materials, services or equipment for any reason;

(j) strikes, work stoppages or other labor disputes or disturbances; or

(k) any act, event or circumstance occurring outside of the United States.

“Underwriters” means the underwriters listed on the cover page of this Official Statement.

“Variable Payment” has the meaning set forth in the MSA (see “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Service Fee—Variable Payment” contained in Appendix E).
APPENDIX D

SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

The following is a brief summary of certain provisions of the Resolution. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Resolution, a copy of which is on file with the Trustee.

Resolution to Constitute Contract

In consideration of the purchase and acceptance of the Bonds by those who hold the same from time to time, the provisions of the Resolution constitute a contract between the Authority, the Trustee and the Holders from time to time of the Bonds; and the pledge made in the Resolution and the provisions, covenants and agreements therein set forth to be performed by or on behalf of the Authority are for the equal benefit, protection and security of the Holders of any and all the Bonds, each of which, regardless of the time or times of its issue or maturity, are of equal rank without preference, priority or distinction over any other thereof except as expressly provided in the Resolution.

Obligation of Bonds

The Bonds are special obligations of the Authority payable solely from the Trust Estate, and no other revenues or assets of the Authority shall be, or shall be deemed to be, pledged to the payment of the Bonds; provided, however, that nothing contained in the Resolution shall prevent the pledge of any Credit Facility relating to any particular Bonds, or the proceeds of such Credit Facility, to the payment of Bonds. The bonds, notes and other obligations of the Authority (including but not limited to the Bonds) shall not be a debt of the State or of any municipality, and neither the State nor any municipality shall be liable thereon. Neither the credit, the revenues nor the taxing power of the State or of any municipality shall be, or shall be deemed to be, pledged to the payment of any bonds, notes or other obligations of the Authority (including but not limited to the Bonds).

Conditions Precedent to Delivery of Bonds

Bonds may be issued pursuant to a Supplemental Resolution in such principal amount or amounts for each such Series as may be specified in such Supplemental Resolution. Such Bonds shall be delivered by the Authority under the Resolution upon the delivery of, among other things, a Supplemental Resolution authorizing such Bonds, an opinion of Bond Counsel with respect to the validity of the Bonds and a certificate of an Authorized Representative of the Authority to the effect that, upon delivery of the Bonds, the Authority will not be in default in the performance of the terms and provisions of the Resolution or of any of the Bonds, and a certificate of an Authorized Representative of LIPA to the effect that LIPA is not in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Financing Agreement.

Any Supplemental Resolution may provide that (i) so long as a Credit Facility providing security (but not liquidity) is in full force and effect, and payment on the Credit Facility is not in default and the issuer of the Credit Facility is qualified to do business, the issuer of the Credit Facility shall be deemed to be the sole Owner of the Outstanding Bonds the payment of which such Credit Facility secures when the approval, consent or action of the Owners of such Bonds is required or may be exercised under the Resolution, or, in the alternative, that the approval, consent or action of the issuer of the Credit Facility shall be required in addition to the approval, consent or action of the applicable percentage of the Owners of Outstanding Bonds and including, without limitation, the Resolution and following an Event of Default, and (ii) in the event that the principal, Sinking Fund Installments, if any, and Redemption Price, if applicable, and interest due on any Outstanding Bonds shall be paid under the provisions of a Credit Facility, all covenants, agreements and other obligations of the Authority to the Owners of such Bonds
shall continue to exist and such issuer of the Credit Facility shall be subrogated to the rights of such Owners in accordance with the terms of such Credit Facility.

Any Supplemental Resolution authorizing Bonds may delegate to any officers or employees of the Authority the determination of any details of such Bonds, within limitations which shall be set forth in such Supplemental Resolution. Any such determination shall be in writing, and each such written determination shall be deemed to be part of the Supplemental Resolution providing for the same.

Conditions Precedent to Delivery of Refunding Bonds

All Refunding Bonds shall be executed by the Authority for issuance and delivered to the Trustee, and thereupon shall be authenticated by the Trustee and delivered to the Authority or upon its order, but only upon the receipt by the Trustee of: (i) the documents required under the heading entitled “Conditions Precedent to Delivery of Bonds” and (ii) such documents, instructions, moneys and securities as are required by the provisions of the Resolution or any Supplemental Resolution adopted pursuant to the Resolution to cause the Bonds or portions thereof to be refunded to be paid or deemed to have been paid within the meaning and with the effect expressed in the Resolution.

Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness

The Resolution provides that all Option Securities will be issued as Subordinated Indebtedness.

Payments to Qualified Counterparties under Financial Contracts shall constitute Subordinated Indebtedness, except that such payments under Financial Contracts relating to Outstanding LIPA Unsecured Debt shall constitute Outstanding LIPA Unsecured Debt.

In connection with any Bonds, the Authority may obtain or cause to be obtained one or more Credit Facilities and agree with the issuer of a Credit Facility to reimburse such issuer directly for amounts paid under the terms of such Credit Facility, together with interest thereon; provided, however, that no obligation to reimburse an issuer of a Credit Facility shall be created, for purposes of the Resolution, until amounts are paid under such Credit Facility. Such payments to reimburse the issuer of a Credit Facility are referred to as “Reimbursement Obligations.” Any Reimbursement Obligation (a “Parity Reimbursement Obligation”) may be secured by a pledge of and a lien on the Trust Estate on a parity with the lien created thereon by the Resolution. Any such Parity Reimbursement Obligation shall be deemed to be a part of the Series to which the Credit Facility which gave rise to such Parity Reimbursement Obligation relates.

Payments to reimburse the issuer of a Subordinated Credit Facility (a “Subordinated Reimbursement Obligation”) shall constitute Subordinated Indebtedness.

With respect to any contract of the Authority or LIPA with another entity for fuel, energy or power (a “Supply Contract”), the obligation of the Authority or LIPA, as the case may be, to pay that portion of any rates, fees, charges, surcharges or payments for the specific purpose of meeting principal or interest or both on that entity’s obligations directly associated with such contract and payable to such entity regardless of whether fuel or energy is delivered or made available for delivery and the principal and/or interest component of any Capital Lease, (such portion or component, the “Debt Service Component”) shall be (i) payable from Revenues and secured by a pledge of, and lien on, the Trust Estate on a parity with the lien created by the Resolution to secure the Bonds (a “Parity Contract Obligation”) only if, when such Supply Contract or Capital Lease is entered into, the Authority shall have satisfied the test set forth above in either paragraph (a) or (b) under the heading “Conditions Precedent to Delivery of Bonds”, subject to paragraph (d) under the same heading, with respect to such Debt Service Component or (ii) payable from funds withdrawn from the Revenue Fund as permitted by the Resolution, in all other events.
Separately Financed Project

Nothing in the Resolution shall prevent the Authority from authorizing and issuing bonds, notes, or other obligations or evidencing of indebtedness other than Bonds, for any purpose of the Authority authorized by the Act or by other applicable State statutory provisions, or from financing any such purpose from other available funds (such purpose being referred to in the Resolution as a “Separately Financed Project”), if the debt service on such bonds, notes, or other obligations or evidences of indebtedness, if any, and the Authority’s share of any operating expenses related to such Separately Financed Project, are payable solely from the revenues or other income derived from the ownership or operation of such Separately Financed Project or from other funds withdrawn from the Revenue Fund as permitted by the Resolution, and may be secured by the Authority’s or LIPA’s ownership interest therein.

Pledge of Funds and Revenues

The Trust Estate is pledged for the payment of the Bonds and Parity Obligations in accordance with their terms and the provisions of the Resolution, subject only to the provisions of the Resolution, the Act and the Financing Agreement permitting the application thereof. As further security for the payment of the Bonds and Parity Obligations, the Authority assigns, transfers and pledges to the Trustee all of its rights and interests under and pursuant to the Financing Agreement (excluding rights to notice and other procedural rights, its rights to indemnification and rights and interests not material to Bondholders).

The Resolution establishes the following funds:

1. Construction Fund, to be held by the Authority;
2. Revenue Fund, to be held by the Authority;
3. Operating Expense Fund, to be held by the Authority;
4. Debt Service Fund, to be held by the Trustee;
5. Parity Contract Obligations Fund, to be held by the Authority;
6. Subordinated Indebtedness Fund, to be held by the Authority, except as may otherwise be permitted by the Resolution;
7. LIPA Unsecured Debt Fund, to be held by the Authority;
8. PILOTs Fund, to be held by the Authority; and
9. Rate Stabilization Fund, to be held by the Authority.

The Trustee shall, at the request of the Authority, establish within any Fund held by the Trustee such Accounts or sub-accounts. The Authority may do likewise with respect to any Fund held by it.

Construction Fund

The Resolution provides that the Authority shall deposit into the Construction Fund any amount required to be deposited therein pursuant to the Resolution or the Financing Agreement, and any other amounts received by the Authority for or in connection with the System and determined by the Authority to be deposited therein, which are not otherwise required to be applied in accordance with the Resolution. The Authority shall also deposit in the Construction Fund, the proceeds of insurance, if any, maintained by the Authority or LIPA against physical loss of or damage to the System, or of contractors’ performance bonds with respect thereto, pertaining to the period of acquisition or construction of System Improvements, to the extent not deposited to the Revenue Fund. Except as otherwise provided in the Resolution, amounts in the Construction Fund shall be expended only to pay Costs of System Improvements as determined by the Authority from time to time. To the extent that other moneys are not
available therefor in any of the other Funds and Accounts established under the Resolution, amounts in the Construction Fund shall be applied to the payment of the Principal Installments of and interest on Bonds.

Revenue Fund

The Resolution provides that the Authority shall, as promptly as practicable after receipt thereof by the Authority, deposit all Revenues in the Revenue Fund, unless required by the Resolution to be deposited to any other Fund or Account. There shall also be deposited in the Revenue Fund all other amounts required by the Resolution or the Financing Agreement to be so deposited.

Payments Into Certain Funds

The Resolution provides that amounts on deposit from time to time in the Revenue Fund shall be withdrawn and deposited as follows and, as of any time, in the following order of priority:

FIRST: to the Operating Expense Fund, the amount determined by the Authority from time to time to be deposited thereto to pay, or to be set aside therein as a reserve for the payment of, Operating Expenses; and

SECOND: (A) to the Debt Service Fund, the amounts required to pay or provide for the payment of the Principal Installments and Redemption Price of and interest on Bonds and Parity Reimbursement Obligations; provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

(B) to the Parity Contract Obligations Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Parity Contract Obligations provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

provided, however, that if the balance remaining to make all such deposits is less than sufficient to do so in full, deposits shall be made pro rata between the Debt Service Fund and the Parity Contract Obligations Fund in the same ratio that the amount required to be deposited thereto bears to the sum of the amount required to be deposited to each such Fund;

THIRD: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST or SECOND above, to the Subordinated Indebtedness Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of principal and redemption price of and interest on Subordinated Indebtedness in accordance with the Resolution; provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

FOURTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND or THIRD above, to the LIPA Unsecured Debt Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Outstanding LIPA Unsecured Debt in accordance with the Resolution;

FIFTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD or FOURTH above, to the PILOTs Fund, the amount determined by the Authority to be required to be deposited in such Fund to pay or provide for the payment of PILOTs in accordance with the Resolution in accordance with the System Budget or the entire balance if less than sufficient; and

SIXTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD, FOURTH or FIFTH above, to the Rate Stabilization Fund, the
amount determined by the Authority to be deposited therein to provide for any payments or deposits from Revenues thereafter.

Any moneys remaining in the Revenue Fund at any time and not deposited as set forth above may be retained in the Revenue Fund or may be withdrawn and used for any lawful purpose of the Authority or LIPA as determined by the Authority, including but not limited to the purchase or redemption of any bonds, notes or other obligations of the Authority or LIPA and, to the extent specified by the Authority, the payment of any incentive payments payable by LIPA under any System Agreements which are not payable as an Operating Expense; provided, however, that prior to any such withdrawal, the Authority shall have determined, taking into account, among other considerations, anticipated future receipts of Revenues and other moneys constituting part of the Trust Estate, that the moneys to be withdrawn are not needed for any other purpose provided in paragraphs FIRST through SIXTH set forth above. Amounts paid out or withdrawn pursuant to this paragraph shall be free and clear of the lien and pledge created by the Resolution unless deposited into any Fund or Account; provided, however, that to the extent amounts are paid out or withdrawn for the purpose of paying any expense of LIPA, such amounts shall remain subject to the lien and pledge of the Resolution until such amounts are actually applied by the Authority or LIPA to the payment of such expense.

Purchases of Bonds or Subordinated Indebtedness from amounts in the Revenue Fund shall be made at the direction of the Authority, with or without advertisement and with or without notice to other Holders of Bonds or Subordinated Indebtedness. Such purchases shall be made at such price or prices as determined by the Authority. If Sinking Fund Installments have been established for the maturities of Bonds purchased by the Authority, then the Authority shall direct the Trustee to credit the principal amount purchased against the applicable Sinking Fund Installments in such order and amounts as are determined by the Authority.

Operating Expense Fund

Amounts credited to the Operating Expense Fund shall be applied from time to time solely to the payment of Operating Expenses at the times, in the manner, and on the other terms and conditions as determined by the Authority from time to time. If and to the extent provided in a Supplemental Resolution authorizing Bonds, amounts from the proceeds of such Bonds may be credited to the Operating Expense Fund and set aside therein as specified in the Supplemental Resolution for any purpose of such Fund.

Debt Service Fund

The Trustee shall for all Outstanding Bonds and Parity Reimbursement Obligations, pay (i) on each Bond Payment Date, (1) from the moneys on deposit in the Debt Service Fund the amounts required for the payment of the Principal Installments, if any, due on such Bond Payment Date and (2) from the moneys on deposit in the Debt Service Fund, including the moneys credited to the sub-account, if any, established for such Series in the Capitalized Interest Account, the interest due on such Bond Payment Date, and (ii) on any redemption date or date of purchase, the amounts required for the payment of accrued interest on Bonds to be redeemed or purchased on such date unless the payment of such accrued interest shall be otherwise provided.

As soon as practicable after the forty-fifth day preceding the due date of any Sinking Fund Installment, the Trustee shall proceed to call for redemption, pursuant to the Resolution, Bonds of the Series and maturity for which such Sinking Fund Installment was established in such amount as shall be necessary to complete the retirement of the principal amount specified for such Sinking Fund Installment of the Bonds of such Series and maturity. The Trustee shall so call such Bonds for redemption whether or not it then has moneys in the Debt Service Fund sufficient to pay the applicable Redemption Price thereof
on the redemption date. The Trustee shall apply to the redemption of the Bonds on each such redemption date the amount required for the redemption of such Bonds.

Parity Contract Obligations Fund

Amounts credited to the Parity Contract Obligations Fund shall be applied from time to time solely to pay or provide for the payment of Parity Contract Obligations at the times, in the manner, and on the other terms and conditions as determined by the Authority from time to time, subject to the Resolution which provides that if at any time any amount remains on deposit in the Parity Contract Obligations Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

Subordinated Indebtedness Fund

Amounts on deposit in the Subordinated Indebtedness Fund shall be applied by the Authority solely to pay or provide for the payment of the principal and redemption price of and interest on Subordinated Indebtedness, or as otherwise provided by the resolution of the Authority authorizing each issue of Subordinated Indebtedness, subject to the provisions set forth below under this heading.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund or Parity Contract Obligations Fund shall be less than the current requirements thereof, the Authority shall withdraw from the Subordinated Indebtedness Fund and deposit in such other Funds the amounts necessary (or all the moneys in the Subordinated Indebtedness Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

If at any time any amount remains on deposit in the Subordinated Indebtedness Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

LIPA Unsecured Debt Fund

Amounts on deposit in the LIPA Unsecured Debt Fund shall be applied by the Authority solely to the payment of the principal of and interest on Outstanding LIPA Unsecured Debt, subject to the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund or Subordinated Indebtedness Fund shall be less than the current requirements thereof, LIPA shall withdraw from the LIPA Unsecured Debt Fund and deposit in such other Funds the amounts necessary (or all the moneys in said Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

If at any time any amount remains on deposit in the LIPA Unsecured Debt Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

PILOTs Fund

Amounts on deposit in the PILOTs Fund shall be applied by the Authority, or paid to LIPA for application by LIPA, solely to make payments to the State, or any municipality or other political subdivision of the State, which shall be entitled to receive PILOTs under the Act, at such times and in such amounts as the Authority shall determine to be required to make such payments, subject to the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund, Subordinated Indebtedness Fund or LIPA Unsecured Debt Fund shall be less than the current requirements thereof, the Authority shall withdraw from the PILOTs Fund and deposit in such
other Funds the amounts necessary (or all the moneys in the PILOTs Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

Amounts on deposit in the PILOTs Fund which the Authority may determine to be in excess of the amount required to be maintained therein for the purposes of such Fund shall be transferred to the Revenue Fund.

**Rate Stabilization Fund**

Amounts on deposit in the Rate Stabilization Fund may be used for any lawful purpose of the Authority or LIPA, including but not limited to making any deposits required by the Resolution to any Fund or Account, as determined by the Authority; provided, however, that no such deposit to any such Fund or Account shall be required except as specified by the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund, Subordinated Indebtedness Fund, LIPA Unsecured Debt Fund or PILOTs Fund shall be less than the current requirements thereof, the Authority shall withdraw from the Rate Stabilization Fund and deposit in such other Funds the amounts necessary (or all the moneys in the Rate Stabilization Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

Amounts on deposit in the Rate Stabilization Fund which the Authority may determine to be in excess of the amount required to be maintained therein for the purposes of such Fund shall be transferred to the Revenue Fund.

**Investment of Certain Funds**

Moneys held in all Funds and Accounts shall be invested and reinvested by the Authority or the Trustee, as the case may be, to the fullest extent practicable in Investment Securities which mature not later than at such times as shall be necessary to provide moneys when needed for payment to be made from such Funds and Accounts, subject, in the case of the Subordinated Indebtedness Fund and LIPA Unsecured Debt Fund, to the terms of any resolutions, indentures, or other instruments securing any issue of Subordinated Indebtedness or Outstanding LIPA Unsecured Debt, as the case may be. The Trustee shall make all such investments of moneys held by it in accordance with written instructions from any Authorized Representative of the Authority. In making any investment in any Investment Securities with moneys in any Fund or Account established under the Resolution, the Authority may, and may instruct the Trustee to, combine such moneys with moneys in any other Fund or Account, but solely for purposes of making such investment in such Investment Securities.

Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) and other investment earnings on any moneys or investments in the Funds and Accounts, other than the Construction Fund and Capitalized Interest Account, shall be paid into the Revenue Fund as and when received. Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) and other investment earnings on any moneys or investments in the Construction Fund and Capitalized Interest Account shall remain in such Fund or Account, respectively, unless the Authority elects to pay the same into the Revenue Fund.

**Rate Covenants; Related Obligations**

The Authority shall establish and maintain System fees, rates, rents, charges and surcharges sufficient in each Fiscal Year so that Revenues reasonably expected to be produced in such Fiscal Year will be at least equal to the sum of (i) 100% of Debt Service, and amounts under all Parity Contract Obligations, payable by the Authority in such Fiscal Year, (ii) 100% of the Operating Expenses payable
in such Fiscal Year, (iii) 100% of the amount necessary to pay all PILOTs payable in such Fiscal Year, and (iv) 100% of the amount necessary to pay other Required Deposits, all other payments required pursuant to the Resolution and the Financing Agreement, and all other payments required for the System, for such Fiscal Year; provided, however, that if at any time such fees, rates, rents, charges and surcharges are or will be insufficient to meet the requirements of the Resolution, it shall not constitute a violation of the Resolution if and to the extent the Authority promptly takes action reasonably expected by the Authority to cure or avoid any such deficiency or to cause the same to be cured or avoided, or if the Authority complies with the provisions of the last paragraph set forth under this heading. Revenues shall include (i) any amount withdrawn or expected to be withdrawn thereafter in any Fiscal Year from the Rate Stabilization Fund which were either (a) on deposit therein prior to such Fiscal Year or (b) proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits, (ii) Revenues shall not include any proceeds from the sale of LIPA assets or proceeds of insurance and (iii) Debt Service, Parity Contract Obligations, PILOTs and other Required Deposits shall not include any amounts thereof expected by the Authority to be paid from any funds, other than Revenues, reasonably expected by the Authority to be available therefor (including without limitation the anticipated receipt of proceeds of sale of Bonds or Subordinated Indebtedness, or moneys not a part of the Trust Estate, expected by the Authority to be used to pay the principal of Bonds, Parity Contract Obligations, Outstanding LIPA Unsecured Debt or Subordinated Indebtedness other than proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits), which expectations, if included in a resolution of the Authority or Certificate of an Authorized Representative, shall be conclusive.

The Authority shall review, or cause LIPA to review, the adequacy of System fees, rates, rents, charges and surcharges at least annually. If such annual or more frequent review, or the report of the Rate Consultant pursuant to the Resolution, indicates that the rates, fees, rents, charges and surcharges are, or will be, insufficient to meet the requirements of the provisions stated in the preceding paragraph, the Authority shall promptly take, or cause LIPA to take, the necessary action to cure or avoid any such deficiency, except as otherwise may be provided by the last paragraph under this heading.

Except to the extent required by law, the Authority will not permit LIPA to furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private, unless and to the extent the Authority shall have determined that other adequate consideration has been or is expected to be received by LIPA in connection therewith, and the Authority will cause LIPA to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

The failure in any Fiscal Year to comply with the covenant in clauses (iii) and (iv) of the first sentence of the first paragraph above (the “non-debt service and operating expense rate covenant”) shall not constitute an Event of Default if the Authority shall comply with the provisions contained in this paragraph. If the Authority shall fail in any Fiscal Year to comply with the non-debt service and operating expense rate covenant, the Authority shall retain a Rate Consultant and a Consulting Engineer for the purpose of reviewing System fees, rates, rents, charges and surcharges and reviewing the System Budget in the manner described in the Resolution. If the Rate Consultant (relying upon the certificate of the Consulting Engineer) shall be of the opinion, as shown by a certificate filed with the Trustee pursuant to the Resolution, that a schedule of fees, rates, rents, charges and surcharges for the System which would provide funds to meet the requirements specified in the non-debt service and operating expense rate covenant is impracticable at that time and the Authority therefore cannot comply with the non-debt service and operating expense rate covenant, then the Authority shall fix and establish such schedule of System fees, rates, rents, charges and surcharges as is recommended in such certificate by the Rate Consultant to comply as nearly as practicable with the non-debt service and operating expense rate covenant and in such event the failure of the Authority to comply with the non-debt service and operating expense rate covenant, shall not constitute an Event of Default. The Rate Consultant’s
certificate shall be accompanied by a certificate of the Consulting Engineer setting forth estimates of amounts required as provided by the Resolution for the then-current and the ensuing two Fiscal Years.

**Tax Covenant**

In the Supplemental Resolution authorizing the Offered Securities, the Authority has covenanted not to take or omit to take any action which would cause interest on any Offered Security to be included in the gross income of any Owner thereof for Federal income tax purposes by reason of subsection (b) of Section 103 of the Internal Revenue Code of 1986 (Title 26 of the United States Code) as in effect on the date of original issuance of the Offered Securities (for purposes of this paragraph, the “Code”) and, without limiting the generality of the foregoing, that no part of the proceeds of any Bonds or any other funds of the Authority shall be used directly or indirectly to acquire any securities or obligations the acquisition of which would cause any Offered Security to be an “arbitrage bond” as defined in section 148 of the Code and to be subject to treatment under subsection (b)(2) of Section 103 of the Code as an obligation not described in subsection (a) of said section. Notwithstanding any other provision of the Resolution to the contrary, upon the Authority’s failure to observe, or refusal to comply with, this covenant, remedies are limited to specific performance and the Owners and Trustee shall not be entitled to any other rights and remedies provided under the Resolution.

**Consulting Engineer and Rate Consultant**

Subject to the Resolution, the Authority shall employ or cause LIPA to employ a Consulting Engineer and a Rate Consultant whose duties, respectively, shall be to make any certificates and perform any other acts required or permitted of the Consulting Engineer and the Rate Consultant under the Resolution or under the Financing Agreement.

Commencing with Fiscal Year 1999 and no less frequently than every other Fiscal Year thereafter, the Consulting Engineer and the Rate Consultant shall make an examination of, and shall report on, the properties and operations of the System. Such report shall be submitted to the Authority, LIPA, and the Trustee no later than eight months after the close of the Fiscal Year to which such examination relates and shall set forth the following: (i) the Consulting Engineer’s advice and recommendation as to the proper operation, maintenance and repair of the System during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes; (ii) the Consulting Engineer’s advice and recommendations as to improvements which should be made during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes, showing the amount projected to be expended during such Fiscal Years from the proceeds of Bonds or Subordinated Indebtedness issued under or pursuant to the Resolution; (iii) the Rate Consultant’s recommendation as to any necessary or advisable revisions of rates, fees, rents, charges and surcharges and such other advice and recommendation as it may deem desirable; and (iv) the Consulting Engineer’s findings as to whether the System has been maintained in good repair and sound operating condition, and its estimate of the amount, if any, required to be expended to place such properties in such condition and the details of such expenditures and the approximate time required therefor.

The Authority covenants that if any such report shall set forth that the properties of the System have not been maintained in good repair and sound operating condition, it will cause LIPA to promptly restore the properties to good repair and sound operating condition with all expedition practicable.

At any time after the expiration of the term of the initial Management Services Agreement the Authority may perform any duty or obligation of the Consulting Engineer or Rate Consultant for certain purposes as provided in the Resolution.

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Further Assurance

At any and all times the Authority shall, so far as it may be authorized by law, pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for better assuring, conveying, granting, pledging, assigning and confirming all and singular, the rights, assets, revenues and other moneys, securities, funds and property pledged or assigned by the Resolution, or intended so to be, or which the Authority may become bound to pledge or assign.

Indebtedness and Liens

The Resolution provides that the Authority shall not, and shall not permit or allow LIPA to, issue any bonds, notes or other evidences of indebtedness or otherwise incur any indebtedness or contract obligations, other than Bonds or Parity Obligations, secured by a pledge of or other lien or charge on the Trust Estate which is prior to or of equal rank or priority with the pledge made by the Resolution. The Authority shall not create or cause to be created, and shall not permit or allow LIPA to create or cause to be created, any lien or charge on the Trust Estate which is prior to or of equal rank or priority with the pledge made by the Resolution.

The Authority may issue either (i) Subordinated Indebtedness payable from the Subordinated Indebtedness Fund, secured by a pledge of and lien or charge on the Trust Estate, and further secured by an assignment of rights and interests under and pursuant to the Financing Agreement to the extent provided by the Resolution, in each case subject and subordinate in all respects to the pledge thereof and lien and charge thereon, or assignment thereof, as the case may be, created by the Resolution in favor of Bonds and Parity Obligations, or (ii) other bonds, notes or other evidences of indebtedness for borrowed money payable from funds withdrawn from the Revenue Fund as permitted by the Resolution.

Agreement of the State

The Resolution provides that, in accordance with Section 1020-o of the Act, the Authority, as agent for the State, agrees with the holders of obligations issued under the Resolution that the State will not limit or alter the rights vested in the Authority by the Act until such obligations together with the interest thereon are fully met and discharged, provided that nothing contained in the Resolution shall preclude such limitation or alteration if and when adequate provision shall be made by law for the protection of the Holders of such obligations of the Authority.

Annual System Budget

Prior to the beginning of each Fiscal Year, the Authority shall file with LIPA and the Trustee an annual System Budget for the ensuing Fiscal Year which shall set forth in reasonable detail the estimated Revenues and Operating Expenses for the System for such year. Such annual System Budget shall include the LIPA Budget (as such term is defined in the Financing Agreement) and the Authority Budget and also may set forth such additional material as the Authority may determine. At the end of each quarter, the Authority shall review its estimates for such Fiscal Year, and in the event such estimates do not substantially correspond with actual Revenues or Operating Expenses, or if there are at any time during any such Fiscal Year extraordinary receipts or payments of unusual costs, the Authority shall prepare an amended annual System Budget for the remainder of the then current Fiscal Year. The Authority also may at any time adopt an amended annual System Budget for the remainder of the then-current Fiscal Year.

If for any reason the Authority shall not have adopted the System Budget by the time required by the Resolution, the System Budget for the then-current Fiscal Year shall be deemed to be the System Budget for the ensuing Fiscal Year until a new System Budget is adopted.
Deposits to Funds

The Resolution provides that the Authority will take such action as may be required to cause all Revenues to be deposited in the Revenue Fund (or, if so required by the Resolution, any other Fund or Account).

Enforcement and Amendment of Financing Agreement

The Authority shall enforce or cause to be enforced the provisions of the Financing Agreement and duly perform its covenants and agreements under the Financing Agreement. The Authority will not consent or agree to or permit any rescission of or amendment to or otherwise take any action under or in connection with the Financing Agreement except in accordance with the Resolution.

Amendments to Financing Agreement

Except as otherwise provided in the Resolution, the Financing Agreement may not be amended, changed, modified or terminated, nor may any provision thereof be waived, without the consent of the Holders of Outstanding Bonds as provided in the Resolution, if such amendment, change, modification, termination or waiver adversely affects the interest of the Holders of Outstanding Bonds in any material respect.

No such amendment, change, modification, termination or waiver shall take effect unless the prior written consent of (a) the Holders of at least a majority in principal amount of the Bonds then Outstanding, or (b) in case less than all Bonds then Outstanding are affected by the amendment, change, modification, termination or waiver, the Holders of not less than a majority in principal amount of the Bonds so affected and then Outstanding; provided, however, that if such amendment, change, modification, termination or waiver will, by its terms, not take effect so long as any specified Bonds remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any such calculation of Outstanding Bonds.

For purposes of this section, any purchasers of the Bonds, whether purchasing as underwriters, for resale or otherwise, upon such purchase, may consent to an amendment, change, modification, termination or waiver permitted by this section with the same effect as a consent given by the Holders of such Bonds.

For the foregoing purposes, a Bond shall be deemed to be adversely affected by an amendment, change, modification, termination or waiver of the Financing Agreement if the same adversely affects or diminishes the rights of the Holder of such Bond in any material respect. The Trustee may in its discretion determine whether or not, in accordance with the foregoing provisions, any particular Bond would be adversely affected in any material respect by any amendment, change, modification, termination or waiver, and any such determination shall be binding and conclusive on the Authority and all Holders of Bonds.

For the foregoing purposes, the Trustee shall be entitled to rely upon an opinion of counsel, which counsel shall be satisfactory to the Trustee, with respect to whether any amendment, change, modification, termination or waiver adversely affects the interests of any Holders of Bonds then Outstanding in any material respect.

No Competitive Facilities

The Authority shall not construct, acquire or operate any plants, structures, facilities or properties which will provide electric transmission or distribution service in the Service Area (as defined in the Act) in competition with and not as part of the System unless such construction, acquisition or operation, in the judgment of the Authority, does not materially impair the ability of the Authority to comply with the rate covenant in the Resolution.
Disposition of Assets

The Authority shall not sell or otherwise dispose of, or encumber or grant a security interest in, any common or preferred stock or other evidence of the Authority’s equity interest in LIPA, unless the Authority or any subsidiary thereof shall thereupon own or effectively control the operation of the System. Except as provided by the Financing Agreement, the Authority shall not dispose of, or cause the disposition of, or permit to be disposed of, any real or personal properties of the System unless such disposal, in the judgment of the Authority, (i) is desirable in the conduct of the business of the System and (ii) does not materially impair the ability of the Authority to comply with the rate covenant in the Resolution.

Supplemental Resolutions; Amendments

The Authority may adopt (without the consent of any Holder) supplemental resolutions to, among others, authorize additional Bonds; to add to the restrictions contained in the Resolution upon the issuance of additional indebtedness; to add to covenants of the Authority contained in, or surrender any rights reserved to or conferred upon it by, the Resolution; to confirm any pledge under the Resolution or subject other property to the pledge; to permit qualification of the Resolution under, or add provisions permitted by, the Trust Indenture Act of 1939 or any similar Federal statute, and permit the qualification of the Bonds for sale under the securities laws of any state in the United States; to comply with such regulations and procedures as are from time to time in effect relating to establishing and maintaining a book-entry-only system; to comply with the requirements of any Rating Agency in order to maintain or improve a rating on the Bonds by such Rating Agency; to implement the last sentence of the definition of Revenues in the Resolution; to modify any provision of the Resolution, provided that such modification is effective upon or prior to the issuance of any Bonds affected or is effective only after all Bonds theretofore Outstanding cease to be Outstanding; to cure any ambiguity, supply any omission or to correct any defect or inconsistent provision in the Resolution; or to modify any provision provided that such modification shall not adversely affect the interests of the Bondholders in any material respect (and also provided that the Trustee consents thereto).

Any of the provisions of the Resolution may be amended by the Authority upon the written consent of the Holders of at least a majority in principal amount of the Bonds Outstanding at the time such consent is given, and in case less than all Bonds then Outstanding are affected by the modification or amendment, of the Holders of at least a majority in principal amount of such Outstanding Bonds that are or may be so affected; except that if such modification or amendment will, by its terms, not take effect so long as any particular Bonds remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under the Resolution. No such modification or amendment shall permit a change in the terms of redemption or maturity of the principal of any Outstanding Bond or of any installment of interest thereon or a reduction in the principal amount or the Redemption Price thereof or in the rate of interest thereon without the consent of the Holder of such Bond, or shall reduce the percentages or otherwise affect the classes of Bonds the consent of the Holders of which is required to effect any such modification or amendment, or shall change or modify any of the rights or obligations of any Fiduciary without its written assent thereto. For the purposes of this paragraph, a Bond shall be deemed to be affected by a modification or amendment of the Resolution if the same materially and adversely affects or diminishes the rights of the Holder of such Bond.

Events of Default; Remedies Upon Default

Pursuant to the Resolution, any of the following events set forth in clauses (1) through (6) constitutes an “Event of Default” if: (1) the Authority defaults on the payment of Principal or the Redemption Price of any Bond; or (2) the Authority defaults on the payment of any installment of interest on any Bond, and such default shall continue for a period of five (5) days; or (3) the Authority defaults in
the performance or observance of any other of the covenants, agreements or conditions on its part in the Resolution, any Supplemental Resolution or in the Bonds contained, and such default shall continue for a period of sixty (60) days after written notice thereof (and stating that it is a “Notice of Default”) to the Authority by the Trustee, or to both by the Holders of not less than sixty-six and two-thirds percent (66 2/3%) of the principal amount of Bonds Outstanding, provided that if such default shall be such that it cannot be corrected within such sixty day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; or (4) LIPA defaults under the Financing Agreement and such default continues for a period of sixty (60) days after written notice thereof (and stating that it is a “Notice of Default”) to the Authority by the Trustee, or to both by the Holders of not less than sixty-six and two-thirds percent (66 2/3%) of the principal amount of Bonds Outstanding, provided that if such default shall be such that it cannot be corrected within such sixty day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; or (5) if the Authority or LIPA (a) files a petition seeking a composition of its indebtedness under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (b) consents to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of the Authority or LIPA or any substantial portion of either of their property; (c) makes any assignment for the benefit of creditors; or (d) admits in writing its inability generally to pay its debts generally as they become due; or (6) if (a) a decree or order for relief is entered by a court having jurisdiction of the Authority or LIPA adjudging the Authority or LIPA a bankrupt or insolvent or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition in respect of the Authority or LIPA in an involuntary case under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (b) a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of the Authority or LIPA or of any substantial portion of either of their property is appointed; or (c) the winding up or liquidation of its affairs is ordered and the continuance of any such decree or order unstayed and in effect for a period of sixty (60) consecutive days.

Upon an Event of Default, the Trustee may and, upon the written request of the Holders of not less than sixty-six and two-thirds percent (66 2/3%) of the principal amount of the Bonds Outstanding the Trustee shall declare the principal of all the Bonds then Outstanding to be due and payable immediately. Such declaration may be annulled or rescinded as described in the Resolution.

Under the Resolution the Authority covenants that upon an Event of Default, the books of record and account of the Authority shall at all times be subject to the inspection and use of the Trustee and of its agents and attorneys, and the Authority will, upon demand of the Trustee, account for all Revenues and other moneys, securities and funds pledged or held under the Resolution for such period as shall be stated in such demand. Upon a default, the Trustee may proceed to protect and enforce its rights and the rights of the Holders of the Bonds under the Resolution by a suit in equity or at law, whether for the specific performance of any covenant contained in the Resolution, in aid of the execution of any power granted therein, or for an accounting against the Authority as if the Authority were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee. No Holder of any Bond shall have any right to institute any suit, action or proceeding at law or in equity for the enforcement of any provision of the Resolution or the execution of any trust under the Resolution or for any remedy under the Resolution, unless the Trustee has been requested by not less than sixty-six and two-thirds percent (66 2/3%) in principal amount of the Bonds then Outstanding, and such Holders shall have offered the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee has failed to commence such suit in the manner provided in the Resolution.
Defeasance

Bonds or any portion thereof for the payment or redemption of which moneys shall have been set aside and shall be held in trust by the Trustee (through deposit by the Authority of funds for such payment or redemption or otherwise) at the maturity or redemption date thereof shall be deemed to have been paid within the meaning of the Resolution and shall cease to be entitled to any lien, benefit or security under the Resolution either (A) as provided in the Supplemental Resolution authorizing their issuance or (B) if the following conditions are met: (i) in case any Bonds to be redeemed on any date prior to their maturity, the Authority shall have given to the Trustee instructions accepted in writing by the Trustee to mail as provided in the Resolution notice of redemption of such Bonds (other than Bonds which have been purchased by the Trustee at the direction of the Authority as provided prior to the mailing of such notice of redemption) on said date, (ii) there shall have been deposited with the Trustee either moneys in an amount which shall be sufficient, or Defeasance Obligations the principal installments of and/or the interest on which when due, without reinvestment, will provide moneys which, together with the moneys, if any, deposited with the Trustee at the same time, shall be sufficient, to pay when due the Principal Installments or Redemption Price, if applicable, and interest due and to become due on said Bonds or portion thereof on or prior to the redemption date or maturity date thereof, as the case may be, and (iii) in the event said Bonds are not to be redeemed within the next succeeding 60 days, the Authority shall have given the Trustee in form satisfactory to it irrevocable instructions to mail, as soon as practicable, a notice to the Holders of such Bonds that the deposit required by clause (ii) above has been made with the Trustee and that said Bonds or portion thereof (as the same thereafter may change) are deemed to have been paid in accordance with the Resolution and stating such maturity or redemption date (as the same thereafter may change) upon which moneys are to be available for the payment of the Principal Installments or Redemption Price, if applicable, on said Bonds or portion thereof (other than Bonds which have been purchased by the Trustee at the direction of the Authority as provided prior to the publication of the notice of redemption referred to above). The Trustee shall, as and to the extent necessary, apply moneys held by it pursuant to the Resolution to the retirement of said Bonds (or portions thereof) in amounts equal to the unsatisfied balances of any Sinking Fund Installments with respect to such Bonds (or portions thereof), all in the manner provided in the Resolution.

Unclaimed Moneys

Any moneys held by a Fiduciary in trust for the payment and discharge of the principal of or interest on any Bonds which remain unclaimed for two years after the date when such principal or interest, respectively, has become due and payable, either at their stated maturity dates or by call for earlier redemption, if such moneys were held by the Fiduciary at such date, or for two years after the date of deposit of such moneys if deposited with the Fiduciary after the said date when such principal or interest, as the case may be, becomes due and payable, shall, at the written request of the Authority, be repaid by the Fiduciary to the Authority, as its absolute property and free from trust, and the Fiduciary shall thereafter be released and discharged with respect thereto and the Bondholders shall look only to the Authority for the payment of such principal or interest, as the case may be. Notwithstanding the foregoing, any moneys held by a Fiduciary in trust for the payment and discharge of the principal of or interest on any Bonds which remain unclaimed after such moneys were to be applied to the payment of such principal or interest, as the case may be, in accordance with the Resolution may be applied in accordance with the provisions of the Abandoned Property Law of the State, being Chapter 1 of the Consolidated Laws of the State, or any successor provision thereto, and upon such application, the Fiduciary shall thereupon be released and discharged with respect thereto and the Holders of Bonds shall look only to the Authority or the Comptroller of the State for the payment of such principal or interest, as the case may be. Before being required to make any such payment to the Authority or to apply such moneys in accordance with the Abandoned Property Law (or its successor) of the State, the Fiduciary shall, at the expense of the Authority, cause to be mailed to the Bondholders entitled to receive such moneys a notice that said moneys remain unclaimed and that, after a date named in said notice, which
date shall be not less than 30 days after the date of the mailing, the balance of such moneys then unclaimed will be returned to the Authority or applied in accordance with the Abandoned Property Law (or its successor) of the State, as the case may be.

**SUMMARY OF CERTAIN PROVISIONS OF THE FINANCING AGREEMENT**

The following is a brief summary of certain provisions of the Financing Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Financing Agreement, a copy of which is on file with the Trustee.

**Agreement to Finance Acquisition of System and Cost of System Improvements**

The Authority agreed in the Financing Agreement to finance (i) the Property Tax Settlement, (ii) the retirement of certain outstanding debt of LILCO, and (iii) all or a part of the Cost of System Improvements, by the issuance of Authority Obligations from time to time in accordance with the Resolution, in each case unless and to the extent funded from other sources. The Authority and LIPA agree that the issuance of Authority Obligations, including the issuance of Authority Obligations for the purpose of refunding Authority Obligations or Outstanding LIPA Unsecured Debt in accordance with the Financing Agreement and the Resolution, shall be deemed to constitute a loan to LIPA. The obligation of LIPA to repay such loan and to make payments in accordance with the Financing Agreement shall be evidenced by the delivery of the LIPA Note.

**Obligation to Make Payments to the Authority; Grant of Revenues and Certain Other Security to the Authority**

On or before one business day prior to each due date for the payment of the principal of and redemption price, if any, or interest on, or other payments required under, Authority Obligations, until the same shall have been paid in full or provision for the payment thereof in full shall have been made in accordance with the Resolution or the provisions thereof, LIPA shall make or cause to be made payments on the LIPA Note to the Authority in an amount which, when added to any moneys then on deposit under the Resolution and available therefor, including any dividends theretofore paid to the Authority and held thereunder, shall be equal to the amount payable on such due date with respect to the Authority Obligations, as provided in the Resolution, including amounts due for the payment of the principal of and sinking fund installments and premium, if any, and interest on the Bonds. The principal amount from time to time due and owing under the LIPA Note and the scheduled amortization thereof and related interest rates (or the method of determining the same) shall be evidenced by the periodic delivery to LIPA of a certificate of an Authorized Representative of the Authority setting forth the same.

Outstanding LIPA Unsecured Debt shall be paid pursuant to and in accordance with the Resolution and the respective resolutions, indentures or similar instruments authorizing and providing for the issuance thereof.

LIPA has granted and transferred to the Authority all of its right, title and interest in and to the Revenues and the Promissory Notes, including all of its rights to collect and receive the same, subject only to the provisions of the Financing Agreement and the Resolution permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Financing Agreement and the Resolution.

LIPA has further pledged and assigned to the Authority, and granted to the Authority a security interest in, the System Agreements, subject however to the right and obligation of LIPA to exercise its rights and to carry out its obligations and duties thereunder, and further subject to the terms of the Financing Agreement and the Resolution, the right and obligation to enforce or realize upon its rights and interests in the System Agreements.
Powers as to Grant, Conveyance and Transfer and as to Revenues of the System

LIPA warrants and agrees that the Revenues, the System Agreements and other moneys, securities and funds and the rights under contracts so granted, conveyed, pledged and transferred are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, of equal rank with, the pledge created or authorized by the Resolution, and all corporate action on the part of LIPA to that end has been duly and validly taken. LIPA shall at all times, to the extent permitted by law, defend, preserve and protect the pledge of the Revenues, the System Agreements and other moneys, securities and funds and the rights under the contracts pledged under the Financing Agreement and the Resolution and all the rights of the Authority and the Bondholders under the Financing Agreement and the Resolution against all claims and demands of all persons whomsoever.

Subject to the provisions of the Financing Agreement, upon consummation of the LIPA/LILCO Merger, LIPA became, and agrees that so long as any Authority Obligations remain outstanding it will at all times continue to be, the owner of the System.

LIPA shall, so long as any Authority Obligations remain outstanding, perform all acts and duties required to be performed by it with respect to the System Agreements, and shall not permit any rescission or termination or amendment thereof, or otherwise take any action under or in connection with either, not expressly provided for by the terms thereof, which will in any manner impair or adversely affect the rights of LIPA thereunder, or the rights or security of the holders of or parties to Authority Obligations under the provisions thereof or of the Resolution, and any action by LIPA in violation of this covenant shall be null and void as to LIPA.

Powers as to System and Collection of Revenues

The Financing Agreement provides that so long as any Authority Obligations remain outstanding, LIPA will have or will use its best efforts to obtain good right and lawful authority to maintain, operate and improve the System; to impose and collect such fees, rates, rents and charges for the use or services of the System as are established from time to time by the Authority in accordance with the Resolution and the Act; and to demand and collect all Revenues becoming due to it for the use or services of the System.

State not Liable with Respect to LIPA Note

The LIPA Note and other obligations of LIPA under the Financing Agreement shall not be a debt of the State or of any municipality, and neither the State nor any municipality shall be liable thereon. Neither the credit, the revenues nor the taxing power of the State or of any municipality shall be, or shall be deemed to be, pledged to the payment of the LIPA Note or other obligations of LIPA.

Payment From Construction Fund

The Costs incurred by LIPA with respect to System Improvements shall be evidenced to the Authority by a certificate signed by an Authorized Representative of LIPA which shall contain the information required to be set forth in a Disbursement Request. Upon receipt of such certificate the Authority shall pay or cause to be paid to the person entitled thereto amounts sufficient to pay all such certified Costs but solely from amounts available therefor in the Construction Fund.

Revenue Fund

The Financing Agreement provides that all Revenues, as promptly as practicable after receipt thereof by or on behalf of LIPA, shall be deposited by LIPA or by the System Manager into the Revenue Fund. LIPA shall take such actions as it shall determine necessary and appropriate to assure that the System Manager complies with the applicable provisions of the Management Services Agreement and that the Energy Manager complies with the applicable provisions of the Energy Management Agreement relating to the application of moneys of LIPA.
LIPA General Fund

There shall be deposited in the LIPA General Fund all amounts received by LIPA from the Authority or the Trustee pursuant to the Resolution for the purpose of paying LIPA Expenses and any necessary and proper renewals, replacements and extensions of the System or, as provided in the Financing Agreement, PILOTs. All amounts in the LIPA General Fund shall be held in trust by LIPA and applied only as provided in the Financing Agreement, in the Act or in the Resolution. Amounts on deposit in the LIPA General Fund shall be applied by LIPA solely for the payment of LIPA Expenses or any such renewals, replacements, extensions, or PILOTs.

Application of Revenues After Event of Default

LIPA covenants that if an “Event of Default”, as defined in the Resolution, shall occur, LIPA, upon demand of the Trustee, shall pay over or cause to be paid over to the Trustee all moneys and securities then held by LIPA or by any System Manager in LIPA General Fund, and thereafter, as promptly as practical, the Revenues, for application in accordance with Section 1003 of the Resolution.

Rate Covenant

LIPA and the Authority have covenanted and agreed that fees, rates, rents, charges and surcharges for the use of, or services furnished, rendered or made available by, the System shall be established by the Authority in accordance with the Resolution and the Act such that such fees, rates, rents, charges and surcharges shall be adequate, together with any other available funds, to provide for, among other things, (i) the timely payment of the Principal Installments of and interest on all Bonds, the principal of and interest on any other Authority Obligations payable from Revenues, and the principal of and interest on the Outstanding LIPA Unsecured Debt, (ii) the proper operation and maintenance of the System, (iii) all other payments required for the System not otherwise provided for and (iv) all other payments required pursuant to the Financing Agreement and any System Agreements.

If the periodic review of System fees, rates, rents, charges and surcharges conducted by the Authority in accordance with the Resolution, or the report prepared pursuant to the Resolution, indicates that such rates, fees, rents, charges and surcharges are, or will be, insufficient to meet the requirements of Section 701 of the Resolution, LIPA, in accordance with the directions, if any, of the Authority, shall promptly take and diligently pursue all necessary actions within its reasonable control to cure or avoid any such deficiency.

Except to the extent required by law, LIPA will not furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private unless and to the extent the Authority shall have determined that other adequate consideration has been or is expected to be received by LIPA in connection therewith, and LIPA will use reasonable efforts to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

Nothing contained in the Financing Agreement shall be deemed to limit or restrict the right or obligation of the Authority or LIPA to comply with any covenant relating to rates to be charged for the use of, or services provided by, the System which may be made with the holders of or parties to Authority Obligations in accordance with the Act.

Compliance with Report as to System Condition

LIPA covenants that if any report prepared in accordance with the Resolution shall set forth that the properties of the System have not been maintained in good repair and sound operating condition, it will restore the properties or cause the properties to be restored to good repair and sound operating condition as promptly as practicable.
Operation and Maintenance

LIPA has covenanted that it shall, at all times:

(a) In accordance with the advice and recommendations set forth in the reports prepared from time to time in accordance with the Resolution, operate the System properly and in a sound and economical manner and shall maintain, preserve, and keep the same preserved and kept with the appurtenances and every part and parcel thereof, in good repair, working order and condition, and shall from time to time make, or cause to be made, all necessary and proper repairs, replacements, renewals and extensions so that at all times the operation of the System may be properly and advantageously conducted; provided, however, that nothing contained in the Financing Agreement shall require LIPA to operate, maintain, preserve, repair, replace, renew or reconstruct any part of the System if, in the case of any part of the System having a market value of greater than $1 million, there shall be filed with LIPA, the Authority and the Trustee a certificate of an Authorized Representative of LIPA stating that, in the opinion of LIPA, abandonment of operation of such part of the System will not adversely affect the operation of the System or impair the ability of LIPA and the Authority to comply with the provisions of the Financing Agreement and the Rate Covenant set forth in the Resolution;

(b) enforce the rules and regulations governing the operations, use and services of the System established from time to time by LIPA or the Authority; and

(c) observe and perform all of the terms and conditions contained in the Act, and comply with all valid acts, rules, regulations, orders and directions of any legislative, executive, administrative or judicial body having competent jurisdiction of LIPA or the System; provided, however, that the failure of LIPA to comply with the covenant contained in this paragraph (c) for any period shall not constitute a default on its part so long as LIPA (i) is taking reasonable and timely steps to permit compliance and (ii) LIPA shall have delivered to the Trustee and to the Authority a Certificate of an Authorized Representative of LIPA which (1) sets forth in reasonable detail the facts and circumstances attendant to such non-compliance, (2) sets forth the steps being taken by LIPA to permit compliance, (3) sets forth the estimated date on which LIPA will be in compliance and (4) states that in the opinion of such Authorized Representative such non-compliance during the period described will not adversely affect the operation of the System or the amount of Revenues to be derived therefrom.

Annual LIPA Budget

Not less than thirty (30) days prior to the beginning of each Fiscal Year, LIPA shall file with the Authority and the Trustee a LIPA Budget for the ensuing Fiscal Year which shall set forth in reasonable detail the estimated Revenues, LIPA Expenses and renewals, replacements and extensions for the System for such year. At the end of each quarter, LIPA shall review its estimates for such Fiscal Year, and in the event such estimates do not substantially correspond with actual Revenues or LIPA Expenses, or if there are at any time during any such Fiscal Year extraordinary receipts or payments of unusual costs, LIPA shall prepare an amended LIPA Budget for the remainder of the then current Fiscal Year. LIPA also may at any time adopt an amended LIPA Budget for the remainder of the then current Fiscal Year.

Compliance with Agreements; Tax Exemption

LIPA has covenanted with the Authority that it will take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Financing Agreement and the Resolution. The Authority has covenanted with LIPA that it will take all such actions or refrain from taking any such actions, as the case may be, so as to comply with the terms and provisions of the Resolution and the Financing Agreement.
LIPA has covenanted with the Authority, so long as any Bonds or other Authority Obligations, issued with the intent that the interest thereon not be included in gross income for Federal income tax purposes, shall be outstanding, that it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on any such Bonds or other Authority Obligations.

**Compliance with Resolution**

LIPA shall take all such actions and refrain from taking all such actions, as the case may be, and otherwise shall operate the System as shall ensure their compliance, and the compliance of the Authority, with the terms and provisions of the Resolution, or any other agreement entered into by the Authority in connection with the financing or operation of the System and which shall, by its terms, directly or indirectly apply to LIPA.

**Enforcement of Rules and Regulations**

LIPA shall enforce or cause any System Manager of the System to enforce the rules and regulations providing for discontinuance of or disconnection from the provision of electric service, for non-payment of fees, rates, rents or other charges imposed by the Authority and LIPA, provided that such discontinuance or disconnection shall not be carried out except in the manner and upon notice consistent with the Act.

**Books, Records and Accounts**

Each of the Authority and LIPA shall keep or cause to be kept, proper books of record and account in which complete and correct entries shall be made of all transactions relating to their corporate purposes under the Act and the Financing Agreement.

**Liens**

Until all Authority Obligations have been paid in full or provision has been made therefor in accordance with the Resolution, LIPA shall not create, and, except to the extent permitted by the Financing Agreement and to the extent it has the power to do so, shall not permit to be created, any lien upon or pledge of the System, any real or personal properties comprising any part of the System, or the Trust Estate including but not limited to the Revenues, except the lien and pledge thereon created by the Financing Agreement, the Resolution, and the Act.

**Compliance with Law**

The Authority and LIPA have covenanted and agreed each for itself that it will observe and perform all of the terms and conditions contained in the Act, and comply with all valid laws, acts, rules, regulations, orders and directions of any legislative, executive, administrative or judicial body having competent jurisdiction over its property or affairs.

**Insurance**

LIPA shall maintain or cause the System Manager to maintain with responsible insurers all insurance required and reasonably obtainable in the amounts and of the types customarily maintained by electric utilities consistent with prudent utility practice, to indemnify for loss of or damage to the System, and against public and other liabilities relating to the operations of LIPA and the System. LIPA shall also maintain or cause to be maintained any additional or other insurance which is required by the System Agreements. LIPA may insure itself against any risk at the recommendation of an insurance consultant chosen by or acceptable to an Authorized Representative of LIPA; provided, however, that LIPA shall provide adequate funding of such self-insurance if and to the extent recommended by such insurance consultant.
Covenant Regarding Additional System Agreements

Any additional System Agreement executed by LIPA shall contain such terms and conditions as will enable LIPA to retain such overall supervision and control of the business, design, operating, management, transportation, maintenance, planning and research and development functions of the System as may be required by law, the Financing Agreement or the Resolution.

Limitations on Operating Expenses and Costs of Major Renewals and Replacements

LIPA shall not incur or allow any System Manager to incur Operating Expenses or costs of major renewals, replacements and extensions for the System in any year in excess of the reasonable and necessary amount of such Operating Expenses or costs, respectively, and, except as may be necessary to respond to emergency conditions and to assure the continuing operation of the System, shall not expend any amount from the Operating Expense Fund for Operating Expenses or from the Construction Fund for costs of major renewals, replacements and extensions for the System for such year in excess of the respective amounts provided therefor in the LIPA Budget as originally adopted or as amended.

Maintenance of Existence

LIPA covenants and agrees that during the term of the Financing Agreement it will maintain its existence as a corporation, will continue to be a corporation either organized under the laws of or duly qualified to do business in the State, will not dissolve or otherwise dispose of all or substantially all of its assets and will not consolidate with or merge into one or more other entities or permit one or more other entities to consolidate with or merge into it. LIPA may, however, consolidate with or merge into one or more other entities or permit one or more other entities to consolidate with or merge into it, or sell or otherwise transfer to one or more other entities all or substantially all of its assets as an entirety and thereafter liquidate or dissolve if (a) LIPA is the surviving, resulting or transferee entity, or (b) in the event LIPA is not the surviving, resulting or transferee entity, such entity (i) is solvent, and either organized under the laws of or duly qualified to do business subject to service or process in the State, (ii) assumes in writing all of the obligations of LIPA as set forth in the Financing Agreement and (iii) is either the Authority or is wholly owned by the Authority, and (c), in either event, the Trustee shall have been furnished (1) an opinion of Bond Counsel to the effect that under then existing statutes and court decisions, such consolidation, merger, sale or transfer does not adversely affect the exclusion of interest on any obligations of the Authority then outstanding the interest on which is excluded from gross income for federal income tax purposes, and (2) written confirmation from each Rating Agency to the effect that such consolidation, merger, sale or transfer, in and of itself, will not result in a withdrawal, suspension or downward revision of the rating assigned by such Rating Agency to the Bonds.

Disposition of Property

LIPA may, with the approval of the Authority, dispose of properties if such disposal, in the judgment of LIPA, (i) is desirable in the conduct of its business, (ii) is not disadvantageous in any material respect to the Holders of Authority Obligations and (iii) does not materially impair the ability of the Authority and LIPA to comply with the Financing Agreement and the rate covenant set forth in the Resolution.

Competitive Facilities

LIPA has covenanted that it will not construct, acquire, or operate, any plants, structures, facilities or properties which will provide electric service in the Service Area (as defined in the Act) unless the same are a part of the System.
Payment of Lawful Charges

LIPA shall pay or cause to be paid, to the extent not paid by the Authority, all taxes and assessments or other municipal or governmental charges, if any, and all PILOTs to the extent not paid by the Authority, lawfully levied or assessed upon or in respect of the System, or upon any part thereof or upon the Revenues, when the same shall become due, and shall duly observe and comply in all material respects with all valid requirements of any municipal or governmental authority relative to any part of the System, and shall not create or suffer to be created any lien or charge upon the System or any part thereof or upon the Revenues therefrom, except the pledge and lien created by the Financing Agreement and by the Resolution for the payment of the principal and redemption price of and interest on, and other payments under, Authority Obligations. Nothing in the Resolution or the Financing Agreement shall be construed to prevent LIPA or the Authority from entering into agreements to make PILOTs.

Agreement of the State

In accordance with the Act, the Authority, as agent for the State, pledges to and agrees with the holders of any obligations issued under the Act and the parties to any contracts with the Authority thereunder that the State will not limit or alter the rights thereby vested in the Authority until such obligations together with the interest thereon are fully met and discharged and/or such contracts are fully performed on the part of the Authority, provided that nothing in the Financing Agreement shall preclude such limitation or alteration if and when adequate provision shall be made by law for the protection of the holders of such obligations of the Authority, or those entering into such contracts with the Authority.

Events of Default

An “event of default” means any one or more of the following events: (a) failure by LIPA to make the payments required to be made to the Authority pursuant to the Financing Agreement; (b) failure by LIPA to remit or cause to be remitted the Revenues, or any portion thereof, to the extent received by LIPA, for deposit in the Revenue Fund; (c) failure of LIPA to observe any covenant, term or condition of the Financing Agreement, provided that such failure shall have continued for a period of sixty (60) days after written notice, specifying such failure and requesting that it be remedied, is given to LIPA by the Authority, unless the Authority shall agree in writing to an extension of such time prior to its expiration, and provided further that such extension shall not be unreasonably withheld if LIPA has instituted and is diligently pursuing corrective action within the applicable period; (d) if LIPA (1) files a petition seeking a composition of its indebtedness under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (2) consents to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of LIPA or any substantial portion of its property; (3) makes any assignment for the benefit of creditors; (4) admits in writing its inability to pay its debts generally as they become due; or (5) takes action in furtherance of any of the foregoing; (e) if (1) a decree or order for relief is entered by a court having jurisdiction of LIPA adjudging LIPA a bankrupt or insolvent or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition in respect of LIPA in an involuntary case under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (2) a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of LIPA or of any substantial portion of its property is appointed; or (3) the winding up or liquidation of its affairs is ordered and the continuance of any such decree or order unstayed and in effect for a period of sixty (60) consecutive days; or (f) the respective provisions of the Act pursuant to which the Resolution has been adopted or Authority Obligations have been issued or entered into, including, without limitation, those provisions pursuant to which the lien upon the Revenues has been created pursuant to the Financing Agreement and the Resolution and those provisions authorizing the establishment of LIPA, shall be materially and adversely limited, altered or impaired by any legislative action or any formal judgment or the terms, conditions and security provided under the Financing
Agreement, Authority Obligations and the Resolution shall be materially and adversely limited, altered or impaired by any legislative action or any final judgment.

Remedies

Whenever an event of default shall have occurred and be continuing, and written notice of the event of default, if required, shall have been given to LIPA by the Authority or by the Trustee and the event of default shall not have been cured within the period provided therefor, the Authority and the Trustee may take whatever action at law or in equity to collect the payments then due and as they thereafter become due, and the Authority and the Trustee, so long as any Bonds are outstanding, may take whatever action at law or in equity to enforce performance and observance of any obligation, agreement or covenant of LIPA under the Financing Agreement.

Termination

The Financing Agreement terminates and the covenants and other obligations contained in the Financing Agreement are discharged and satisfied, when (i) payment of all Authority Obligations has been made or provided for in accordance with the Resolution and (ii) either all payments required thereunder have been made in full, or provision for such payments satisfactory to the Authority and the Trustee has been made or the Authority pays or assumes all liabilities, obligations, duties, rights and powers of LIPA thereunder.

Amendments to Agreement; Consents

The parties to the Financing Agreement may enter into any amendment, change or modification of the Financing Agreement; provided, the parties shall not enter into or consent to, any amendment, change or modification which materially adversely affects the rights of the Owners of the Bonds by modifying or revoking certain enumerated provisions of the Financing Agreement without first obtaining the consent of the holders of or parties to Authority Obligations in accordance with and to the extent provided by the provisions of the Resolution.

Indemnity by LIPA

To the extent permitted by law, LIPA releases and agrees to hold harmless and indemnify the Authority and its trustees, officers, officials, agents and employees from and against all, and agrees that the Authority and its trustees, officers, officials, agents and employees shall not be liable for any, (i) liabilities, suits, actions, claims, demands, damages, losses, expenses and costs of every kind and nature resulting from any action taken in accordance with, or permitted by the Financing Agreement, or the Resolution, or arising from or incurred by the Authority by reason of its incurrence of Authority Obligations pursuant to the Financing Agreement and the Resolution, or (ii) loss or damage to property or any injury to or death of any or all persons that may be occasioned by any cause whatsoever pertaining to the System arising by reason of or in connection with the presence on, in or about the premises of the System of any person; provided, however, that the indemnity shall be effective only to the extent of any loss or liability that may be sustained by the Authority or another party so indemnified by LIPA in excess of net proceeds received from any insurance carried with respect to such loss or liability.

Conflicts

The Financing Agreement provides that its provisions shall not change or in any manner alter the terms of the Resolution, or the security, rights or remedies of the Trustee or the holders or owners of Authority Obligations. In the event any provision of the Financing Agreement conflicts at any time, or in any manner, with the provisions of the Resolution or any Authority Obligations, the provisions of the Resolution or Authority Obligations shall be controlling and conflicting provisions of the Financing Agreement shall be disregarded.
SUMMARY OF OPERATING AGREEMENTS
SUMMARY OF CERTAIN PROVISIONS OF THE MANAGEMENT SERVICES AGREEMENT1

The following is a brief summary of certain provisions of the Management Services Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Management Services Agreement, a copy of which is on file with the Trustee.

General

The Management Services Agreement establishes the terms and conditions under which the Authority has contracted with KeySpan and its subsidiaries (the “Manager”) for the purpose of providing the Operation and Maintenance Services and the Construction Work relating to the T&D System in a manner consistent with policies established by LIPA in order to assure the continued delivery of electric energy to the customers of the T&D System.

Ownership of the T&D System

The Agreement provides that the Manager will not have any ownership or leasehold interest in the T&D System. LIPA has engaged the Manager as an independent contractor to furnish the services described in the Agreement.

The Agreement provides that the Manager will not, without LIPA’s prior written consent, create or permit to be created or to remain, and will promptly discharge at its expense, any Encumbrance on the T&D System, other than (1) Encumbrances existing as of the date of the Agreement, or (2) any Lien affecting the T&D System (i) resulting solely from any action or failure to act by LIPA or anyone claiming by, through or under LIPA; or (ii) created by Subcontractors that are promptly discharged or bonded against by the Manager. The Agreement provides that nothing in the Agreement will be deemed to create any Lien or Encumbrance in favor of the Manager on any asset of LIPA as security for the obligations of LIPA under the Agreement.

Operation of the T&D System

General. The Agreement provides that the Manager will not transmit or distribute Power and Energy other than Power and Energy obtained by, on behalf of, or with the approval of LIPA, and will not use the T&D System for any purpose other than the purposes contemplated by the Agreement or to serve or benefit any person other than LIPA and its customers in the Service Area.

Operation and Maintenance. The Agreement provides that, commencing on the LIPA/LILCO Merger Closing Date, the Manager will provide Operation and Maintenance Services and Construction Work for the T&D System on behalf of LIPA in accordance with the Contract Standards. The Manager will be responsible for the safe and reliable operation and maintenance of the T&D System, management and/or performance of construction of improvements thereto and delivery of Power and Energy to LIPA’s customers and will be responsible for the following tasks and services, among others: (a) day-to-day operation and maintenance of the T&D System; (b) construction activities performed by the Manager’s work force; (c) supervision of routine and major capital improvements; (d) preparation of recommended and monitoring of approved annual capital and operating expenditure budgets, load and energy forecasts

1 The Authority and KeySpan have entered into an amended Management Services Agreement which will not take effect unless certain governmental approvals are obtained and certain other conditions are satisfied. A summary of certain provisions of the amended Management Service Agreement is attached as Appendix F.
and long and short range system and strategic plans; (e) preparation of long and short range transmission and distribution planning analyses; (f) performance of accounting and tax and payment in lieu of tax reporting functions and preparation of monthly reports concerning the T&D System; (g) operation of the T&D System in compliance with applicable provisions of the bond resolutions, and with other requirements pertaining to qualification of the bonds for tax-exemption under the Code; (h) other actions necessary to safely and reliably operate the T&D System in accordance with Prudent Utility Practice; (i) administration and management, at the direction of LIPA, of LIPA’s interest in NMP2; and (j) billing and collection, in accordance with LIPA’s direction, of all fees and charges in connection with the use or availability of the T&D System for wheeling services.

**Maintenance and Repair of T&D System.** The Agreement provides that the Manager will maintain the T&D System, the T&D System Site and the Common Facilities in good working order and repair and in a neat and orderly condition, and will conduct periodic, corrective, and preventive maintenance and repair of the T&D System consistent with the Contract Standards for the purpose of, among other things, mitigating and preventing abnormal wear, tear and usage.

The Agreement provides that all additions to the T&D System purchased in conjunction or for the use with any part of the T&D System during the term of the Agreement shall be the property of LIPA, except those which are leased or constitute part of the Common Facilities.

**Performance Guarantees.** The Agreement provides that, commencing on the LIPA/LILCO Merger Closing Date, the Manager will at all times comply with the Performance Guarantees, except to the extent excused by Uncontrollable Circumstances or Authority Fault. If the Manager fails to comply with any Performance Guarantee, the Manager shall, without relief under any other Performance Guarantee under the Agreement, (1) promptly notify LIPA of any such noncompliance, (2) promptly provide LIPA with copies of any notices sent to or received from any Governmental Body having regulatory jurisdiction with respect to any violations of Applicable Law, (3) promptly make any applicable payments provided for in the Agreement, and (4) at its own cost and expense to the extent required under the Agreement, promptly take any action necessary in order to comply with such Performance Guarantee, continue or resume performance under the Agreement and eliminate the cause of, and avoid or prevent recurrence of noncompliance with such Performance Guarantee.

**Rights and Responsibilities of LIPA.** The Agreement provides that LIPA will retain the ultimate authority and control over the assets and operations of the T&D System and the right to direct the Manager in connection with the performance of the Manager’s obligations under the Agreement. Without limiting the generality of the foregoing, LIPA’s specific rights and responsibilities with respect to the T&D System include: (a) the right to determine all T&D System rates and charges, line extension policies and service rules and regulations applicable to the T&D System and System Power Supply; (b) the right to determine and to change from time to time, in its sole discretion, all policies and procedures for the T&D System consistent with Applicable Law and Prudent Utility Practice; (c) the right to review, amend as appropriate and approve annual capital and operating expenditure budgets pursuant to the procedures outlined in the Agreement and approve or in its discretion, develop, all long-range strategic plans for the T&D System and System Power Supply; and (d) to the extent the Manager acts as the representative of LIPA in connection with the North American Electric Reliability Council, Northeast Power Coordinating Council, the New York Power Pool, the ISO and any other similar institutions or organizations, the right to direct the Manager’s actions with respect thereto.

**Customer Services, Rates and Rules of Service.** The Agreement provides that the Manager shall perform normal and customary customer services in a manner designed to achieve the highest level of customer service, including, but not limited to: customer account service and maintenance; service restorations account inquiry work; customer assistance, credit and collection services; cashiering; account connection and disconnection; and conservation advice.
The Agreement provides that the Manager shall, unless otherwise directed by LIPA, read the meters of electric commercial, industrial, residential heating and residential multiple rate period customers on a monthly basis and all other electric customer meters on a bi-monthly basis. The Manager shall, according to the schedule of rates, tariffs and policies (the “Schedule of Rates”) then in effect, render bills to all T&D System customers in the name of LIPA for electric service delivered on behalf of LIPA and in the format determined by LIPA. To the extent directed by LIPA, such bills will also reflect electric services provided to T&D System customers by other parties. LIPA may implement changes to such rates, rules of service, regulations and procedures by giving written notice to the Manager not later than sixty (60) days prior to the effective date of such change to the extent practicable given the nature of the change. The Manager will maintain customer bills and records as LIPA reasonably requests.

The Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for service provided to customers, and for other services, in accordance with the Schedule of Rates for the periods in which services were provided, and (2) other monies owed to LIPA pursuant to the operation of the T&D System. The Manager’s responsibilities will also include the institution of legal proceedings in LIPA’s name to collect utility billings and other monies owed LIPA related to the T&D System. All monies collected by the Manager or its Subcontractors will be the property of LIPA and will be deposited by the Manager daily in an account of LIPA specified pursuant to the Agreement. In collecting such monies, the Manager and any Subcontractor will act solely as an agent for LIPA and will have no right or claim to such moneys and, without limiting the generality of the foregoing, will have no right to assert a claim of set-off, recoupment, abatement, counterclaim or deduction for any amounts which may be owed to the Manager under the Agreement or with respect to any other matter in dispute thereunder.

It is expected that gas customers of Manager’s Affiliate and the T&D System electric customers will be billed in a single statement. In the event any electric customer who is also a gas customer will pay less than the total amount due at any time under a single statement, the amounts collected will be applied pro rata between the amounts owed by such customer with respect to electric service and gas service. To the extent monies are collected for any power supply services provided by any unrelated party, amounts collected will be allocated in accordance with the directions of LIPA. The Manager may elect to bill gas customers separately, provided that the Manager will bear all incremental costs arising by reason of any such election.

**Licenses, Permits and Approvals.** The Manager will identify for LIPA, prepare, and with LIPA approval, make and prosecute all filings, applications and reports necessary to obtain and maintain all permits, licenses and approvals required to be made, obtained or maintained by each under Applicable Law in order to operate the T&D System.

**Operating Period Insurance.** During the term of the Agreement, the Manager will obtain and maintain, the Required Operating Period Insurance as specified in accordance with the Agreement and will comply with all applicable Insurance Requirements.

**Manager’s Reporting Requirements**

**Monthly Reports.** The Manager will provide LIPA and the Consulting Engineer with monthly reports no later than 15 Business Days after the end of each month, which include the following data: (1) on a monthly and year-to-date basis, the actual T&D System costs versus the Annual T&D Budget and the prior year’s costs at such time, (2) a description and explanation of significant variations (at least $1,000,000 and 3%) from the Annual T&D Budget or the prior year’s results, (3) a description of partial or total shutdowns for maintenance and repairs during the prior month and anticipated during the current month, (4) any known or anticipated adverse conditions which may be expected to arise during the next 30 day period that may affect the ability of the Manager to transmit and distribute Power and Energy in accordance with the Performance Guarantees and the annual operating plan established for the T&D System, (5) identification of those costs which are classified as capital versus operating in sufficient detail
in order to allow LIPA to determine which costs qualify for bonding under the Resolution and which are to be recovered through T&D System rates, and (6) any other information or statement which is requested by LIPA and which may be reasonably produced from records maintained by the Manager in the normal course of business. The Manager will also provide a quarterly forecast of projected expenditures by line item through year-end.

Semi-Annual Reports. The Manager will, on a semi-annual basis within 60 days after the end of each half of the Contract Year, provide LIPA and the Consulting Engineer with a report of actual Direct Costs and Third Party Costs together with identification of any material Direct Costs projects or Third Party Costs projects which were included in the Direct Cost Budget or the Third Party Cost Budget from the previous Contract Year which were deferred to the current Contract Year or proposed to be deferred to a subsequent Contract Year, or such costs in the current Contract Year which the Manager proposes deferring beyond the current Contract Year.

Other Costs Reports. The Manager will promptly notify LIPA when an event occurs, or is anticipated to occur, that the Manager believes qualifies for treatment as an Other Cost.

Annual Reports. The Manager will furnish LIPA and the Consulting Engineer with the Annual Settlement Statement, an annual summary of the statistical data provided in the monthly reports, certified by the Manager and the Manager’s independent public accountants.

Operations Reports. The Manager will prepare appropriate reports concerning matters reasonably related to the operation of or planning for the T&D System, including, but not limited to: source of Power and Energy supply; revenues and unit sales of Power and Energy supplied to customers in the aggregate and by customer class; environmental requirements and compliance; compliance with Applicable Law; safety requirements and compliance; and reports relating to any incentive and penalty provisions set forth in the Agreement.

Fiscal Affairs, Accounting and Record Keeping. The Manager will maintain possession of operating equipment, buildings, materials and supplies, maps, plans, specifications, and customer billing records during the term of the Agreement in accordance with the Manager’s customary practices or in such manner as LIPA may reasonably require. The Manager also will maintain LIPA’s fixed asset books and records for those activities performed by the Manager in general conformity with municipal electric utility accounting standards or such other standards as reasonably requested by LIPA.

All cash held by the Manager for the account of LIPA and all cash collected by the Manager for the account of LIPA after the LIPA/LILCO Merger Closing Date will be deposited on each business day in bank accounts in such bank as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

Purchase of Equipment, Materials and Services. The Agreement provides that the Manager will arrange for the purchase or rental for the account of LIPA of equipment, materials, and supplies and services which are not purchased directly by LIPA or other items necessary to properly operate and maintain the T&D System and to maintain the records of LIPA, and to make such additions and extensions to the T&D System, all as may be required by LIPA. Subcontractors will be subject to approval by LIPA in accordance with the Agreement.

Other Services. The Manager will timely pay all bills related to the T&D System which are proper, appropriate and not otherwise disputed and which it has authority to pay and will assure that, to the extent within the Manager’s control, no mechanic’s or similar liens are filed against any portion of the T&D System.
Major Capital Improvements

**Major Capital Improvements Generally.** The Major Capital Plan and Budget provided for in the Agreement is intended to provide for the implementation of major repairs and replacements not constituting routine maintenance of the T&D System. In addition, the Major Capital Plan and Budget is intended to recognize that it will be necessary or desirable from time to time during the term of the Agreement to modify, alter or improve the T&D System from its then-current condition. All such projects which constitute Major Capital Improvements will be made in accordance with the Agreement and will be owned by LIPA. The Manager will not make a Major Capital Improvement without notifying LIPA and receiving written consent from LIPA unless such Major Capital Improvement is included in the then-current annual Major Capital Plan and Budget. LIPA will have the right, when the Manager has materially exceeded the Major Capital Plan and Budget as of an interim date, to require the Manager to defer specific Major Capital Improvements planned for the remainder of the year.

**Major Capital Plan and Budget.** Contemporaneously with the preparation of the “Annual T&D Budget”, the Manager is obligated to prepare a proposed annual and five year Major Capital Plan and Budget concerning planned Major Capital Improvement projects.

The annual Major Capital Plan and Budget will be approved by LIPA before or contemporaneously with the adoption of the Annual T&D Budget, provided that in the event the Major Capital Plan and Budget has not been adopted by LIPA as of the beginning of a Contract Year, the Manager may undertake such Major Capital Improvements as reasonably approved by LIPA on a project-by-project basis.

**Cost Determination.** Major Capital Improvements, except those awarded to the Manager as a result of the competitive procurement procedures established pursuant to the Agreement, will be performed at the cost of the service without any multiplier fee or mark-up.

The Manager will be entitled to incentive payments for cost savings and disincentive payments for cost overruns and delays in scheduled completion of approved Major Capital Improvements equal to 50% of all variances from the approved Major Capital Plan and Budget; provided, however, that no such incentive or disincentive will be payable for cost variances in excess of 15% of the approved Major Capital Plan and Budget. Incentives and disincentives will be trued-up upon the closing and acceptance by LIPA of approved capital projects.

**Public Works Improvements.** The Agreement provides that the budget for each Public Works Improvement will be subject to LIPA approval and the Manager will not undertake any Public Works Improvement until the budget therefor has been adopted.

Public Works Improvements will be performed at the cost of the service without any multiplier fee or mark-up; provided, however, that such costs will be reduced by all reimbursements or payments received from the applicable Governmental Body for the planning, engineering, procurement and completion of the Public Works Improvement. The Manager will be entitled to certain incentive payments for cost savings and disincentives for cost overruns and delays in scheduled completion that result in incremental costs for approved Public Works Improvement.

**Major Capital Improvements for which Manager is Responsible.** If the T&D System is damaged or destroyed by reason of circumstances for which the Manager is responsible, described below under the heading “Allocation of Risks of Certain Costs and Liabilities”, the Manager shall promptly proceed to make or cause to be made all Major Capital Improvements reasonably necessary to permit the Manager to perform its obligations under this Agreement. All such Major Capital Improvements for which the Manager is responsible as described under the heading “Allocation of Risks of Certain Costs and Liabilities” shall be made at the Manager’s sole cost and expense, and the Manager shall not be entitled to any compensation from LIPA as a result thereof.
Compensation and Budgets

Service Fee

Formula. Commencing with the first “Billing Period” and for each Billing Period during the term of the Agreement, LIPA will pay the Manager a Service Fee for the services provided by the Manager under the terms of the Agreement in accordance with the following formula:

\[ SF = FDF + TPC + VP + CIF + NCPI \]

Where

- \( SF \) = Service Fee
- \( FDF \) = Fixed Direct Fee
- \( TPC \) = Third Party Costs
- \( VP \) = Variable Payment
- \( CIF \) = Cost Incentive Fee
- \( NCPI \) = Non-cost Performance Incentives and Disincentives

Each component of the Service Fee will be computed in accordance with the Agreement and may be adjusted from time to time as provided in the Agreement. In addition to the Service Fee, Manager will be entitled to payment for cost overruns as and to the extent as discussed below.

Fixed Direct Fee. LIPA will make a monthly payment to the Manager equal to ninety percent (90%) of the approved annual Direct Cost Budget (the “Fixed Direct Fee”).

Third Party Costs. LIPA will make a monthly payment to the Manager for the monthly allocation of the approved annual Third Party Cost Budget.

Variable Payment. The Manager will be entitled to a Variable Payment equal to the lesser of (a) the difference between actual Total Costs (the sum of the actual Direct Costs and the actual Third Party Costs), less the sum of the Fixed Direct Fee and the lesser of actual or budgeted Third Party Costs or (b) the difference between the approved Total Cost Budget (the sum of the Direct Cost Budget and the Third Party Cost Budget) less the sum of the Fixed Direct Fee and the lesser of the actual or budgeted Third Party Costs. Monthly allocation of such payment will be determined by the parties based on historical monthly trends to minimize working capital costs.

Management Fee, Cost Incentive Fee and Non-cost Performance Incentives and Disincentives. To the extent actual Total Costs are less than the approved Total Cost Budget for the year, the Manager will be paid the portion of its Management Fee, described within the definition of Direct Costs as discussed below under the heading “Annual T&D Budget and Five Year Planning Budget” (relating to cost savings), in an amount equal to such cost savings up to a maximum of $5 million. Beyond such $5 million level, the Manager will be paid a Cost Incentive Fee equal to 50% of such additional savings, provided that no incentive will be paid for savings in excess of 15% of the Total Cost Budget. All savings above this cap will be for the benefit of LIPA.

Cost Overruns. To the extent actual Total Costs, excluding the Management Fee, are greater than the Total Cost Budget, excluding the net Management Fee, for the applicable Contract Year, the Manager will absorb the first dollars of such overruns, up to a maximum total of $15 million in each Contract Year. For cost overruns in excess of this amount, the Manager will be entitled to a payment through the Annual Settlement Statement equal to the amount of such excess overruns (the “Overrun Payment”).
**Limitations.** The Agreement provides that the ratio of (1) the sum of the Variable Payment plus the Cost Incentive Fee plus the sum of the Non-cost Performance Incentives and Disincentives (as discussed below under the heading “Non-Cost Performance Incentives and Disincentives”) plus the Overrun Payment divided by (2) the sum of (a) the amounts described in (1) above and (b) the Fixed Direct Fee, will not be greater than twenty percent (20%) in any Contract Year.

**Annual T&D Budget and Five Year Planning Budget Process**

**General.** The Agreement provides that the Annual T&D Budget and the Five-Year Planning Budget will be established in the manner described below and will provide for the determination and payment of the Manager’s costs of operating and maintaining the T&D System and performing its obligations under the Agreement, inclusive of fees paid to the Manager. The Annual T&D Budget and the Five-Year Planning Budget will be comprised of two broad categories: Direct Costs and Third Party Costs. These categories of costs will exclude Incremental Internal Costs and additional Third Party Costs relating to Major Capital Improvements, Public Works Improvements, and Other Costs.

In establishing the Direct Cost Budget for the initial Annual T&D Budget under the Agreement, the Direct Cost Budget will include (1) amounts to compensate the Manager for Operation and Maintenance Services costs anticipated to be reasonably predictable and incurred by the Manager through the utilization of either its work force, or its owned assets, in carrying out its responsibilities under the Agreement and (2) the Manager’s fee.

The Third Party Cost Budget will include amounts for reimbursement of, on a dollar for dollar basis, all recurring capital or operating costs incurred by the Manager in carrying out its responsibilities under the Agreement and paid to parties other than the Manager, its parent or affiliates, and any of their employees.

The Manager will be entitled to receive Cost Incentive Fees, as discussed above under the heading “Service Fee”, for costs savings from the amounts included for Direct Costs and Third Party Costs in the approved Annual T&D Budget.

**Annual T&D Budget Preparation.** The Agreement provides that no later than six months prior to the end of each Contract Year, the Manager will prepare a recommended annual budget for the operation and maintenance, including routine capital projects not constituting Major Capital Improvements or Public Works Improvements, of the T&D System and a recommended annual budget for total revenue requirements, inclusive of LIPA’s own costs, with the costs that will be paid by LIPA to Manager under the Agreement specifically and separately identified (together, the “Annual T&D Budget”). The recommended Annual T&D Budget will be accompanied by the Five-Year Planning Budget. The Authority will hold at least one hearing to solicit public input on the initial budgets.

LIPA has established an initial Direct Cost Budget. Subsequent annual Direct Cost Budgets will be calculated based upon the initial Direct Cost Budget, subject to adjustments for the “Direct Cost Budget Indices” described in an appendix to the Agreement.

The Agreement provides that the Annual T&D Budget and Five-Year Planning Budget prepared by the Manager and submitted to LIPA for review and approval will be accompanied by any Manager-recommended rate adjustments for the upcoming year at least six months before the beginning of each subsequent Contract Year. The Agreement provides that LIPA will have 60 days to review the proposed Annual T&D Budget and Five-Year Planning Budget and any rate adjustments and to propose modifications as it deems appropriate, so as to have the Annual T&D Budget and the Five-Year Planning Budget adopted at least two months before the beginning of the next Contract Year. All rate proposals will be subject to public hearings prior to approval by LIPA.
**Other Costs.** The Agreement provides that “Other Costs” are those costs which cannot reasonably be anticipated and will include those costs the Manager and LIPA agree are not included in the Direct Cost Budget, Third Party Cost Budget or Major Capital Plan and Budget (“Other Costs”). Other Costs include the Incremental Internal Costs and additional Third Party Costs incurred by the Manager as a result of events (including but not limited to major storms and extreme weather) that the Manager and LIPA agree have caused costs to be incurred by the Manager to respond to significant (i) damage to or adverse affects on the T&D System, (ii) changes in the level of required maintenance or operation of the T&D System, or (iii) tasks which are necessary for safety reasons.

Although Other Costs will not be budgeted, the Manager will recommend, and LIPA will adopt, an annual reserve level for Other Costs for each Annual T&D Budget and Five-Year Planning Budget to enable estimation of total “System Revenue Requirements,” consisting of the sum of the annual Service Fee, plus an estimate of other costs plus debt service requirements on the Authority’s Revenue Bonds plus the Authority’s costs as reported to the Manager pursuant to the Agreement. The Manager will be reimbursed for reasonably incurred Other Costs.

**Non-Cost Performance Incentives and Disincentives.** In addition to the cost saving incentives discussed above under the heading “Annual T&D Budget and Five Year Planning Budget Process,” the Manager will be eligible for incentives for performance above certain threshold target levels of performance standards (“Non-cost Performance Incentives”) and subject to disincentives for performance below certain other threshold minimum performance standard levels (“Non-cost Performance Disincentives”), with an intermediate band of performance in which neither incentives nor disincentives will apply, for reliability, worker safety, and customer service, all as provided in or established pursuant to the Agreement.

In any Contract Year in no event will the total of the Non-cost Performance Incentives, net of any applicable Non-cost Performance Disincentives, together with the System Power Supply Performance Incentive/Disincentive, be greater than $7.5 million, nor will the total Non-cost Performance Disincentives, net of any applicable Non-cost Performance Incentives together with the System Power Supply Performance Incentive/Disincentive be greater than $7.5 million.

**LIPA Non-Performance.** If caused by an event the costs of which LIPA is responsible for as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities,” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, the amount of any such incremental cost increase will be borne by LIPA to the extent it is responsible therefor and will not be considered for purposes of calculating any incentive or disincentive thereunder.

If at any time the T&D System is damaged or destroyed due to an event for which LIPA is responsible, LIPA will pay all Major Capital Improvement Costs and adjustments as are required to be made by LIPA pursuant to applicable provisions of the Agreement.

**Manager Non-Performance.** If due to an event for which the Manager is responsible as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities,” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, or in LIPA’s costs associated with performing obligations under the Agreement, the amount of any such incremental cost increase will be borne by the Manager to the extent it is responsible therefor.

**Annual Settlement.** The Agreement provides that the Manager will deliver to LIPA within 60 days after the end of each Contract Year, an Annual Settlement Statement, setting forth the actual aggregate Service Fee payable with respect to such Contract Year and a reconciliation of such amount with the amounts actually paid by LIPA pursuant to the billing statements. The Annual Settlement Statement will also include an accounting of any incentives or disincentives accrued during the applicable Contract Year which LIPA will have an opportunity to review prior to payment.
During the first quarter of the following Contract Year, the monthly payments made to the Manager by LIPA will be (i) reduced by any overpayment by LIPA or (ii) increased to reflect any Non-Cost Performance Incentive earned by the Manager during the previous year and/or any Overrun Payment due.

**LIPA’s Payment Obligations.** The Agreement provides that amounts payable to the Manager under the Agreement will be paid from T&D System revenues and other funds of LIPA available for such purposes in accordance with the terms of the Resolution.

The Agreement contemplates that if any billing disputes cannot be resolved within 30 days, either party may refer such dispute for resolution as discussed below under the heading “Non-Binding Mediation; Arbitration.”

**Allocation of Risks of Certain Costs and Liabilities.** The Agreement provides that except to the extent due to Subsidiary Fault (as determined by either a final non-appealable order or judgment of a court of competent jurisdiction (including administrative tribunals) or a final non-appealable binding arbitration decision), the Manager will be responsible and liable to LIPA for, and will not be entitled to reimbursement from LIPA for any Loss-and-Expense incurred by the Manager or LIPA,

(a) due to any gross negligence or willful misconduct by the Manager during the period commencing six months prior to the LIPA/LILCO Merger Closing Date to the extent LILCO knew or should have known of such gross negligence or willful misconduct and during the term of the Agreement in carrying out its obligations thereunder,

(b) due to any violation of or failure of compliance with Applicable Law by the Manager (except as provided below) during the period commencing six months prior to the LIPA/LILCO Merger Closing Date to the extent LILCO knew or should have known of such violation or failure of compliance and during the term of the Agreement which materially and adversely affects

(i) the condition or operations of the T&D System,

(ii) the financial condition of LIPA,

(iii) the performance or ability of the Manager to perform its obligations under the Agreement, or

(iv) the cost of providing electric service to the customers of the T&D System, provided, however, that Manager will not be responsible and liable to LIPA under the provisions of the Agreement described in this clause (b) with respect to any violation of, failure of compliance with, or liability under, Environmental Laws (as defined in the LIPA/LILCO Merger Agreement) for which LIPA or the Manager may be strictly liable provided that Manager (or for actions prior to the LIPA/LILCO Merger Closing Date, LILCO) acted in a manner consistent with Prudent Utility Practice. Notwithstanding the foregoing, Manager will in all events be liable for any fine or penalty arising by reason of any violation of or failure of compliance with Applicable Law for acts or omissions of the Manager not consistent with Prudent Utility Practice,

(c) due to any criminal violation of Applicable Law by the Manager (or for actions prior to the LIPA/LILCO Merger Closing Date, LILCO), or

(d) due to an event which gives rise to a cost not included in the Direct Cost Budget or Third Party Cost Budget or a cost incurred with respect to Major Capital Improvements or Public Works Improvements, that is incurred by reason of actions or omissions of the Manager not consistent with Prudent Utility Practice.
Default, Termination For Cause And Dispute Resolution

Remedies for Breach. Subject to the provisions of the Agreement described below under the heading “Non-Binding Mediation; Arbitration,” in the event that either party breaches any other obligation under the Agreement or any representation made by either party under the Agreement is untrue in any material respect, the other party will have the right to take any action at law or in equity it may have to enforce the payment of any damages or the performance of such other obligation under the Agreement and such right to recover damages or to be reimbursed as provided therein will ordinarily constitute an adequate remedy for any breach of such other obligation or any material untruth in any such representation. Either party may enforce by an action for specific performance the other party’s obligations under the Agreement in the event a material breach thereof has occurred and is continuing. Neither party will have the right to terminate the Agreement for cause except after an Event of Default determined in accordance with the provisions of the Agreement has occurred.

Events of Default by the Manager

(1) Events of Default Not Requiring Cure Opportunity for Termination. Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement without any requirement of cure opportunity:

(a) Change of Control. Change of Control of the Manager, the Parent or the Guarantor; provided, however, that the combination effectuated under the BUG/LILCO Agreement or the LIPA/LILCO Merger Agreement shall not constitute a Change of Control of the Manager for purposes of this provision.

(b) Worker Safety/Customer Service. Failure for two out of three consecutive years, for reasons other than major storms or extreme weather, to achieve the “Minimum Worker Safety Standard” or “Minimum Customer Service Standard,” as such standards are established in accordance with appendices to the Agreement.

(c) Bankruptcy. Certain voluntary or involuntary events relating to bankruptcy affecting the Manager, the Parent or the Guarantor.

(d) Credit Enhancement. Failure of the Manager to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see “General—Credit Enhancement in Certain Circumstances” below).

(e) Letter of Credit Draw. Failure of the Manager to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see “General—Credit Enhancement in Certain Circumstances” below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

(2) Events of Default Requiring Cure Opportunity for Termination. Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

(a) System Reliability. Failure to achieve, for two out of three consecutive years, the “Minimum Reliability Standard” specified in the Agreement.

(b) Failure to Pay or Credit. Failure of the Manager to pay or credit undisputed amounts owed to LIPA under the Agreement within 90 days following the applicable due date.

(c) Failure to Comply with Agreement or Guaranty. The failure or refusal of the Manager to perform any material obligation under the Agreement, or the failure of the Guarantor to comply with any of its material obligations under the Guaranty unless such failure or refusal is
excused by an Uncontrollable Circumstance or Subsidiary Fault; except that no such failure or refusal in clause (b) or (c) will constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to the Manager or the Guarantor and the Manager or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if the Manager or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as the Manager or the Guarantor is continuing to take such steps to correct such default).

**Events of Default by LIPA.** Each of the following shall constitute an Event of Default on the part of LIPA for which the Manager may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

(a) **Failure to Pay.** The failure of LIPA to pay undisputed amounts owed to the Manager under the Agreement within 90 days following the due date for such payment.

(b) **Failure to Comply with Agreement.** The failure or refusal by LIPA to perform any material obligation under the Agreement unless such failure or refusal is excused by an Uncontrollable Circumstance or Manager Fault; except that no such failure or refusal will constitute an Event of Default giving the Manager the right to terminate the Agreement for cause unless the Manager has given prior written notice to LIPA and LIPA has neither challenged in an appropriate forum the Manager’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA is continuing to take such steps to correct such default).

(c) **Change of Control of LIPA.** A change of control of LIPA which results in ownership control of LIPA by other than a state public benefit corporation, authority, political subdivision or other instrumentality of the State or any political subdivision thereof.

**Procedure for Termination for Cause.** If any party has a right of termination for cause, the right may be exercised by giving a notice of termination for cause to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default or a Change of Control, simultaneously with, or, in the case of an Event of Default as discussed above under the heading “Events of Default by LIPA,” six months) the date of termination specified in such notice (the “Termination Date”).

**Non-Binding Mediation; Arbitration**

The Agreement provides that any dispute arising out of or relating to the Agreement will be resolved in accordance with the mediation and arbitration procedures for the resolution of such disputes established by the Agreement, which shall constitute the sole and exclusive procedures for the resolution of such disputes.

Either party may, without prejudice to any negotiation, mediation, or arbitration procedures, proceed in any court to obtain provisional judicial relief if, in such party’s sole discretion, such action is necessary to avoid imminent irreparable harm, to provide uninterrupted electrical and other services, or to preserve the status quo pending the conclusion of the dispute procedures specified in the Agreement.

**Provisional Relief**

**LIPA Emergency Powers.** The Agreement provides that if the Manager, due to Uncontrollable Circumstances or any other reason whatsoever, fails to provide any Operation and Maintenance Services and Construction Work contemplated by the Agreement and LIPA or any Governmental Body finds that
such failure endangers or menaces the public health, safety or welfare, then LIPA will have the right, upon notice to the Manager, during the period of such emergency, to take possession of and use any or all of the Operating Assets necessary to transmit and distribute Power and Energy which the Manager would otherwise be obligated to transmit and distribute. The Manager will fully cooperate with LIPA to effect such a temporary transfer of possession of the Operating Assets for LIPA’s use of the same.

**Term**

**Term of Agreement.** The Agreement commenced on June 26, 1997 and will continue in effect until May 28, 2006, unless earlier terminated in accordance with its terms.

**Mandatory Competitive Selection of Future Managers.** LIPA will conduct a competitive procurement for T&D System management services following May 28, 2003. The Manager will have the right or be ineligible to submit a bid in such procurement on the same basis as other bidders unless the Agreement is terminated due to an Event of Default of the Manager. The Manager is obligated to cooperate with LIPA during such procurement process.

**Miscellaneous Provisions**

**Affiliate.** Pursuant to the Agreement, the Manager has agreed to remain an Affiliate of the Guarantor.

**Credit Enhancement in Certain Circumstances.** The Agreement provides that if the Guarantor’s credit rating declines below investment grade, then the Manager shall provide credit enhancement of its obligations under the Agreement in the form of either (i) an unconditional guarantee of all of GENCO’s obligations under the Power Supply Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO’s obligations under the Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, in a face amount of $60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade. The amount of such letter of credit shall be reduced by $30,000,000 if the Energy Management Agreement has theretofore been or is thereafter terminated and by $4,000,000 if the Power Supply Agreement has theretofore been or is thereafter terminated, such obligation to continue until the expiration or termination of the Agreement, the Power Supply Agreement and the Energy Management Agreement.

**Uncontrollable Circumstances Generally.** Except as otherwise specifically provided in the Agreement, neither LIPA nor the Manager will be liable to the other for any failure or delay in performance of any obligation under the Agreement to the extent due to the occurrence of an Uncontrollable Circumstance.

**Indemnification.** The Agreement provides that the Manager, to the extent permitted by law, will protect, indemnify and hold harmless LIPA and its respective representatives, trustees, officers, employees and subcontractors (as applicable in the circumstances), (the “LIPA Indemnified Parties”) from and against (and pay the full amount of) any Loss-and-Expense and will defend LIPA Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of any matter for which the Manager is responsible under the caption “Allocation of Risk of Certain Costs and Liabilities” in the Agreement and LIPA, to the extent permitted by law, will protect, indemnify and hold harmless the Manager Indemnified Parties from and against (and pay the full amount of) any Loss-and-Expense, and will defend the Manager Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of any matter for which LIPA is responsible under the caption “Allocation of Risk of Certain Costs and...
Liabilities” in the Agreement. The foregoing indemnifications are subject to certain exceptions, including the negligence or other wrongful conduct of any indemnified party and any Uncontrollable Circumstance.

Assignment and Transfer. The Agreement may be assigned by either party only with the prior written consent of the other party, except that without the consent of the other party (1) LIPA may make such assignments, create such security interests in its rights thereunder and pledge such monies receivable thereunder as may be required in connection with issuance of Revenue Bonds; (2) LIPA may assign its rights, obligations and interests thereunder, or transfer such rights and obligations by operation of law, to any other governmental entity or to a subsidiary of LIPA provided that the successor entity gives reasonable assurances to the Manager that it will be able to fulfill LIPA’s obligations thereunder; and (3) the Manager may assign its rights, obligations and interests thereunder to the Parent or any Affiliate thereof except that the Manager may not, without the consent of LIPA, make any assignment or other transfer to any person of its rights and obligations under the Agreement unless the Guaranty is and remains in full force and effect and unless the Guarantor or a majority-owned direct or indirect subsidiary of the Guarantor will have control of and responsibility for the Operation and Maintenance Services and any Construction Work. The Authority may assign its rights, obligations and interests under the Agreement to LILCO (then a wholly-owned subsidiary of the Authority) and the Manager shall assign all of its rights, obligations and interests under the Agreement to the Parent or any Affiliate thereof.

SUMMARY OF CERTAIN PROVISIONS OF THE POWER SUPPLY AGREEMENT

The following is a brief summary of certain provisions of the Power Supply Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Power Supply Agreement, a copy of which is on file with the Trustee.

General

The Power Supply Agreement sets forth the terms and conditions for the sale and delivery of electric capacity and energy by BL Holding Corp. and its subsidiaries (“GENCO”) to LIPA.

Power Supply

Delivery of Power. The Agreement provides that during the term of the Agreement GENCO shall sell and deliver to LIPA, and LIPA shall purchase and accept delivery from GENCO of, (i) all the capacity from the GENCO Generating Facilities, and (ii) all the energy that GENCO produces from the GENCO Generating Facilities, in accordance with the Agreement, that LIPA requests to meet the electricity requirements of its retail and wholesale electricity customers (regardless of whether located inside or outside the Service Area). The Agreement also provides that GENCO will provide the various Ancillary Services as required by LIPA, and LIPA shall pay for any associated costs not otherwise compensated by LIPA.

Sale or Assignment of Generating Units. The Agreement provides that GENCO shall not sell or otherwise assign any interest in any of its generating units (as set forth in an appendix to the Agreement) except for (i) liens securing bona fide debt or other encumbrances incurred in the ordinary course of business, (ii) capital leases, or (iii) sales or assignments made with LIPA’s prior written consent, which consent shall be deemed to have been given in respect of certain easements specified in the Agreement.

Transmission Requirements. The Agreement provides that LIPA is responsible for all transmission reinforcements required in conformance with Prudent Utility Practice for any new generation, including any new interconnections and other T&D System requirements regardless of their location, sufficient to maintain the delivery of electricity from the GENCO Generating Facilities onto the T&D System. The additional costs charged to GENCO for such transmission reinforcements will not be greater than if such costs were allocated to all of the LIPA Electricity Customers and transmission service customers on an average system basis.
Purchase Price and Payment

The Agreement provides that during the term of the Agreement LIPA will pay to GENCO monthly an amount equal to the aggregate of the following components:

(i) a capacity charge to compensate GENCO for its fixed costs of generating electricity from the GENCO Generating Facilities,

(ii) a variable charge based on the variable operation and maintenance costs as established by the Agreement, multiplied by the actual MWh of operation of the GENCO Generating Facilities,

(iii) a charge for any costs incurred by GENCO in providing certain Ancillary Services to LIPA, if any such services are required by LIPA which are not otherwise compensated by the charges described in items (i) and (ii) above,

(iv) a charge for non-variable related expenses net of insurance proceeds, that cannot be planned for with any certainty and are outside the control of GENCO, and

(v) certain other miscellaneous charges as specified in the Agreement.

Budgets

Pursuant to the Agreement, GENCO and LIPA have agreed to an initial five-year plan which provides details on the fixed and variable costs of operating the GENCO Generating Facilities. The budget establishes the monthly capacity charge and the monthly variable charge for the first year of the five-year period, which forms the basis for adjustment for subsequent years in such period in accordance with the terms of the Agreement.

The Agreement provides that prior to the commencement of each successive five-year period during the term of the Agreement, GENCO shall prepare and submit to LIPA for review and approval a proposed five-year budget plan. If GENCO and LIPA are unable to reach agreement concerning the budget plan, those portions that are in dispute shall be resolved in a proceeding before the FERC.

The Agreement also provides that GENCO shall annually prepare and submit to LIPA a rolling Five Year Capital Improvement Budget for incremental capital expenditures and associated rate adjustments for LIPA’s review and approval.

Capacity Ramp Down Option

The Agreement provides that, commencing in the seventh year of the Agreement, LIPA may determine to reduce the amount of capacity purchased from GENCO. In any such an event, LIPA shall immediately reimburse GENCO for the capacity charges in the amount set forth in the Agreement that would have been recovered from LIPA over the remaining portion of the original term of the Agreement. The Agreement provides that such reduction may not be greater than 1500 MW.

Term and Termination

Term. The Agreement commenced on May 28, 1998 for an initial term of fifteen (15) years. The Agreement provides that it shall terminate upon the purchase of the GENCO Generating Facilities by LIPA as provided for under the Generation Purchase Right Agreement attached to the LIPA/LILCO Merger Agreement.

Termination for Cause by GENCO. The Agreement provides that GENCO shall have the right to terminate the Agreement for cause if one of the following events shall have occurred:
(1) **Failure to Pay.** The failure of LIPA to pay undisputed amounts owed to GENCO under the Agreement within 90 days of such amounts having become due.

(2) **Failure to Comply with Agreement.** The failure or refusal by LIPA substantially to perform any material obligation under the Agreement unless such failure or refusal is excused by force majeure (as defined in the Agreement), except that the Agreement further provides that no such failure or refusal to pay or perform as referenced in these clauses (1) and (2) shall constitute an Event of Default giving GENCO the right to terminate the Agreement for cause unless GENCO has given prior written notice to LIPA stating that a specified failure or refusal to perform exists and LIPA has neither challenged in an appropriate forum GENCO’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA is continuing to take such steps to correct such default).

**Termination For Cause by LIPA.** The Agreement provides that LIPA shall have the right to terminate the Agreement for cause after one of the following Events of Default as determined in accordance with the provisions of the Agreement shall have occurred:

(1) **Events of Default Not Requiring Cure Opportunity for Termination.** Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement without any requirement of cure opportunity:

   (a) **Change of Control of GENCO.** Change of Control of GENCO or the Guarantor has occurred; provided, however, that the combination effectuated under the LIPA/LILCO Merger Agreement shall not constitute a Change of Control of GENCO for purposes of this provision.

   (b) **Bankruptcy.** Certain voluntary or involuntary events relating to bankruptcy affecting GENCO or the Guarantor.

   (c) **Credit Enhancement.** Failure of GENCO to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see below, “Credit Enhancement in Certain Circumstances” below).

   (d) **Letter of Credit Draw.** Failure of GENCO to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see “Credit Enhancement in Certain Circumstances” below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

(2) **Events of Default Requiring Cure Opportunity for Termination.** Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions of the Agreement described below:

   (a) **Failure to Comply with Agreement.** The failure or refusal by GENCO to substantially perform any material obligation under the Agreement, except that no such failure or refusal shall constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to GENCO or the Guarantor, as applicable, stating that a specified failure or refusal to perform exists and GENCO or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if GENCO or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an
Event of Default for as long as GENCO or the Guarantor is continuing to take such steps to correct such default).

**Procedure for Termination for Cause.** If either GENCO or LIPA shall have a right of termination for cause in accordance with the provisions of the Agreement outlined above, the same may be exercised by notice of termination given to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default or a Change of Control, simultaneously with or, in the case of an event of default described in clauses (1)(c) or (1)(d) above, six months) the date of termination specified in such notice.

**Non-binding Mediation; Arbitration**

The Agreement provides that any dispute arising out of or relating to the Agreement shall be resolved in accordance with the mediation and arbitration procedures for the resolution of such disputes established by the Agreement which shall constitute the sole and exclusive procedures for the resolution of such disputes.

**Affiliate**

Pursuant to the Agreement, GENCO has agreed to remain an Affiliate of the Guarantor.

**Credit Enhancement in Certain Circumstances**

The Agreement provides that if the Guarantor’s credit rating declines below investment grade, then GENCO shall provide credit enhancement of its obligations under the Agreement at its sole cost and expense in the form of either (i) an unconditional guarantee of all of GENCO’s obligations under the Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO’s obligations under the Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, in a face amount of $60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade.

**Allocation of Risk of Certain Costs and Liabilities**

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Allocation of Risks of Certain Costs and Liabilities.”

**SUMMARY OF CERTAIN PROVISIONS OF THE ENERGY MANAGEMENT AGREEMENT**

The following is a brief summary of the Energy Management Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Energy Management Agreement, a copy of which is on file with the Trustee.

**General**

The Energy Management Agreement establishes the terms and conditions for the management by the KeySpan subsidiary party thereto (the “Energy Manager”) of fuel supplies used at the GENCO Generating Facilities to produce electric energy for delivery to LIPA, and for management and administration of the System Power Supply on behalf of LIPA in a manner consistent with policies established by LIPA.
Scope of Energy Management Services

As described in the Agreement, the Energy Manager is responsible for (a) fuel procurement, delivery, storage, and management for GENCO Generating Facilities to meet the energy generation requirements of the Electricity Customers, (b) the dispatch of all System Power Supply available to LIPA to meet total capacity and energy requirements of the Electricity Customers and Off-System Sales, (c) the purchase, on behalf of LIPA, of all capacity and energy to meet the needs of the Electricity Customers and (d) the sale, on behalf of LIPA, of Electricity owned by, or under contract to, LIPA which is not otherwise required to meet the needs of the Electricity Customers. The Agreement provides that all such responsibilities will be discharged in a manner consistent with Prudent Utility Practice, the System Policies and Procedures and New York State Public Service Commission policies and procedures pertaining to retail gas customer service. In discharging all such functions, the Energy Manager is obligated to use best efforts to obtain the least-cost fuel and least-cost capacity and energy for the benefit of the Electricity Customers.

The Energy Manager agrees to establish policies and procedures satisfactory to LIPA designed to assure that the Energy Manager’s responsibilities are performed without consideration of the ownership or economic return to the Energy Manager or its Affiliates, except for the incentive provisions of the Agreement (described below at “Fuel Management—Fuel Management Compensation—Fuel Purchase Performance Incentives/Disincentive Payments”), and comply with such policies and procedures.

The Agreement provides that in no event will the Energy Manager take title to Electricity being purchased or sold thereunder.

Fuel Management

Fuel Management Services. The Agreement provides that the Energy Manager will manage all aspects of the Fuel supply for the GENCO Generating Facilities, including determinations regarding the type of Fuel used for operating the GENCO Generating Facilities and the source of such Fuel supply taking into account the purchase of alternate sources of Electricity in lieu of Electricity from the GENCO Generating Facilities when economic. LIPA agrees to compensate the Energy Manager for such Fuel management services, including a Fuel Purchase Performance Incentive/Disincentive Payment, in accordance with the terms of the Agreement (see “Fuel Management—Fuel Purchase Performance Incentives/Disincentive Payments” below). The Energy Manager will not contract for additional firm assets specifically for use in the GENCO Generating Facilities unless LIPA and the Energy Manager agree to the contract.

Fuel Management Compensation. During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the Monthly Fuel Management Fee, plus (ii) the Monthly Fuel Payment, plus or minus (iii) the Fuel Purchase Performance Incentive/Disincentive.

Fuel Management Fee. The Energy Manager will be paid an annual Fuel Management Fee in consideration for the Energy Manager’s performance of the Fuel Services contemplated in the Agreement. The Agreement provides that the cost-related component of the initial Fuel Management Fee, once established and approved by LIPA, will be indexed in the same manner as the Direct Cost Budget under the Management Services Agreement until the termination of the Management Services Agreement and thereafter will be subject to mutually agreeable adjustments. LIPA is obligated to pay the Fuel Management Fee to the Energy Manager in twelve equal monthly installments.

Monthly Fuel Payment. LIPA will, in accordance with the provisions discussed below at “Fuel Management—Payment,” pay the total monthly cost of all Fuel for use in the GENCO Generating Facilities that are under contract to LIPA pursuant to the Power Supply Agreement, including but not limited to any current or future fuel related taxes or other fuel related fees or costs reasonably incurred by
the Energy Manager. This cost will be based upon (a) the actual variable cost of gas delivered to the
delivery points for such fuel plus (i) any incremental Firm Gas Supply costs which are incurred based on
use of Firm Gas Supplies in the operation of the GENCO Generating Facilities, (ii) any costs the Energy
Manager incurs based on non-use of gas it has otherwise contracted to purchase for use in the operation of
the GENCO Generating Facilities, and (iii) the Local Transportation Charge and (b) the delivered cost of
oil for use in GENCO’s Generating Facilities.

**Fuel Purchase Performance Incentives/Disincentive Payments.** The Energy Manager will
receive a Fuel Purchase Performance Incentive/Disincentive Payment, which will be calculated at the end
of each month, with the results reflected in the following month’s invoice. The total Fuel Purchase
Performance Incentive/Disincentive Payment will not exceed $5.0 million on an annual basis.

**Payment.** The Energy Manager will submit monthly invoices to LIPA for the Monthly Fuel
Management Fee and the Fuel Purchase Performance Incentive/Disincentive Payment by the tenth (10th)
Business Day following the month of service, consistent with the provisions in this description of “Fuel
Management.” Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15)
Business Days of LIPA receiving such invoices.

**Minimization of Costs.** In providing the Fuel, Energy Manager shall use best efforts to minimize
Fuel costs for the GENCO Generating Facilities, such efforts being consistent with (i) all applicable
insurance policies, (ii) all applicable prudent industry practices and standards, including Prudent Utility
Practice, (iii) all applicable operating and contract constraints for Fuel delivery, (iv) Energy Manager’s
collective bargaining agreements and (v) Applicable Law.

**Off-System Sales**

The Agreement provides that the Energy Manager will use best efforts to market to Off-System
Sales customers, on LIPA’s behalf, Electricity from the System Power Supply that is not otherwise
needed by the Electricity Customers in a manner which will reduce the net cost of Electricity provided to
the Electricity Customers. The Energy Manager will receive 33 percent of the revenue net of incremental
costs from Off-System Sales of Electricity from the System Power Supply and LIPA will receive 67
percent of the revenue net of incremental costs from these Off-System Sales of Electricity from the
System Power Supply. The incremental costs for such Off-System Sales will be based upon the
incremental cost of energy for such Electricity sales including any other costs or charges (including
applicable taxes) incurred to produce and deliver the Electricity and/or Ancillary Services for sale by the
Energy Manager. The incremental costs associated with capacity sales will include the cost of
replacement capacity incurred as a result of the sale, if any, and any other costs or charges related to the
sale, including startup, no-load operation, transmission, and applicable taxes.

Notwithstanding any of the above, the Energy Manager will only attempt to sell excess Electricity
to the extent that, in GENCO’s judgment, such Electricity sales do not jeopardize any of GENCO’s tax-
exempt debt and to the extent that, in LIPA’s judgment, such Electricity sales do not jeopardize the tax-
exempt status of any of the Authority’s debt. Each party will furnish the other an appropriately detailed
description of the constraints imposed on such sales and will update such description from time to time to
reflect any applicable changes in law or regulation.

**System Power Supply Management**

**Lowest Cost Electricity.** In connection with the purchase and management of the System Power
Supply, on LIPA’s behalf, the Energy Manager is obligated to use best efforts to provide the lowest cost
Electricity to the T&D System and the Electricity Customers, given (i) the transmission and distribution
limitations unique and/or external to the T&D System; (ii) the terms of the Existing Power Supply
Agreements; (iii) availability of power through the New York Power Pool or its successor; (iv) regulatory
and reliability council requirements, including, but not limited to system safety and reliability; and (v) System Policies and Procedures, including environmental policies contained therein.

**Specific Energy Manager Responsibilities.** In implementing its System Power Supply responsibilities, the Energy Manager will, subject to the transmission, contractual and reliability constraints referred to in the preceding paragraph:

(i) schedule deliveries of and Dispatch energy from the System Power Supply;

(ii) arrange for LIPA’s purchase of Electricity to the extent the System Power Supply is insufficient to meet the requirements of the T&D System;

(iii) continually monitor the market for LIPA’s sale and purchase of wholesale Electricity and purchase Electricity, on LIPA’s behalf, on the wholesale market to displace System Power Supply if such purchases, including the cost of transmission services to deliver such Electricity, will reduce total power supply costs;

(iv) sell Electricity on LIPA’s behalf from the System Power Supply that is surplus to the requirements of the T&D System whenever such sales, including consideration of any incremental cost of Transmission for delivery of such sales, are advantageous to LIPA;

(v) arrange for such additional transmission services and capacity as will be necessary for the purchase or sale of Electricity by LIPA; and

(vi) with the prior written consent of LIPA, subcontract with power marketers or brokers, or similar entities, to assist in the acquisition of Electricity and the marketing and sale of excess Electricity.

All contracts for the purchase or sale of Electricity will be entered into by LIPA or by the Energy Manager as agent for LIPA. The Agreement provides that no contract for the purchase or sale of Electricity for a term in excess of three months will be entered into without the prior written consent of LIPA.

**System Power Supply Management Compensation.** Except as otherwise provided in the Agreement, the payments LIPA will make to the Energy Manager pursuant to the Agreement with respect to System Power Supply Services other than Off-System Sales will be calculated as set forth in the Agreement and as summarized below. During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the System Power Supply Management Fee, plus or minus (ii) the System Power Supply Performance Incentive/Disincentive.

**System Power Supply Management Fee.** The Energy Manager will be paid an annual System Power Supply Management Fee, in consideration for the Energy Manager’s performance of the System Power Supply management services contemplated in the Agreement. The amount of such System Power Supply Management Fee includes a fee of $750,000 and an allowance for certain costs which, for 1998, has been established at $868,000. Such allowance for costs will be indexed during the term of the Agreement in the same manner as the Direct Cost Budget under the Management Services Agreement. LIPA will pay the System Power Supply Management Fee to the Energy Manager in twelve equal monthly installments.

**System Power Supply Performance Incentives/Disincentive.** The Energy Manager will receive a System Power Supply Performance Incentive/Disincentive, calculated in accordance with the Agreement which will not exceed $2 million on an annual basis.
**Payment.** The Energy Manager will submit monthly invoices to LIPA for the Monthly System Power Supply Management Fee and the System Power Supply Performance Incentive/Disincentive Payments and Off-System Sales compensation by the tenth (10th) Business Day following the month of service. Such invoices will show separately amounts payable with respect to Off System Sales and System Power Supply Management. Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15) Business Days of LIPA receiving such invoices.

**Records; Information**

**Account Records; Collection of Monies; Availability of Energy Manager**

*Account Records.* The Energy Manager is obligated to maintain such records as LIPA reasonably requests setting forth in accurate and reasonable detail the information relating to the purchase and sale of Fuel and Electricity under the Agreement requested by LIPA.

*Collection of Monies.* The Energy Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for Off-System Sales, and (2) any other monies owed to LIPA in connection with System Power Supply and other matters within the purview of the Energy Manager. The Energy Manager will provide current and historical billing information concerning Fuel and System Power Supply to LIPA monthly in such form as reasonably requested by LIPA. All such monies collected by the Energy Manager or any Subcontractor thereto will be the property of LIPA and will be deposited by the Energy Manager daily into such accounts and in the manner as LIPA may from time to time designate. The Energy Manager is unconditionally and absolutely obligated to pay or deposit such moneys as directed by LIPA.

**Compliance with Applicable Law.** The Energy Manager is obligated to perform all of its obligations under the Agreement in accordance with Applicable Law.

**Information.** The Agreement requires the Energy Manager to establish and maintain an information system to provide storage and real time retrieval for LIPA review and copying of operating data relating to (i) cost and quantities of Fuel Supply and Power Purchases, (ii) revenues from and quantities of Off-System Sales and (iii) the performance by the Energy Manager of its obligations under the Agreement, including, but not limited to, all information necessary to verify calculations made pursuant to the Agreement.

**Books and Records.** The Energy Manager will prepare and maintain proper, accurate and complete books, records and accounts regarding Fuel and System Power Supply to the extent necessary (1) to enable LIPA to prepare LIPA’s financial statements in accordance with generally accepted accounting principles, (2) to verify data with respect to any operations or transactions in which LIPA has a financial or other material interest under the Agreement, (3) to prepare periodic performance reports and statements relating to purchase of Fuel and System Power Supply, which will be submitted by the Energy Manager to LIPA and (4) to enable LIPA to administer any fuel adjustment clause or similar provision applicable to Electricity sales. The Energy Manager will, upon notice and demand from LIPA, produce for examination and copying by representatives of LIPA, any documents showing all acts and transactions relating to the Agreement, any Subcontract or any transactions in which LIPA has or may have a financial or other material interest under the Agreement, and will produce such operation books and records for examination and copying in connection with the costs for which LIPA may be responsible under the Agreement.

**Fiscal Affairs, Accounting and Record Keeping**

**General.** The Energy Manager will maintain possession of equipment, materials and supplies, maps, plans and specifications, and Fuel and System Power Supply billing records during the term of the Agreement and will duly account to LIPA for such items.
**Bank Deposits.** All cash held by the Energy Manager for the account of LIPA and all cash collected by the Energy Manager for the account of LIPA after the LIPA/LILCO Merger Closing Date will be deposited on each Business Day in bank accounts in such bank or banks as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

**Bill Payments.** The Energy Manager will timely pay all bills related to Fuel which are proper and appropriate and which it has authority to pay and will assure that, to the extent within the Energy Manager’s control, no liens are filed against any portion of the assets or revenues of LIPA.

**Allocation of Risk of Certain Costs and Liabilities**

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Allocation of Risks of Certain Costs and Liabilities.”

**Term; Events of Default**

**Term.** The term of the Agreement commenced on May 28, 1998 and, except as otherwise provided therein, will remain in full force and effect for an initial term of (i) fifteen (15) years from such date with respect to the Fuel Services and (ii) eight (8) years from such date with respect to System Power Supply Services.

**Events of Default; Procedures for Termination**

The Agreement contains provisions relating to Events of Default by the Energy Manager or LIPA and the procedures for termination that are substantially the same as the provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Events of Default by the Manager—Events of Default by LIPA” and “—Procedure for Termination for Cause.”

**LIPA Emergency Assumption of Fuel and System Power Supply Management Services.** Should the Energy Manager, due to Uncontrollable Circumstances or any other reason whatsoever, fail, refuse or be unable to provide any or all Fuel and System Power Supply Services contemplated hereby and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then, in any of those events and to the extent of such failure, LIPA will have the right, upon notice to the Energy Manager, during the period of such emergency, to perform the services which the Energy Manager would otherwise be obligated to perform under the Agreement. The Energy Manager agrees that in such event it will fully cooperate with LIPA to effect such a temporary assumption. The Energy Manager agrees that, in such event, LIPA may take and use any or all of the operating assets of the Energy Manager necessary for the above-mentioned purposes without paying the Energy Manager or any other person any additional charges or compensation whatsoever for such possession and use; provided, however, that if such emergency is due to Uncontrollable Circumstances, LIPA will reimburse the Energy Manager for its Cost-Substantiated costs incurred due to such a transfer of the operating assets.

**Energy Manager’s Reporting Requirements**

**Monthly Reports.** The Energy Manager is obligated to provide LIPA and the Consulting Engineer with monthly reports no later than 20 days after the end of each month, including such data relating to the Fuel Services and System Power Supply Services as may reasonably be requested to be furnished by LIPA.

**Annual Reports.** The Energy Manager will furnish LIPA and, the Consulting Engineer, within 60 days after the end of each Contract Year, an Annual Settlement Statement together with annual
summary of the statistical data provided in the monthly reports, certified by the Energy Manager, as well as such other data relating to the services provided under the Agreement as may be reasonably requested to be furnished by LIPA.

**Fuel Consumption Reports.** Fifteen (15) “Business Days” following the end of each month, Energy Manager is obligated to submit to LIPA a report summarizing the Fuel burned during that month and such other information as the parties may mutually agree.

**Indemnification**

The Agreement contains indemnification provisions that are substantially the same as the indemnification provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Indemnification.”

**Miscellaneous Provisions**

**Insurance.** The Agreement provides that Energy Manager shall maintain with financially responsible insurance companies insurance in such amounts and against such risks and losses as are customary for companies engaged in the business of providing services or undertaking activities similar to the Fuel Services and System Power Supply Services to be provided thereunder.

**Assignment and Transfer.** Agreement contains provisions relating to assignment and transfer that are substantially the same as the assignment and transfer provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Assignment and Transfer.”

**Non-Binding Mediation; Arbitration.** The Agreement contains provisions relating to mediation and arbitration that are substantially the same as the mediation and arbitration provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Non-Binding Mediation; Arbitration.”

**Affiliate.** Pursuant to the Agreement, the Energy Manager has agreed to remain an Affiliate of the Guarantor.

**Credit Enhancement in Certain Circumstances.** The Agreement contains provisions relating to credit enhancement that are substantially the same as the credit enhancement provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Credit Enhancement in Certain Circumstances.”

**Hedging Policies.** The Energy Manager agrees not to engage in any hedging activities relating to the Fuel Services or System Power Supply Services without express approval from the Boards of Directors of the Energy Manager and its Parent and without notifying and consulting with LIPA at least 60 days prior to implementing such activities. The Agreement provides that in the event that approval for the use of hedging activities is implemented, the incentive/disincentive program will be reexamined by the parties to determine the appropriateness of the inclusion or exclusion of the related costs, gain or losses and appropriate mutually agreeable revisions thereto will be made.
APPENDIX F

SUMMARY OF CERTAIN PROVISIONS OF THE AMENDED AND RESTATED MANAGEMENT SERVICES AGREEMENT

The following is a brief summary of certain provisions of the Amended and Restated Management Services Agreement.

The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Amended and Restated Management Services Agreement, a copy of which is on file with the Authority.

General

The Authority (acting through LIPA) and KeySpan Electric Services LLC (the “Manager”) have entered into an Amended and Restated Management Services Agreement (the “Agreement”), which becomes effective pending the approval of the New York State Attorney General (as to form) and the approval of the New York State Comptroller.

The Amended and Restated Management Services Agreement establishes the terms and conditions under which the Authority has contracted with the Manager for the purpose of providing the Operation and Maintenance Services and the Construction Work relating to the T&D System in a manner consistent with policies established by LIPA in order to assure the continued delivery of electric energy to the customers of the T&D System.

Ownership of the T&D System

The Agreement provides that the Manager does not and will not have any ownership or leasehold interest in the T&D System. LIPA has engaged the Manager as an independent contractor to furnish the services described in the Agreement.

The Agreement provides that the Manager will not, without LIPA’s prior written consent, create or permit to be created or to remain, and will promptly discharge at its expense, any Encumbrance on the T&D System, other than (1) Encumbrances existing as of the date of the Agreement, or (2) any Lien affecting the T&D System (i) resulting solely from any action or failure to act by LIPA or anyone claiming by, through or under LIPA; or (ii) created by Subcontractors that are promptly discharged or bonded against by the Manager. The Agreement provides that nothing in the Agreement will be deemed to create any Lien or Encumbrance in favor of the Manager on any asset of LIPA as security for the obligations of LIPA under the Agreement.

The Agreement provides that the Manager will provide LIPA with unrestricted access to the T&D System. The Manager will provide LIPA and its consultants and designees with a dedicated on-site office space located at the Manager’s current headquarters building or another mutually agreed site and a separate work space adequate to enable LIPA to exercise its oversight rights and responsibilities under this Agreement. LIPA has the right to designate up to four LIPA employees (each a “LIPA Designee”) to be located at the Manager’s offices. One such LIPA Designee will fully participate with the senior executives of the Manager and its Affiliates who are responsible for the provision of electric service, up to two LIPA Designees will fully participate with the senior management of the Manager’s Electric Planning Organization for the T&D System and with respect to electric resource planning work performed by such organization, and one such LIPA Designee will fully participate with the Manager’s combined Electric Sales and Marketing Organization.
Operation of the T&D System

General. The Agreement provides that the Manager will not transmit or distribute Power and Energy other than Power and Energy obtained by, on behalf of, or with the approval of LIPA, and will not use the T&D System for any purpose other than, the purposes contemplated by the Agreement or to serve or benefit any person other than LIPA and its customers in the Service Area.

Operation and Maintenance. The Agreement provides that the Manager will provide Operation and Maintenance Services and Construction Work for the T&D System on behalf of LIPA at all times in accordance with the Contract Standards. The scope of services to be provided by the Manager is subject to modification during the Term of the Agreement to reflect changes in Prevalent Utility Services. The Manager will be responsible for all electric transmission, distribution, and load serving activities the safe and reliable operation and maintenance of the T&D System, management and/or performance of construction of improvements thereto and delivery of Power and Energy to LIPA’s customers and will be responsible for the following tasks and services, among others: (a) day-to-day operation and maintenance of the T&D System; (b) engineering activities; (c) asset management; (d) identification and assistance in the development and administration of third-party research and development; (e) contract administration of third party generation and transmission and interface with daily operation; (f) preparation of recommended and monitoring of the approved Capital Plan and Budget, load and energy forecasts and long and short range system and strategic plans; (g) preparation of long and short range transmission and distribution planning analyses and forecasts; (h) monitoring the regulatory environment for changes or trends that could impact LIPA and recommending appropriate courses of action; (i) performance of accounting and tax and payment in lieu of tax reporting functions; (j) representation of LIPA before, among others, NYISO, NY State Reliability Counsel and ISO-NE, if requested by LIPA; (k) administration and management, at the direction of LIPA, of LIPA’s interest in NMP2; (l) billing and collection, in accordance with LIPA’s direction, of all fees and charges in connection with the use or availability of the T&D System for wheeling services; (m) under LIPA’s direction, assistance in the administration, development and/or implementation of energy conservation and load management programs for the T&D System and its customers; (n) performance of Capital Improvements including customer connections and disconnections and supervision; (o) repair or modification activities required due to Public Works Improvements; (p) reasonable cooperation with third parties providing services to LIPA with respect to the provision of electric service; (q) other activities necessary, appropriate or advisable to safely, reliably and efficiently operate and maintain the T&D System in accordance with the Contract Standards and Prevalent Utility Services.

The Manager will be responsible for implementation of customer service functions related to the provision of electric service, including, but not limited to, the following: (a) maintaining customer contact through call centers with toll free service numbers, customer offices, authorized payment centers, maintaining and overseeing customer portion of LIPA’s Web Site, co-management of customer loyalty and satisfaction programs, customer services field operations, and customer care and institutional communications and responding to customer inquiries regarding LIPA provided services; (b) development and maintenance of all necessary information and accounting systems and controls relating to the provision and reporting of customer services, and updating customer records in the financial and customer information system; (c) marketing and sales for retail system expansion, retail customer retention, and customer care and service programs, including all aspects of marketing, promotion and communications; market research; account relationship management; economic development, field sales; trade ally relations; demand response programs; and participating in and complying with LIPA’s clean energy initiatives; (d) planning and managing the design of customer meter reading and billing systems, reading of customer meters, issuance of accurate and timely customer bills, and collection of customer payments and timely investigation of customer bill inquiries, all in accordance with the Contract Standards and unusual or unmetered usage, unbilled revenues and theft of services; (e) auditing, on a timely basis, of adjustments for billing errors, and seeking refunds and interest payments from customers;
(f) collection of reliability, meter reading, call answering, collection and customer satisfaction performance data; (g) inclusion of communications to customers requested and approved by LIPA in customer bills; (h) identification, assistance in the development of, and administration of third party produced research and development to provide solutions to fulfill customer needs and expectations, renewable technologies and clean energy initiatives; and (i) other activities necessary, appropriate or advisable to implement LIPA’s customer service programs in accordance with the Contract Standards and Prevalent Utility Services.

The Manager is responsible for (a) the preparation of recommended revenue requirements for the management of the T&D System; (b) the preparation of recommended rate classification and designs for the T&D System; (c) at LIPA’s request, public presentation of recommended rate and capital expenditure adjustments at LIPA rate hearings; (d) cost of service and planning; (e) tariff development, administration, and enforcement; (f) regulatory monitoring; and (vii) load research and forecasting.

The Manager is responsible for the following other activities with respect to the provision of electric service to customers of the T&D System: (a) assisting LIPA in developing and maintaining System Policies and Procedures and training the Manager’s work force in accordance therewith; (b) assigning and supervising the Manager’s and its Subcontractor’s work force consistent with the day-to-day requirements of the Agreement; (c) assigning and allocating physical resources consistent with the day-to-day operational requirements of the Agreement; (d) recruiting, retaining, deploying, and supervising subcontract labor and resources; (e) determining, acquiring, deploying, and maintaining tools, equipment, and information systems necessary to perform all activities under the Agreement; (f) preparing and delivering cost and budget input data for LIPA’s annual budgeting processes; (g) accounting for and documenting the costs and revenues resulting from the Manager’s performance under the Agreement in accordance with GAAP, GASB, FERC and/or NYSPSC requirements as necessary; (h) developing safety programs, safety reports, and written procedures and practices for the Manager’s staff; (i) producing and delivering information as may be necessary to determine the Manager’s performance under the Agreement; (j) contracting for and maintaining services, including utilities, communication systems, and internet and intranet services, necessary for the Manager’s office facilities and to fulfill the Manager’s obligations under the Agreement; (k) monitoring industry advancements and technological changes in the provision of transmission and distribution services by electric utilities and recommending improvements in current programs and practices for LIPA’s consideration; (l) in accordance with current practices of the Manager, staffing public events and presenting workshops, seminars, and similar activities during normal business hours, evenings, weekends, and holidays, as may be required from time to time by LIPA; and (m) providing vehicle and refueling operations.

The Manager is responsible for developing and implementing business continuity, disaster recovery and emergency response plans, and all necessary emergency response and reporting relating to the T&D System, and coordinating such plans with LIPA’s plans and the plans of LIPA’s other service providers for business continuity and disaster recovery.

If requested by LIPA, the Manager will perform additional services reasonably related to the T&D System and not included within the Manager’s scope of services based upon terms and conditions (including compensation) agreed to by the parties. The Manager’s scope of services does not include (a) operation, maintenance and repair of transmission or distribution facilities which are owned in whole or in part by third parties, other than certain specified cables or (b) operation, maintenance and repair of transmission or distribution facilities located outside of the Long Island Control Area owned by LIPA which are constructed or acquired after the date of delivery of the Agreement (the “Contract Date”).

**Maintenance and Repair of T&D System.** The Agreement provides that the Manager will maintain the T&D System, the T&D System Site and the Common Facilities in good working order and repair and in a neat and orderly condition, and will conduct periodic, corrective, and preventive
maintenance and repair of the T&D System consistent with the Contract Standards for the purpose of, among other things, mitigating and preventing abnormal wear, tear and usage.

All additions to the T&D System purchased in conjunction or for the use with any part of the T&D System during the term of the Agreement shall be the property of LIPA, except those which are leased or constitute part of the Common Facilities.

**Performance Metrics.** The Agreement provides that the Manager will monitor and report to LIPA with respect to the Manager’s performance during each month under the following operational and customer service performance metrics: Actual Meter Read Rate, Billing Accuracy, Customer Satisfaction Index, Days Sales Outstanding, Bad Debt Ratio, Expanded Electronic Transactions, Call Answer Rate & Average Speed of Call Answer, First Call Resolution, Workplan Completion Index, Capital Cost Per Customer, Multiple Customer Outages, System Average Interruption Duration Index, System Average Interruption Frequency Index, Customer Average Interruption Duration Index, Storm Customer Average Interruption Duration Index, Worker Safety, Planned Substation Maintenance, and Primary Cable Faults, as set forth in Appendix 5 to the Agreement (the “Performance Metrics”). The Manager’s performance in meeting the Performance Metrics will determine the extent, if any, to which the Manager will be assessed performance penalties, which penalties shall in no event exceed either (i) Seven Million Dollars ($7,000,000) in the aggregate during any one Contract Year for such Performance Metrics, or (ii) an amount which would result in the Manager receiving less than the Minimum Compensation amount for such Contract Year. The deviation from the agreed upon level of performance with respect to the metrics, and the associated penalty amount, are set forth in Appendix 5 to the Agreement.

**Rights and Responsibilities of LIPA.** The Agreement provides that LIPA will retain the ultimate authority and control over the assets and operations of the T&D System and the right, consistent with Applicable Law, Prudent Utility Practices, Prevalent Utility Services, subject to the Agreement, to direct the Manager, in connection with the performance of the Manager’s obligations under the Agreement. Without limiting the generality of the foregoing, LIPA’s specific rights and responsibilities with respect to the T&D System include: (a) the right to determine all T&D System rates and charges, line extension policies and service rules and regulations applicable to the T&D System and System Power Supply; (b) the right to determine and to change from time to time, in its sole discretion, all policies and procedures for the T&D System; (c) the right to review, amend as appropriate and approve the annual Capital Plan and Budget pursuant to the procedures outlined in the Agreement and approve or in its discretion, develop, all long-range strategic plans for the T&D System and System Power Supply; and (d) to the extent the Manager acts as the representative of LIPA in connection with the NERC, NPCC, the NYISO, the NYSPSC, the ISO-NE, PJM and any other similar institutions or organizations, the right to direct the Manager’s actions with respect thereto.

**Customer Services, Rates and Rules of Service.** The Agreement provides that the Manager will perform normal and customary customer services in a manner designed to achieve the highest level of customer service, including, but not limited to: customer account service and maintenance; service restorations account inquiry work; customer assistance, credit and collection services; cashiering; account connection and disconnection; and conservation advice.

The Agreement provides that the Manager will, unless otherwise directed, by LIPA, read the meters of electric commercial, “industrial”, residential heating and residential multiple rate period customers on a monthly basis and all other electric customer meters on a bi-monthly basis. The Manager will, according to the schedule of rates, tariffs and policies (the “Schedule of Rates”) then in effect, render bills to all T&D System customers in the name of LIPA for electric service delivered on behalf of LIPA and in the formal determined by LIPA. To the extent directed by LIPA, such bills will also reflect electric services provided to T&D System customers by other parties. LIPA may implement changes to such rates, rules of service, regulations and procedures by giving written notice to the Manager not later than
sixty (60) days prior to the effective date of such change to the extent practicable given the nature of the change. The Manager will maintain customer bills and records as LIPA reasonably requests.

The Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for service provided to customers, and for other services; in accordance with the Schedule of Rates for the periods in which services were provided, and (2) other monies owed to LIPA pursuant to the operation of the T&D System. The Manager’s responsibilities will also include the institution of legal proceedings in LIPA’s name to collect utility, billings and other monies owed LIPA related to the T&D System. All monies collected by the Manager or its Subcontractors will be the property of LIPA and will be deposited by the Manager daily in an account or LIPA specified pursuant to the Agreement. In collecting such monies, the Manager and any Subcontractor will act solely as an agent for LIPA and will have no right or Claim to such monies and, without limiting the generality of the foregoing, will have no right to assert a claim of set-off, recoupment, abatement, counterclaim or deduction for any amounts which may be owed to the Manager under the Agreement or with respect to any other matter in dispute thereunder.

To the extent monies are collected for any power supply services provided by any unrelated party, amounts collected will be allocated in accordance with the directions of LIPA.

**Licenses, Permits and Approvals.** The Manager will identify for LIPA, prepare, and with LIPA approval, make and prosecute all filings, applications and reports necessary to obtain and maintain all permits, licenses and approvals required to be made, obtained or maintained by each under Applicable Law in order to operate the T&D System.

**Operating Period Insurance.** During the term of the Agreement, the Manager will obtain and maintain the Required Operating Period Insurance to the extent that such insurance remains available on commercially reasonable terms. If, as a result of material changes in the market for insurance products, one or more Required Operating Period Insurance policies is or are not generally available or available only on terms not considered to be commercially reasonable, the Manager will so notify LIPA. If such insurance is not generally available, LIPA will be entitled to an equitable adjustment in the Minimum Compensation for the Scope of Services. If such insurance is available, but only at a cost that Manager considers to be commercially unreasonable, Manager will advise LIPA of such cost. If, after consultation, the parties are unable to agree on whether the Manager should procure such insurance at such additional cost, LIPA may either obtain such insurance at its own cost or determine to forego such insurance coverage. In either event, LIPA will be entitled to an equitable reduction in the Minimum Compensation for the Scope of Services. LIPA has the right, upon ninety days’ notice to the Manager, at any time at its expense to cancel or replace and obtain independently all or any portion of the Required Operating Period Insurance, in which case LIPA will be entitled to an equitable reduction in the Base Fee for the Scope of Services. If the Manager obtains additional insurance not set forth on Appendix 4 at LIPA’s request, LIPA will reimburse the Manager for the costs thereof as an Additional Service.

**Manager’s Reporting Requirements**

**Monthly Reports.** The Manager will provide LIPA and the Consulting Engineer with monthly reports no later than 15 Business Days after the end of each month (except for (i) item (1) below, which will be provided no later than 20 Business Days after the end of each month, provided that Manager agrees, not later than 6 months after the Contract Date, it will examine its reporting practices with an objective of accelerating the reporting of item (1) below so it can be provided no later than 15 Business Days after the end of each month, and (ii) item (3) below, which will be provided no later than 30 Business Days after the end of each month), including the following data: (1) on a monthly and year-to-date basis, the actual Capital Costs, pensions and OPEBs, and Storm Events (collectively, “Reported Costs”) versus the budget for Reported Costs, with variance explanations, and the prior year’s Reported Costs at such time; (2) a capital budget adjustment report; (3) a System Operating Report substantially in the form provided by the Manager as of the Contract Date, together with a report of the Manager’s
performance with respect to the Performance Metrics; (4) a reasonably detailed list of the results of any environmental or other tests or monitoring procedure conducted by or at the direction of any federal, State or local environmental or other regulatory agency during the prior monthly period, and at LIPA’s request copies thereof and copies of any reports or other submittals made to or received from any such agency (it being understood that LIPA will in any event have complete access to the foregoing); (5) a description of partial or total shutdowns for maintenance and repairs during the prior month and anticipated during the current month, any known or anticipated adverse conditions which may be expected to arise during the next 30 day period that may affect the ability of the Manager to transmit and distribute Power and Energy, the results of any regulatory or insurance inspections or tests conducted during the prior month, and identification of those costs which are classified as Capital Costs versus operating in sufficient detail in order to allow LIPA to determine which costs qualify for bonding under the Bond Resolution and which are to be recovered through T&D System rates; and (6) any other documents, reports, data, and other information or statement which LIPA may reasonably request (as to time and format) and which may be reasonably produced from records maintained by the Manager hereunder or pursuant to the Original MSA in the normal course of business consistent with the provisions of the Agreement with respect to record retention.

The Manager will provide LIPA on a monthly basis updated year-end projections of Pass-Through Expenditures beginning in April of each Contract Year.

Semi-Annual Reports. The Manager will, on a semi-annual basis within 60 days after the end of each half of the Contract Year, provide LIPA and the Consulting Engineer with a report of actual Direct Costs and Third Party. Costs together with identification of any material Direct Costs projects or Third Party Costs projects which were included in the Direct Cost Budget or the Third Party Cost Budget from the previous Contract Year which were deferred to the current Contract Year or proposed to be deferred to a subsequent Contract Year, or such costs in the current Contract Year which the Manager proposes deferring beyond the current Contract Year.

Other Costs Reports. The Manager will promptly notify LIPA when an event occurs, or is anticipated to occur, that the Manager believes qualifies for treatment as an Other Cost.

Annual Reports. The Manager will furnish LIPA and the Consulting Engineer with an annual settlement reconciling actual costs for Reported Costs and the budget for Reported Costs (the “Annual Settlement Statement for Reported Costs”), certified by the Manager and the Guarantor’s internal auditor and chief financial officer. The Manager will continue to have its independent auditors certify the Manager’s internal controls in accordance with Section 404 of the Sarbanes-Oxley Act.

Books and Records. The Manager will prepare and maintain and make available to LIPA upon its reasonable (as to time and format) request, distinct, proper, accurate and complete books, records, and accounts regarding the operations and financial or other transactions related to the T&D System to the extent necessary: (1) to enable LIPA to prepare financial statements, regarding the operations of the T&D System, certified in accordance with GAAP and GASB, (2) to verify data with respect to any operations or transactions in which LIPA has a financial or other material interest hereunder, (3) to prepare periodic performance reports and statements of the T&D System, which will be submitted by the Manager to LIPA, and (4) as may be required by Applicable Law or applicable regulatory authority.

Additional Reports. The Manager will provide LIPA with access to reports currently used by the Manager in daily operation of the T&D System. In addition, the Manager and LIPA will develop the scope for the operations management dashboard, consistent with the budget determined by the IT Steering Committee, not later than March 31, 2006 and the Manager will implement such operations management dashboard not later than December 31, 2006. The Manager and LIPA will also develop the scope for the financial data mart and operations data mart, consistent with the budget determined by the IT Steering Committee.
Committee, not later than March 31, 2006 and the Manager will implement such financial data mart and operations data mart not later than December 31, 2006.

**Fiscal Affairs, Accounting and Record Keeping.** The Manager will maintain possession of operating equipment, buildings, materials and supplies, maps, plans, specifications, and customer billing records during the term of the Agreement in accordance with the Manager’s customary practices or in such manner as LIPA may reasonably require. The Manager also will maintain LIPA’s fixed asset books and records for those activities performed by the Manager in general conformity with municipal electric utility accounting standards or such other standards as reasonably requested by LIPA.

All cash held by the Manager for the account of LIPA and all cash collected by the Manager for the account of LIPA will be deposited on each business day in bank accounts in such bank as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

**Purchase of Equipment, Materials and Services.** The Agreement provides that the Manager will arrange for the purchase or rental for the account of LIPA of equipment, materials, and supplies and services which are not purchased directly by LIPA or other items necessary to properly operate and maintain the T&D System and to maintain the records of LIPA, and to make such additions and extensions to the T&D System, all as may be required by LIPA. Subcontractors will be subject to approval by LIPA in accordance with the Agreement.

**Other Services.** The Manager will timely pay all bills related to the T&D System which are proper, appropriate and not otherwise disputed and which it has authority to pay and will assure that, to the extent within the Manager’s control, no mechanic’s or similar liens are filed against any portion of the T&D System.

**Capital Improvements**

**Capital Improvements Generally.** From time to time it will be necessary to make repairs and replacements to the T&D System which do not constitute routine maintenance and it will be necessary or desirable from time to time during the term of the Agreement to modify, alter or improve the T&D System from its then current condition. All such projects which constitute Capital Improvements will be made in accordance with the Agreement and will be owned by LIPA. The Manager will not make a Capital Improvement without notifying LIPA and receiving written consent from LIPA unless such Capital Improvement is included in the then current annual Capital Plan and Budget. LIPA will have the right, when the Manager has materially exceeded the Capital Plan and Budget as of an interim date, to require the Manager to defer specific Capital Improvements planned for the remainder of the year.

**Capital Plan and Budget.** The Manager is obligated to prepare a proposed annual, two and five year Capital Plan and Budget concerning planned Capital Improvement projects.

The annual Capital Plan and Budget will be approved by LIPA prior to or contemporaneously with the adoption of any rate adjustment by LIPA, provided that in the event the Capital Plan and Budget has not been adopted by LIPA as of the beginning of a Contract Year, the Manager may undertake such Capital Improvements as reasonably approved by LIPA on a project-by-project basis.

**Cost Determination.** Capital Improvements will be performed at the cost of the service without any multiplier fee or mark-up. With respect to any Capital Improvement estimated to cost in excess of $2,000,000, after conferring with the Manager, LIPA, at its sole discretion, may (a) conduct an independent procurement, (b) direct the Manager to competitively bid the Capital Improvement, or (c) direct the Manager to complete the work. In that regard, LIPA will give due consideration to the efficient utilization of the Manager’s workforce.
**Capital Improvements for which Manager is Responsible.** If the T&D System is damaged or destroyed by reason of circumstances for which the Manager is responsible, described below under the heading “Allocation of Risks of Certain Costs and Liabilities”, the Manager will promptly proceed to make or cause to be made all Capital Improvements reasonably necessary to permit the Manager to perform its obligations under the Agreement. All such Capital Improvements for which the Manager is responsible as described under the heading “Allocation of Risks of Certain Costs and Liabilities” will be made at the Manager’s sole cost and expense, and the Manager will not be entitled to any compensation from LIPA as a result thereof.

**Compensation and Budgets**

**Manager Compensation.** Commencing with the Initial Contract Year and for each Contract Year during the term of the Agreement, LIPA will pay the Manager a fee for the Scope of Services provided by the Manager under the terms of the Agreement in an amount equal to the lesser of (i) the Minimum Compensation plus the Variable Compensation and (ii) the Minimum Compensation divided by 80%.

“Minimum Compensation” is equal to Two Hundred Twenty Four Million Dollars ($224,000,000.00) for the first three Contract Years. For each subsequent Contract Year, Minimum Compensation will be equal to the prior Contract Year Minimum Compensation multiplied by 1.017, multiplied by the change in the Consumer Price Index (all Urban Consumers) for the New York-Northern New Jersey-Long Island region (Series ID #CUURA101SNA0) as published by the United States Department of Labor Bureau of Labor Statistics (“New York Region CPI”) for the twelve month period ending September 30th of the prior Contract Year.

“Variable Compensation” is equal to the total kilowatt hours of LIPA’s billed sales for the Contract Year less “Base Kilowatt Hours,” multiplied by the “Variable Price Per KWh” for the Contract Year.

“Base Kilowatt Hours” is equal to 16,558,000,000 kilowatt hours for the Initial Contract Year. For each subsequent Contract Year, Base Kilowatt Hours will be set at the prior Contract Year’s Base Kilowatt Hours multiplied by 1.017.

“Variable Price Per KWh” is equal to 1.3377 cents per kilowatt hour ($0.013377/KWh) for the Initial Contract Year. For the second Contract Year, the Variable Price Per KWh will be equal to 1.2870 cents per kilowatt hour ($0.012870/KWh) multiplied by the change in the New York Region CPI for the twelve month period ending September 30, 2006 as compared to September 30, 2005. For the third Contract Year, the Variable Price Per KWh will be equal to 1.2363 cents per kilowatt hour ($0.012363/KWh) multiplied by the change in the New York Region CPI for the twelve month period ended September 30, 2006 multiplied by the change in the New York Region CPI for the twelve month period ended September 30, 2007. For each subsequent Contract Year, the Variable Price Per KWh will be set at the Variable Price Per KWh for the prior Contract Year multiplied by the change in the New York Region CPI for the twelve month period ended on September 30th of the prior Contract Year.

**Payment Schedule.** LIPA will pay to the Manager the Minimum Compensation in monthly installments based on LIPA’s forecasted sales pattern as set forth below:

<table>
<thead>
<tr>
<th>Month</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>8.4%</td>
</tr>
<tr>
<td>February</td>
<td>7.4%</td>
</tr>
<tr>
<td>March</td>
<td>7.9%</td>
</tr>
<tr>
<td>April</td>
<td>7.0%</td>
</tr>
<tr>
<td>May</td>
<td>7.6%</td>
</tr>
</tbody>
</table>
June 9.0%
July 10.5%
August 10.4%
September 8.5%
October 7.7%
November 7.4%
December 8.2%

Pass-Through Expenditures. The Agreement provides that LIPA will reimburse the Manager for all Pass-Through Expenditures in the manner set forth therein. “Pass-Through Expenditures” are those expenditures incurred by the Manager with respect to the following items: (1) Capital Costs; (2) claims, lawsuits, litigations, losses, costs and expenses, judgments, liens, settlement, disbursements and similar expense (including, without limitation, external attorney’s fees) (collectively, “Claims”), incurred in connection with each such Claim or related Claims which exceeds $25,000 in the aggregate; (3) Storm Events; (4) LIPA’s return postage; (5) real property taxes, special franchise taxes, other taxes and any payments in lieu of taxes (PILOTS) related to LIPA-owned assets or revenues (collectively, “Taxes”); (6) customer refunds; (7) completion of repairs and remediation related to E.F. Barrett to Valley Stream 138kV cable leak (circuit no 138-291) identified in the fall of 2005; (8) incremental substation maintenance for Contract Year 2006, in an amount up to $2,000,000; (9) third party conservation and third party research and development costs; (10) repair costs for any damage to the submerged portion of any marine cable; and (11) increases in the annual cost of Long Island Railroad easements above $1,265,000 (which amount will be escalated annually by 1.017 multiplied by the change in the New York Region CPI for the twelve month period ending September 30th of the prior Contract Year).

Exogenous Cost Adjustments. The Agreement provides that LIPA will reimburse the Manager. The Manager is required to credit to LIPA’s account any Exogenous Costs which the Manager incurs during a Contract Year to the extent that the Manager incurs net Exogenous Costs for that Contract Year in excess of $3,000,000 in the aggregate. “Exogenous Costs” are those costs which result in either a positive or negative change in the Manager’s costs of providing services hereunder within the Scope of Services which are (i) outside of the Manager’s control and (ii) not otherwise reflected in the New York Region CPI, and which directly result from one or more of the following: (1) Change in Law (including tax law, except with respect to the Manager’s income tax), regulation or GAAP, but only if and to the extent that such changes are applicable to electric utilities operating in New York State, (2) change in the New York Public Service Law or NYSPSC regulation, but only if and to the extent that such change relates to the safety and reliability of the operation of the T&D System and are adopted as part of the System Policies and Procedures and (3) acts of terrorism.

Storm Costs. LIPA will reimburse the Manager, as a Pass-Through Expenditure, for costs incurred by the Manager in connection with a Storm Event. Such costs will be charged against the Storm Reserve which LIPA will establish and replenish from time to time in the amounts and in the manner set forth in the Agreement.

Mutual Aid Costs. The Manager must obtain authorization from LIPA prior to the release of any internal or third-party crews to assist a utility either within or outside New York State for storm recovery (“Mutual Aid”). The Manager will track all costs related to such Mutual Aid on a segregated basis and will prepare the documentation necessary for cost reimbursement by LIPA. Any and all reimbursement which the Manager receives from the Mutual Aid recipient or third party for such Mutual Aid assistance will accrue to LIPA’s account.
**LIPA Non-Performance.** If due to the occurrence of an event for which LIPA is responsible for as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities,” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, the amount of any such incremental cost increase will be borne by LIPA to the extent it is responsible therefor.

If at any time the T&D System is damaged or destroyed due to an event for which LIPA is responsible, LIPA will pay all Capital Improvement Costs and adjustments as are required to be made by LIPA pursuant to applicable provisions of the Agreement.

**Manager Non-Performance.** If due to an event for which the Manager is responsible as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities;” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, or in LIPA’s costs associated with performing obligations under the Agreement, the amount of any such incremental cost increase will be borne by the Manager to the extent it is responsible therefor.

**LIPA’s Payment Obligations.** The Agreement provides that amounts payable to the Manager under the Agreement will be paid from T&D System revenues and other funds of LIPA available for such purposes in accordance with the terms of the Resolution.

The Agreement contemplates that if any billing disputes cannot be resolved within 30 days, either party may refer such dispute for resolution as discussed below under the heading “Non-Binding Mediation; Arbitration.”

**Allocation of Risks of Certain Costs and Liabilities.** The Agreement provides that except to the extent due to Subsidiary Fault (as determined by either a final non-appealable order or judgment of a court of competent jurisdiction (including administrative tribunals) or a final non-appealable binding arbitration decision), the Manager will be responsible and liable to LIPA for, and will not be entitled to reimbursement from LIPA for any Loss-and-Expense incurred by the Manager or LIPA,

1. due to any gross negligence or willful misconduct by the Manager during the term of the Agreement in carrying out its obligations thereunder,

2. due to any violation of or failure of compliance with Applicable Law by the Manager (except as provided below) which materially and adversely affects
   a. the condition or operations of the T&D System,
   b. the financial condition of LIPA,
   c. the performance or ability of the Manager to perform its obligations under the Agreement, or
   d. the cost of providing electric service to the customers of the T&D System, provided, however, that Manager will not be responsible and liable to LIPA under the provisions of the Agreement described in this clause (b) with respect to any violation of, failure of compliance with, or liability under, Environmental Laws (as defined in the LIPA/LILCO Merger Agreement) for which LIPA or the Manager may be strictly liable provided that Manager acted in a manner consistent with Prudent Utility Practice. Notwithstanding the foregoing, Manager will in all events be liable for any fine or penalty arising by reason of any violation of or failure of compliance with Applicable Law for acts or omissions of the Manager not consistent with Prudent Utility Practice,

3. due to any criminal violation of Applicable Law by the Manager,
4. due to an event which gives rise to a cost incurred with respect to Capital Improvements that is incurred by reason of actions or omissions of the Manager not consistent with Prudent Utility Practice, or

5. due to any claim that (a) the Manager’s use of any Manager Owned Property or Manager Licensed IP in connection with the performance of its services under the Agreement or (b) LIPA’s use of any Manager Owned Property, Manager Licensed IP, or LIPA Owned Property created or developed by the Manager or Manager’s Related Parties and not provided by or on behalf of LIPA or LIPA’s Related Parties, in each case in accordance with the Agreement, infringes or otherwise violates Intellectual Property Rights or other proprietary rights of any third party.

Default, Termination For Cause And Dispute Resolution

Remedies for Breach. Subject to the provisions of the Agreement described below under the heading “Non-Binding Mediation; Arbitration,” in the event that either party breaches any other obligation under the Agreement or any representation made by either party under the Agreement is untrue in any material respect, the other party will have the right to take any action at law or in equity it may have to enforce the payment of any damages or the performance of such other obligation under the Agreement and such right to recover damages or to be reimbursed as provided therein will ordinarily constitute an adequate remedy for any breach of such other obligation or any material untruth in any such representation. Either party may enforce by an action for specific performance the other party’s obligations under the Agreement in the event a material breach thereof has occurred and is continuing. Neither party will have the right to terminate the Agreement for cause except after an Event of Default determined in accordance with the provisions of the Agreement has occurred.

Events of Default by the Manager

1. Events of Default Not Requiring Cure Opportunity for Termination. Each of the following will constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement without any requirement of cure opportunity:

   a. Change of Control. Change of Control of the Manager or the Guarantor.

   b. Bankruptcy. Certain voluntary or involuntary events relating to bankruptcy affecting the Manager or the Guarantor.

   c. Credit Enhancement. Failure of the Manager to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see “General—Credit Enhancement in Certain Circumstances” below).

   d. Letter of Credit Draw. Failure of the Manager to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see “General—Credit Enhancement in Certain Circumstances” below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

   e. Performance Metrics. Failure of the Manager to meet the minimum Performance Metrics for either (i) customer satisfaction for three (3) consecutive Contract Years, or (ii) SAIDI for two (2) out of three (3) consecutive Contract Years; provided, however, that such Event of Default by the Manager will be excused to the extent of a Force Majeure event, strike, work stoppage or other labor dispute with respect to the Manager’s work force that prevents or delays the Manager’s performance of such metric.
2. **Events of Default Requiring Cure Opportunity for Termination.** Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

   a. **Failure to Pay or Credit.** Failure of the Manager to pay or credit undisputed amounts owed to LIPA under the Agreement within 90 days following the applicable due date.

   b. **Failure to Comply with Agreement or Guaranty.** The failure or refusal of the Manager to perform any material obligation under the Agreement, or the failure of the Guarantor to comply with any of its material obligations under the Guaranty unless such failure or refusal is excused by a Force Majeure or LIPA Fault; except that no such failure or refusal in clause (a) or (b) will constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to the Manager or the Guarantor and the Manager or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if the Manager or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as the Manager or the Guarantor cures such default within 270 days from its receipt of such notice).

**Events of Default by LIPA.** Each of the following shall constitute an Event of Default on the part of LIPA for which the Manager may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

1. **Failure to Pay.** The failure of LIPA to pay undisputed amounts owed to the Manager under the Agreement within 90 days following the due date for such payment.

2. **Failure to Comply with Agreement.** The failure or refusal by LIPA to perform any material obligation under the Agreement unless such failure or refusal is excused by a Force Majeure or Manager Fault; except that no such failure or refusal will constitute an Event of Default giving the Manager the right to terminate the Agreement for cause unless the Manager has given prior written notice to LIPA and LIPA has neither challenged in an appropriate forum the Manager’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA corrects such default within 270 days from its receipt of such notice).

3. **Change of Control.** A change of control of LIPA or the Authority which results in ownership control of LIPA or the Authority by other than a state public benefit corporation, authority, political subdivision or other instrumentality of the State or any political subdivision thereof.

**Procedure for Termination for Cause.** If any party has a right of termination for cause, the right may be exercised by giving a notice of termination for cause to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default, a Change of Control or an Event of Default specified in clause (e) above under the heading “Events of Default Not Requiring Cure Opportunity for Termination,” simultaneously with, or, in the case of an Event of Default as discussed in clause (c) and (d) above under the heading “Events of Default Not Requiring Cure Opportunity for Termination,” six months) the date of termination specified in such notice (the “Termination Date”).
Non-Binding Mediation; Arbitration

The Agreement provides that any dispute arising out of or relating to the Agreement will be resolved in accordance with the negotiation, mediation and arbitration procedures for the resolution of such disputes established by the Agreement, which shall constitute the sole and exclusive procedures for the resolution of such disputes.

Provisional Relief

Either party may, without prejudice to any negotiation, mediation, or arbitration procedures, proceed in the NY State Supreme Court, Nassau County, to obtain provisional judicial relief if, in such party’s sole discretion, such action is necessary to avoid imminent irreparable harm, to provide uninterrupted electrical and other services, or to preserve the status quo pending the conclusion of such negotiation, mediation or arbitration.

LIPA Emergency Powers. The Agreement provides that if the Manager, due to a Force Majeure event or any other reason whatsoever, fails to provide any Operation and Maintenance Services and Construction Work contemplated by the Agreement and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then LIPA will have the right, upon notice to the Manager, during the period of such emergency, to take possession of and use any or all of the Operating Assets necessary to transmit and distribute Power and Energy which the Manager would otherwise be obligated to transmit and distribute. The Manager will fully cooperate with LIPA to effect such a temporary transfer of possession of the Operating Assets for LIPA’s use of the same.

Term

Term of Agreement. The Agreement will continue in effect until December 31, 2013, unless earlier terminated in accordance with its terms.

Selection of Future Managers. LIPA may conduct a procurement for T&D System management services to be provided following the expiration or earlier termination of the Agreement. The Manager will have the right or be ineligible to submit a bid in such procurement on the same basis as other bidders unless the Agreement is terminated due to an Event of Default of the Manager. The Manager is obligated to cooperate with LIPA during such procurement process.

Miscellaneous Provisions

Affiliate. Pursuant to the Agreement, the Manager has agreed to remain an Affiliate of the Guarantor.

Credit Enhancement in Certain Circumstances. The Agreement provides that if the Guarantor’s credit rating declines below investment grade, then the Manager will provide credit enhancement of its obligations under the Agreement in the form of either (i) an unconditional guarantee of all of GENCO’s obligations under the Power Supply Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO’s obligations under the Agreement, the Manager’s obligations under the Management Services Agreement, and the Energy Manager’s obligations under the Energy Management Agreement, in a face amount of $60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade. The amount of such letter of credit will be reduced by $30,000,000 if the Energy Management Agreement has theretofore been or is thereafter terminated and by $4,000,000 if the Power Supply Agreement has theretofore been or is thereafter terminated, such obligation to continue until the expiration or termination of the Agreement, the Power Supply Agreement and the Energy Management Agreement.
**Force Majeure Generally.** Except as otherwise specifically provided in the Agreement, neither LIPA nor the Manager will be liable to the other for any failure or delay in performance of any obligation under the Agreement, including any obligations with respect to the Performance Metrics, to the extent due to the occurrence of a Force Majeure event.

**Indemnification.** The Agreement provides that the Manager, to the extent permitted by law, will protect, indemnify and hold harmless LIPA and its respective representatives, trustees, directors, officers, employees and subcontractors (as applicable in the circumstances) (the “LIPA Indemnified Parties”) from and against (and pay the full amount of) any Loss-and-Expense and will defend LIPA Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person; or loss or damage to property arising out of any matter for which the Manager is responsible under the caption “Allocation of Risk of Certain Costs and Liabilities” in the Agreement and LIPA, to the extent permitted by law, will protect, indemnify and hold harmless the Manager Indemnified Parties from and against (and pay the full amount of) any Loss-and-Expense, and will defend the Manager Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of (i) any matter for which LIPA is responsible under the caption “Allocation of Risk of Certain Costs and Liabilities” in the Agreement and (ii) any claim that (a) LIPA’s use of any LIPA Owned Property or any LIPA Licensed IP, (b) the Manager’s use of any LIPA Owned Property provided by or on behalf of LIPA or LIPA’s Related Parties or LIPA Licensed IP in accordance with the Agreement, or (c) the Manager’s use of the LIPA Marks in accordance with the Agreement, infringes or otherwise violates Intellectual Property Rights or other proprietary rights of any third party. The foregoing indemnifications are subject to certain exceptions, including the negligence or other wrongful conduct of any indemnified party and any Force Majeure event.

**Assignment and Transfer.**

**General.** The Agreement may be assigned by either party only with the prior written consent of the other party, except that without the consent of the other party (1) LIPA may make such assignments, create such security interests in its rights thereunder and pledge such monies receivable thereunder as may be required in connection with issuance of Revenue Bonds; (2) LIPA may assign its rights, obligations and interests thereunder, or transfer such rights and obligations by operation of law, to any other governmental entity or to a subsidiary of LIPA provided that the successor entity gives reasonable assurances to the Manager that it will be able to fulfill LIPA’s obligations thereunder; and (3) the Manager may assign its rights, obligations and interests thereunder to the Parent or any Affiliate thereof except that the Manager may not, without the consent of LIPA, make any assignment or other transfer to any person of its rights and obligations under the Agreement unless the Guaranty is and remains in full force and effect and unless the Guarantor or a majority-owned direct or indirect subsidiary of the Guarantor will have control of and responsibility for the Operation and Maintenance Services and any Construction Work.

**T&D System Sale or Transfer.** During the Term of the Agreement, LIPA may, without the Manager’s consent, sell, assign or transfer in whole or in part the T&D System to a federal, state or municipal governmental entity; provided, however, that any such sale, assignment or transfer shall be subject to the Manager’s rights under the Agreement. LIPA may, during the Term of the Agreement, also sell, assign or transfer the T&D System to a private entity, in which event LIPA will have the right to terminate (upon not less than 6 months prior written notice to the Manager) the Agreement effective upon the closing of such sale, assignment or transfer (the “Early Termination Date”); provided, however, that on the Early Termination Date, LIPA pays to the Manager (1) a termination fee of (x) $28,000,000 if the Early Termination Date occurs on or before December 31, 2009, and (y) $20,000,000 if the Early Termination Date occurs after December 31, 2009, and (2) the Manager’s reasonable and actual transition costs related to activities directed by LIPA or the new T&D System owner. In addition, with respect to contracts in the Manager’s name with a term extending for 3 years or more beyond the Early Termination
Date that are not assigned (without material cost) to LIPA or the new T&D System owner, on the Early Termination Date LIPA will pay to the Manager its actual and reasonable cost to terminate such contracts up to $2,000,000 in the aggregate.
APPENDIX G

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the “Disclosure Certificate”) is executed and delivered by the Long Island Power Authority (the “Authority”) in connection with the issuance of its Electric System General Revenue Bonds, Series 2006E (the “Bonds”). The Bonds are being issued pursuant to the Electric System General Revenue Bond Resolution adopted by the Authority on May 13, 1998 as amended and supplemented (the “Resolution”). The Authority covenants and agrees as follows:

SECTION 1. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the Authority for the benefit of the Holders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with S.E.C. Rule 15c2-12(b)(5).

SECTION 2. Definitions. In addition to the definitions set forth in the Resolution, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“Annual Report” shall mean any Annual Report provided by the Authority pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“Beneficial Owner” shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

“Dissemination Agent,” if any, shall mean the person or firm, or any successor Dissemination Agent designated in writing by the Authority pursuant to Section 7 of this Disclosure Certificate.

“Listed Events” shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

“National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently approved by the Securities and Exchange Commission are set forth in Exhibit A.

“Official Statement” shall mean the Authority’s final Official Statement relating to the Bonds.

“Participating Underwriter” shall mean any of the original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

“Repository” shall mean each National Repository and the State Repository.

“Rule” shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“State” shall mean the State of New York.

“State Repository” shall mean any public or private repository or entity designated by the State as the state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Certificate, there is no State Repository.


Capitalized terms not otherwise defined herein shall have the meanings set forth in the Official Statement.

SECTION 3. Provision of Annual Reports. For so long as shall be required by the Rule:
(a) The Authority shall, or shall cause the Dissemination Agent to, not later than 6 months after the end of the Authority’s fiscal year (presently December 31), commencing with the report for the 2006 Fiscal Year, provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate with a copy to the Trustee. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the Authority may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the Authority’s fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(c).

(b) Not later than fifteen (15) Business Days prior to said date, the Authority shall provide the Annual Report to the Dissemination Agent (if other than the Authority). If the Authority is unable to provide to the Repositories an Annual Report by the date required in subsection (a), the Authority shall send a notice to each Repository or the Municipal Securities Rulemaking Board and the State Repository, if any, in substantially the form attached as Exhibit B.

(c) If a Dissemination Agent is appointed by the Authority, the Dissemination Agent shall:

(i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and

(ii) file a report with the Authority certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided.

SECTION 4. Content of Annual Reports. The Authority’s Annual Report shall contain or include by reference the following:

1. The audited basic financial statements of the Authority and its subsidiaries for the prior fiscal year, prepared in accordance with U.S. generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the Authority’s audited basic financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited consolidated financial statements and the audited basic financial statements shall be filed in the same manner as the Annual Report when they become available.

2. Operating results for the prior fiscal year of the type set forth in the Basic Financial Statements of the Authority attached as Appendix A to Part 2 of the Official Statement.


5. The Authority’s own rates and charges (but not regional comparisons) for the prior fiscal year of the type set forth in the Official Statement under the heading “Rates and Charges” in Part 2 of the Official Statement.

7. A discussion of operating results, cash flows, uses of cash and capital expenditures of the type set forth in the audited Basic Financial Statements for the years ended December 31, 2005 and 2004 under the heading “Management’s Discussion and Analysis.”

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Authority or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The Authority shall clearly identify each such other document so included by reference.

SECTION 5. Reporting of Significant Events. For so long thereafter as shall be required by the Rule:

(a) Pursuant to the provisions of this Section 5, the Authority shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies.
2. non-payment related defaults.
3. modifications to rights of Bondholders.
4. optional, contingent or unscheduled bond calls.
5. defeasances.
6. rating changes.
7. adverse tax opinions or events affecting the tax-exempt status of the Bonds.
8. unscheduled draws on the debt service reserves reflecting financial difficulties.
9. unscheduled draws on the credit enhancements reflecting financial difficulties.
10. substitution of the credit or liquidity providers or their failure to perform.
11. release, substitution or sale of property securing repayment of the Bonds.

(b) Whenever the Authority obtains knowledge of the occurrence of a Listed Event, the Authority shall as soon as possible determine if such event would be material under applicable federal securities laws.

(c) If the Authority determines in its sole discretion that knowledge of the occurrence of a Listed Event would be material and would require disclosure under applicable federal securities laws, the Authority shall promptly file a notice of such occurrence with the Repositories or the Municipal Securities Rulemaking Board and the State Repository with a copy to the Trustee. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected Bonds pursuant to the Resolution.

SECTION 6. Termination of Reporting Obligation. The Authority’s obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all
of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the Authority shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

SECTION 7. Dissemination Agent. The Authority may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the Authority pursuant to this Disclosure Certificate. Initially, the Authority will serve as its own dissemination agent. Notwithstanding any other provisions hereof, the Authority or the Dissemination Agent may make the filings required by this Disclosure Certificate either directly with the repositories or through a central information repository approved in accordance with the Rule.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the Authority may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4, or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of the Bonds in the same manner as provided in the Resolution for amendments to the Resolution with the consent of Holders, or (ii) does not, in the opinion of the Trustee or nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the Authority shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Authority. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(c), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the Authority from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the Authority chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the Authority shall have no obligation under this Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. Default. In the event of a failure of the Authority to comply with any provision of this Disclosure Certificate the Trustee may (and, at the request of any Participating Underwriter or the Holders of at least 50% aggregate principal amount of Outstanding Bonds, shall), or any Holder or
Beneficial Owner of the Bonds may (unless the Authority has so complied within 20 days after written notice from the Trustee of its failure to comply) take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Authority to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed a default or an Event of Default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the Authority to comply with this Disclosure Certificate shall be an action to compel performance.

SECTION 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the Authority agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent’s default or negligence or willful misconduct. The obligations of the Authority under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

SECTION 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Authority, the Trustee, the Dissemination Agent, the Participating Underwriters and Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Date: September __, 2006

LONG ISLAND POWER AUTHORITY

By ________________________________
EXHIBIT A

NATIONAL REPOSITORIES

As of the date of this Continuing Disclosure Certificate, the following National Repositories are recognized by the Securities and Exchange Commission:

**Bloomberg Municipal Repositories**
100 Business Park Drive
Skillman, New Jersey 08558

**DPC Data, Inc.**
One Executive Drive
Fort Lee, NJ 07024
Contact: NRMSIR

**FT Interactive Data**
Attn: Repository
100 Williams Street
New York, New York 10038

**Standard & Poor’s Securities Evaluations, Inc.**
55 Water Street, 45th Floor
New York, NY 10041
EXHIBIT B
NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Authority: Long Island Power Authority

Name of Bond Issue: Long Island Power Authority Electric System General Revenue Bonds, Series 2006E

Date of Issuance: September __, 2006

NOTICE IS HEREBY GIVEN that the Authority has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated September __, 2006 of the Authority. The Authority anticipates that the Annual Report will be filed by _____________.

Dated: ____________, ______

LONG ISLAND POWER AUTHORITY

By ________________________________

cc: Trustee
APPENDIX H

BOOK-ENTRY-ONLY SYSTEM

DTC will act as securities depository for the Offered Securities. The Offered Securities will be issued as fully-registered bonds in the name of Cede & Co. (DTC’s partnership nominee). One fully registered bond certificate will be issued for the Offered Securities in the aggregate principal amount of the maturity of such Bonds, and will be deposited with DTC.

The Depository Trust Company (“DTC”) is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over two million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“Direct DTC Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct DTC Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct DTC Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct DTC Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct DTC Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, each a subsidiary of DTCC, as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct DTC Participant, either directly or indirectly (“Indirect DTC Participants”). DTC has Standard & Poor’s Ratings Services’ highest rating: AAA. The DTC Rules applicable to Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Offered Securities under the DTC system must be made by or through Direct DTC Participants, which will receive a credit for the Offered Securities on DTC’s records. The ownership interest of each actual purchaser of Offered Securities (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect DTC Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect DTC Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Securities are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Securities, except in the event that use of the book-entry system for a Series of the Offered Securities is discontinued.

To facilitate subsequent transfers, all Offered Securities deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. The deposit of Offered Securities with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Securities; DTC’s records reflect only the identity of the Direct DTC Participants to whose accounts such Offered Securities are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.
Conveyance of notices and other communications by DTC to Direct DTC Participants, by Direct DTC Participants to Indirect DTC Participants, and by Direct DTC Participants and Indirect DTC Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to Cede & Co. If less than all of the Offered Securities within a maturity of a Series are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct DTC Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to Offered Securities unless authorized by a Direct DTC Participant in accordance with DTC’s procedures. Under its usual procedures, DTC mails an omnibus proxy (the “Omnibus Proxy”) to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct DTC Participants to whose accounts the Offered Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds and principal and interest payments on the Offered Securities will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC’s practice is to credit Direct DTC Participants’ accounts on the payable date in accordance with their respective holdings shown on DTC’s records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in street name, and will be the responsibility of such Participant and not of DTC, the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds and principal and interest payments to DTC is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct DTC Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect DTC Participants.

The Authority and the Trustee may treat DTC (or its nominee) as the sole and exclusive registered owner of the Offered Securities registered in its name for the purposes of payment of the redemption proceeds and principal and interest on the Offered Securities, giving any notice permitted or required to be given to registered owners under the Bond Resolution, registering the transfer of the Offered Securities, or other action to be taken by registered owners and for all other purposes whatsoever. The Authority and the Trustee shall not have any responsibility or obligation to any Participant, any person claiming a beneficial ownership interest in the Offered Securities under or through DTC or any Participant, or any other person which is not shown on the registration books of the Authority (kept by the Trustee) as being a registered owner, with respect to the accuracy of any records maintained by DTC or any Participant; the payment by DTC or any Participant of any amount in respect of the principal, redemption premium, if any, or interest on the Offered Securities; any notice which is permitted or required to be given to registered owners thereunder or under the conditions to transfers or exchanges adopted by the Authority; or other action taken by DTC as a registered owner.

For every transfer and exchange of beneficial ownership of the Offered Securities, a Beneficial Owner may be charged a sum sufficient to cover any tax, fee or other governmental charge that may be imposed in relation thereto.

DTC may discontinue providing its service with respect to a Series of the Offered Securities at any time by giving notice to the Authority and discharging its responsibilities with respect thereto under applicable law, or the Authority may terminate its participation in the system of book-entry transfer through DTC at any time by giving notice to DTC. In either event, the Authority may retain another securities depository for a Series of the Offered Securities or may direct the Trustee to deliver bond certificates in accordance with instructions from DTC or its successor. If the Authority directs the
Trustee to deliver such bond certificates, such Offered Securities of a Series may thereafter be exchanged for an equal aggregate principal amount of Offered Securities in any other authorized denominations and of the same series and maturity as set forth in the Bond Resolution, upon surrender thereof at the principal corporate trust office of the Trustee, who will then be responsible for maintaining the registration books of the Authority.

Unless otherwise noted, certain of the information contained in the preceding paragraphs of this Appendix H has been extracted from information given by DTC. Neither the Authority, the Trustee nor the Underwriters make any representation as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO SUCH DTC PARTICIPANTS, INDIRECT DTC PARTICIPANTS, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO THE PAYMENTS TO OR THE PROVIDING OF NOTICE FOR SUCH DTC PARTICIPANTS, INDIRECT DTC PARTICIPANTS, OR THE BENEFICIAL OWNERS. PAYMENTS MADE TO DTC OR ITS NOMINEE SHALL SATISFY THE AUTHORITY’S OBLIGATION UNDER THE ACT AND THE BOND RESOLUTION TO THE EXTENT OF SUCH PAYMENTS.