

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF THE CONSOLIDATED RESULTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, 2003**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the three months ended March 31, 2003 and 2002. Note that the 2002 results of operations have been restated to correct the effects of the KeySpan error.

Excess of Revenues over Expenses

The excess of expenses over revenues for the three months ended March 31, 2003 was approximately \$63 million compared with approximately \$1 million for the similar period in 2002. The variation of approximately \$62 million is primarily attributable to higher fuel and purchased power costs (as more fully described below), higher O&M, partially offset by higher revenues and lower interest on long-term debt.

Revenue

Revenue for the three months ended March 31, 2003, increased approximately \$46 million when compared to the similar period in 2002. The increase is primarily attributable to the effects of weather estimated to have positively impacted revenue by approximately \$16 million and system load growth totaling approximately \$30 million.

Fuel and Purchased Power Costs

Fuel and purchased power costs increased approximately \$106 million. This increase is due to \$52 million of costs in excess of those charged to customers in base rates as established in 1998 (excess fuel costs) which were not deferred, combined with decrease in the mark-to market valuations of LIPA's fuel hedges of approximately \$37 million, and higher expense recognition of approximately \$16 million due to higher sales.

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). In February 2003, LIPA's Board of Trustees adopted a proposal to change the method in which the Authority collects excess fuel costs from its customers. The modification, when fully implemented in 2004, will permit the Authority to collect its excess fuel costs in the year incurred (as opposed to on a deferral basis), in amounts sufficient to generate revenues in excess of expenses of \$20 million on an annual basis. The modification will be implemented over a two year transition period (2003 – 2004) as follows:

- With respect to 2002 deferred fuel costs, recovery will be over a ten-month period beginning March 2003
- With respect to 2003 excess fuel costs, (i) \$75 million will be collected in 2003 between March and December; (ii) \$70 million will be deferred and collected in 2004; and (iii) an additional amount sufficient to generate an excess of revenue over expenses of \$20 million in 2003 will be deferred and collected in level annual amounts over a ten year period commencing in January 1, 2004.

- With respect to 2004 and subsequent years' excess fuel costs, collections of these amounts will be on a current year basis in amounts sufficient to generate excess revenue over expenses of \$20 million. For the years ending 2003 and beyond, excess fuel costs not deferred will be charged to expense as the Authority would not seek recovery of such amounts under this modification.

During the three months ended March 31, 2003, and 2002 excess fuel costs totaled approximately \$130 million and \$25 million, respectively. Of the \$130 million of 2003 excess, LIPA collected in March, \$2 million of the \$75 million to be collected through year-end. Of the remaining \$128 million, \$16 million of the \$70 million to be recovered in 2004, was deferred, and approximately \$60 million was deferred for collection over the 10-year period to begin January 1, 2004. These two deferral amounts were based upon the relative experience of actual sales generated in the first three months of 2003 relative to the annual sales forecast for the entire year. The remaining \$52 million was charged to expense, as LIPA's latest forecast supports a net income figure of \$20 million with that level of expense through March 31, 2003. The 2002 \$25 million excess was deferred in full at March 31, 2002.

Included in fuel and purchased power expense for the three month period ended March 31, 2003, is an unrealized loss of approximately \$7 million necessary to comply with the provisions of Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires the fuel-related derivatives to be re-valued each period to its fair market value. The \$7 million mark-to-market unrealized loss resulted from the change in fuel related derivative values at March 31, 2003 when compared to its values at December 31, 2002. However, when compared to the mark-to-market values at March 31, 2002, the change in the valuation results in an approximate \$37 million variation effect on Fuel and Purchased Power expense. The unrealized gains/losses are included in Fuel and Purchased Power expense but because this valuation is unrealized, it is excluded from the FPPCA calculation.

Eliminating the effects of the accounting mechanisms used to comply with the Authority's tariffs and SFAS No. 133 demonstrates that fuel and purchased power costs in 2003 increased by approximately \$125 million when compared to the three month period ended March 31, 2002. Approximately \$16 million is attributable to increased sales for the 2003 period compared to 2002, and approximately \$109 million is attributable to increased fuel and purchased power costs.

#### Operations and Maintenance Expense ("O&M")

O&M increased approximately \$7 million for the three months ended March 31, 2003 when compared to the similar period in 2002. This increase is primarily attributable to higher costs associated with clean energy initiatives totaling approximately \$3 million; increased PSA costs totaling approximately \$3 million; increased costs related to incremental repair work on the transmission and distribution system totaling approximately \$1 million; and the recognition of approximately \$1 million related to the accretion of an Asset Retirement Obligation (ARO) recognized in accordance with Financial Accounting Standards Board Statement No. 143-- "Accounting for Asset Retirement Obligations" (as more fully discussed below under the caption *Other Significant Items*), partially offset by lower Nine Mile Point 2 ("NMP2") costs totaling approximately \$1 million.

Other Income

Other income increased approximately \$3 million as a result of the sale of emission credits in January 2003.

Interest Charges and Credits

Interest charges related to debt decreased relative to the similar period in 2002 by approximately \$2 million resulting from maturities of certain Series 1998A and 1998B debt and rates on the variable rate obligations being lower in 2003 when compared with 2002.

Other Significant Items

On January 1, 2003, the Authority adopted Financial Accounting Standards Board Statement 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. As LIPA has an ownership interest in Nine Mile Point 2 nuclear power station, and as there is a legal obligation associated with its retirement, LIPA is required to recognize an ARO. Accordingly, a new caption appears on the liability section of the balance sheet titled Asset Retirement Obligation. This obligation is primarily offset by the capitalization of the obligation and is included in Utility plant, net.

The cumulative effect change if accounting principal results in a benefit of approximately \$2.8 million.

With respect to LIPA's transmission and distribution system assets, no ARO's exists as mass assets are believed to operate in perpetuity, and therefore have indeterminate cash flows, the basis used under Statement No. 143 for determining an ARO. As that exposure is in perpetuity, and cannot be measured, no liability needs to be established. LIPA's ARO will be re-evaluated in future periods until sufficient information exists to determine a reasonable estimate of fair value.

**Consolidated Statement of Revenues, Expenses and  
Changes in Accumulated Deficit  
(Thousands of Dollars)**

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(unaudited) (unaudited)</b>	
<b>Electric Revenue</b>	\$ 550,709	\$ 505,169
<b>Expenses</b>		
Operations - fuel and purchased power	263,139	157,428
Operations and maintenance	175,813	168,258
General and administrative	9,324	9,188
Depreciation and amortization	54,884	53,919
Payments in lieu of taxes	50,575	50,786
Total Operating Expenses	<u>553,735</u>	<u>439,579</u>
<b>Excess of operating (expenses over revenues) revenue over expenses</b>	<u>(3,026)</u>	<u>65,590</u>
<b>Other income, net</b>		
Investment income	2,682	4,441
Carrying charges on regulatory asset	7,497	7,105
Other	<u>4,292</u>	<u>1,503</u>
Total other income, net	<u>14,471</u>	<u>13,049</u>
<b>Excess of revenues over expenses before interest charges and (credits)</b>	<u>11,445</u>	<u>78,639</u>
<b>Interest charges and (credits)</b>		
Interest on long-term debt, net	72,386	75,438
Other interest	6,093	5,939
Allowance for borrowed funds used during construction	<u>(1,135)</u>	<u>(1,866)</u>
Total interest charges	<u>77,344</u>	<u>79,511</u>
<b>Excess of expenses over revenues before Cumulative Effect of a Change in Accounting Principle</b>	(65,899)	(872)
Cumulative Effect of a Change in Accounting Principle	<u>2,873</u>	<u>-</u>
<b>Excess of expenses over revenues</b>	(63,026)	(872)
<b>Accumulated deficit</b>		
Beginning	<u>(11,253)</u>	<u>(31,365)</u>
Ending	<u>\$ (74,279)</u>	<u>\$ (32,237)</u>

**Consolidated Statement of Financial Position**  
(Thousands of Dollars)

	<b>March 31, 2003 (unaudited)</b>	<b>December 31, 2002 (audited)</b>
<b>Assets</b>		
<b>Utility Plant, net</b>	3,112,885	\$ 3,040,592
<b>Property and Equipment, net</b>	1,044	1,107
<b>Current Assets</b>		
Cash and cash equivalents and investments	521,732	610,326
Accounts receivable (less allowance for doubtful accounts of \$19,485)	207,815	236,856
Other accounts receivable	316	21,971
Fuel inventory	65,792	46,839
Material and supplies inventory	7,240	7,277
Interest receivable	1,192	1,409
Prepayments and other current assets	5,441	4,942
<b>Total Current Assets</b>	<b>809,528</b>	<b>929,620</b>
<b>Promissory Notes Receivable</b>		
KeySpan Energy	155,425	602,425
Niagara Mohawk Power Corporation	2,822	2,822
<b>Total Promissory Notes Receivable</b>	<b>158,247</b>	<b>605,247</b>
<b>Nonutility Property and Other Investments</b>		
	69,301	75,324
<b>Deferred Loss related to Non Fuel Derivatives</b>		
	46,970	39,597
<b>Deferred Charges</b>		
	67,943	70,456
<b>Regulatory Assets</b>		
Shoreham settlement	567,688	544,098
Fuel and purchased power cost recoverable	199,938	148,984
<b>Total Regulatory Assets</b>	<b>767,626</b>	<b>693,082</b>
<b>Acquisition Adjustment (net of accumulated amortization of \$705,700 and \$677,530, respectively)</b>		
	3,389,811	3,417,981
<b>Total Assets</b>	<b>\$ 8,423,355</b>	<b>\$ 8,873,006</b>
<b>Capitalization</b>		
Long-term debt	6,792,141	\$ 7,240,357
Accumulated deficit	(74,279)	(11,253)
<b>Total Capitalization</b>	<b>6,717,862</b>	<b>7,229,104</b>
<b>Capital Lease Obligation</b>		
	593,510	599,871
<b>Current Liabilities</b>		
Current maturities of long-term debt	274,480	274,480
Accounts payable and accrued expenses	320,969	342,318
Accrued taxes	11,764	41,265
Accrued interest	87,917	47,745
Customer deposits	24,315	24,658
<b>Total Current Liabilities</b>	<b>719,445</b>	<b>730,466</b>
<b>Asset Retirement Obligation</b>		
	60,804	-
<b>Deferred Credits</b>		
	134,728	131,037
<b>Deferred Gain related to Non Fuel Derivatives</b>		
	34,788	25,955
<b>Swaption</b>		
	141,199	132,366
<b>Claims, Damages and Storm Reserves</b>		
	21,019	24,207
<b>Commitments and Contingencies</b>		
<b>Total Capitalization and Liabilities</b>	<b>\$ 8,423,355</b>	<b>\$ 8,873,006</b>

**Consolidated Statement of Cash Flows  
(Thousands of Dollars)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
<b>Cash Flows From Operating Activities</b>		
Received for system sales and other operating revenues, net of refunds	\$ 591,384	\$ 524,354
Paid to suppliers and employees		
Operations and maintenance	(246,312)	(191,510)
Purchased power	(143,768)	(96,747)
Fuel oil and gas	(159,679)	(91,096)
Payments in lieu of taxes	(94,953)	(88,757)
Net cash (used in) provided by operating activities	<u>(53,328)</u>	<u>56,244</u>
<b>Investing Activities</b>		
Earnings received on investments	2,904	2,308
Other	-	(169)
Net cash provided by investing activities	<u>2,904</u>	<u>2,139</u>
<b>Cash Flows from Capital and related Financing Activities</b>		
Capital and nuclear fuel expenditures	(42,949)	(62,015)
Insurance proceeds	747	1,444
Proceeds from the issuance of swaption, net	21,643	-
Proceeds from KeySpan promissory note	461,345	-
Interest paid, net	(17,611)	(15,168)
Redemption of long-term debt	(461,345)	-
Net cash used in capital and related financing activities	<u>(38,170)</u>	<u>(75,739)</u>
Net decrease in cash, cash equivalents and investments	(88,594)	(17,356)
Cash, cash equivalents and investments at beginning of period	610,326	688,369
Cash, cash equivalents and investments at end of period	<u>\$ 521,732</u>	<u>\$ 671,013</u>
<b>Reconciliation to Net Cash Provided by Operating Activities</b>		
Excess of operating (expenses over revenues)/revenues over operating expenses	(3,026)	\$ 65,590
<b>Adjustments to reconcile excess of (expenses over revenues)/revenues over expenses to net cash provided by operating activities</b>		
Depreciation and amortization	54,884	53,919
Accretion of Asset Retirement Obligation	912	-
Nuclear fuel burned	1,542	1,211
Shoreham Credits	(16,093)	(19,186)
Provision for claims and damages	2,625	2,805
Change in the fair market value of fuel related derivatives	6,778	(29,900)
Other	(2,057)	-
<b>Changes in operating assets and liabilities</b>		
Accounts receivable, net	29,041	37,326
Fuel and Material & supplies inventory	(18,916)	17,309
Fuel and purchased power costs recovered related to prior periods	25,619	30,003
Excess fuel and purchased power costs deferred	(76,573)	(25,140)
Prepaid assets	(365)	(1,042)
Accounts payable and accrued expenses	(28,643)	(47,078)
Accrued taxes	(29,501)	(25,956)
Other, net	445	(3,617)
Net cash (used in) provided by operating activities	<u>\$ (53,328)</u>	<u>\$ 56,244</u>