

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the nine months ended September 30, 2003 and 2002. Note that the 2002 results of operations have been restated to correct the effects of the KeySpan revenue error.

Excess of Revenues over Expenses

The revenues in excess of expenses for the nine months ended September 30, 2003 was approximately \$29 million compared with approximately \$80 million for the similar period in 2002. The variation of approximately \$51 million is primarily attributable to higher fuel and purchased power costs partially offset by higher revenues.

Revenue

Revenue for the nine months ended September 30, 2003, increased approximately \$97 million when compared to the similar period in 2002. The increase is primarily attributable to system load growth totaling approximately \$27 million, higher recoveries of excess fuel costs totaling approximately \$68 million, and the effects of weather, estimated to have positively impacted revenue by approximately \$2 million.

Fuel and Purchased Power Costs

Fuel and purchased power costs increased approximately \$195 million. This increase is due in part to a \$25 million increase in fuel and purchased power costs not recoverable through the Fuel and Purchased Power Cost Adjustment mechanism ("FPPCA"), a decrease in the mark-to-market valuation of LIPA's fuel hedges of approximately \$70 million, higher sales volumes of approximately \$32 million, and higher FPPCA recoveries of approximately \$68 million.

LIPA's tariff includes a fuel recovery provision—the FPPCA. In February 2003, LIPA's Board of Trustees changed the method for recovery from customers of fuel costs in excess of those included in base rates, ("Excess Fuel Costs"). When fully implemented in 2004, the FPPCA will collect the portion of Excess Fuel Costs in the year incurred (as opposed to on a deferral basis), necessary to reach revenues in excess of expenses of \$20 million on an annual basis. The modified FPPCA also contains the following transition provisions:

- 2002 deferred fuel costs totaling \$129 million will be recovered over a ten-month period which began March 7, 2003. (During March through September 2003, approximately \$89 million has been billed to customers.)
- 2003 Excess Fuel Costs will be recovered in three tranches: (i) \$75 million will be collected in 2003 between March and December; (ii) \$70 million will be deferred and collected over the full year of 2004; and (iii) the remaining portion of Excess Fuel Costs necessary to reach 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 January 1, 2004.

During the nine months ended September 30, 2003, Excess Fuel Costs totaled approximately \$422 million. Of this amount, \$53 million has been billed to customers and \$53 million has been deferred for recovery in 2004. Approximately \$221 million has been deferred for collection over the 10-year period to begin January 1, 2004. The remaining \$98 million was charged to expense, as LIPA's current estimates indicate that portion of Excess Fuel Cost does not need to be recovered through the FPPCA in order to reach the target of revenues in excess of expenses of \$20 million for the year ending December 31, 2003.

During the nine months ended September 30, 2002, Excess Fuel Costs totaled \$169 million. Of this excess, \$99 million was deferred for recovery beginning in March 2003, and \$69 million was charged to fuel and purchased power in that period.

Included in fuel and purchased power expense for the nine month period ended September 30, 2003, is an unrealized loss of approximately \$24 million as opposed to a gain of approximately \$47 million during this period last year. The unrealized loss and gain are related to 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 \$24 million mark-to-market unrealized loss resulted from the change in fuel related derivative values at September 30, 2003 when compared to its values at December 31, 2002.

After eliminating the effects of the FPPCA and SFAS No. 133, fuel and purchased power costs in 2003 increased by approximately \$283 million when compared to the nine month period ended September 30, 2002. Approximately \$32 million is attributable to increased sales for the 2003 period compared to 2002, and the balance is attributable to increased fuel and purchased power prices.

Operations and Maintenance Expense ("O&M")

O&M decreased approximately \$67 million for the nine months ended September 30, 2003 when compared to the similar period in 2002. This decrease is primarily attributable to increased utilization of the MSA workforce for capital activities, a decrease in Clean Energy Program costs totaling \$10 million, decreased cost of renting temporary emergency stand-by generators totaling approximately \$28 million, the absence of costs associated with the accelerated completion of certain fast track units totaling approximately \$7 million, the absence of the costs associated with the Y-50 repair (as of September 30, 2002, \$7 million had been accrued) and decreased PSA costs totaling approximately \$4 million.

These decreases were partially offset by a \$5 million charge related to the Shoreham Settlement Agreement; increased customer accounts expense totaling approximately \$5 million; and the recognition of approximately \$3 million related to the accretion of an Asset Retirement Obligation (ARO) as required under Financial Accounting Standards Board Statement No. 143-- "Accounting for Asset Retirement Obligations" (as more fully discussed below under the caption *Other Significant Items*).

General and administrative

General and administrative expenses increased primarily as a result of increased consulting fees associated with auditing and energy risk management activities.

Depreciation and amortization

Depreciation and amortization increased approximately \$9 million. Approximately \$6 million of that increase is related to an adjustment to nuclear decommissioning accruals. The remaining increase is due to higher utility plant balances in 2003 when compared to 2002.

Other Income

Other income decreased approximately \$3 million compared to last year due to a decline in investment income as a result of lower investment balances.

Interest Charges and Credits

Total interest charges increased relative to the same period in 2002 by approximately \$6 million resulting primarily from lower credits from the allowance for funds used during construction ("AFC").

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. LIPA as an 18% owner of Nine Mile Point 2 nuclear power station has a legal obligation associated with its retirement. Accordingly, a new caption appears in the liability section of the balance sheet titled, "Asset Retirement Obligation". This obligation is offset by the capitalization of the obligation and is included in "Utility plant, net".

The cumulative effect of the change in accounting principle results in a benefit of approximately \$2.8 million and is shown as an adjustment to the opening balance of Accumulated Deficit.

During 2003, the Authority entered into two Purchase Power Agreements ("PPA's") for two 55 MW generating units, one at Greenport and one at Jamaica Bay. Each of these facilities began commercial operation in July 2003. Each of the PPA's will likely qualify as capital leases under Financial Accounting Standards Board pronouncement No. 13, "Accounting for Leases" ("FAS No. 13") and will be included in both Utility Plant and Capital Lease Obligations. However, the Authority is currently unable to determine the minimum lease payments as additional details of the charges included in the monthly rental fee have not been provided. Accordingly, the balance sheet does not reflect the capitalized lease or the related obligation.

As permitted under FAS No. 71, "Accounting for the Effects of Certain Types of Regulation," LIPA recognizes through Fuel and Purchased Power an amount equal to the rental expense of the capitalized leases, as allowed through the ratemaking process. During the period July through September 2003, approximately \$4 million of such costs have been recorded.

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

	Nine Months Ended September 30,	
	2003 (unaudited)	2002 (unaudited)
Electric Revenue	\$ 1,990,627	\$ 1,893,916
Expenses		
Operations - fuel and purchased power	854,464	659,305
Operations and maintenance	540,981	607,920
General and administrative	31,539	28,978
Depreciation and amortization	172,422	163,521
Payments in lieu of taxes	160,080	161,542
Total Operating Expenses	<u>1,759,486</u>	<u>1,621,266</u>
Excess of operating revenue over expenses	<u>231,141</u>	<u>272,650</u>
Other income, net		
Investment income	7,559	10,833
Carrying charges on regulatory asset	22,760	21,574
Other	5,531	6,522
Total other income, net	<u>35,850</u>	<u>38,929</u>
Excess of revenues over expenses before interest charges and (credits)	<u>266,991</u>	<u>311,579</u>
Interest charges and (credits)		
Interest on long-term debt, net	220,977	221,611
Other interest	20,741	18,078
Allowance for borrowed funds used during construction	<u>(3,838)</u>	<u>(8,417)</u>
Total interest charges	<u>237,880</u>	<u>231,272</u>
Excess of revenues over expenses	29,111	80,307
(Accumulated deficit) / Retained earnings		
Beginning balance as previously reported	(11,253)	(31,365)
Change in accounting principle	<u>2,873</u>	<u>-</u>
Ending	<u>\$ 20,731</u>	<u>\$ 48,942</u>

Consolidated Statement of Financial Position
(Thousands of Dollars)

	September 30, 2003 (unaudited)	December 31, 2002 (audited)
Assets		
Utility Plant, net	\$ 3,146,554	\$ 3,040,592
Property and Equipment, net	989	1,107
Current Assets		
Cash and cash equivalents and investments	515,310	610,326
Accounts receivable (less allowance for doubtful accounts of \$20,736)	330,894	236,856
Other accounts receivable	16,102	21,971
Fuel inventory	61,892	46,839
Material and supplies inventory	7,537	7,277
Interest receivable	809	1,409
Prepayments and other current assets	13,486	4,942
Total Current Assets	946,030	929,620
Promissory Notes Receivable		
KeySpan Energy	155,425	602,425
Niagara Mohawk Power Corporation	2,822	2,822
Total Promissory Notes Receivable	158,247	605,247
Nonutility Property and Other Investments	53,398	75,324
Deferred Loss related to Non Fuel Derivatives	57,097	39,597
Deferred Charges	77,701	70,456
Regulatory Assets		
Shoreham settlement	580,958	544,098
Fuel and purchased power cost recoverable	308,917	148,984
Total Regulatory Assets	889,875	693,082
Acquisition Adjustment (net of accumulated amortization of \$762,040 and \$677,530, respectively)	3,333,471	3,417,981
Total Assets	\$ 8,663,362	\$ 8,873,006
Capitalization		
Long-term debt	\$ 6,955,260	\$ 7,267,657
Retained earnings / (Accumulated deficit)	20,731	(11,253)
Total Capitalization	6,975,991	7,256,404
Asset Retirement Obligation	63,540	-
Capital Lease Obligation	580,315	599,871
Current Liabilities		
Short-term debt	100,000	100,000
Current maturities of long-term debt	132,050	147,180
Accounts payable and accrued expenses	354,741	342,318
Accrued taxes	30,902	41,265
Accrued interest	83,709	47,745
Customer deposits	24,392	24,658
Total Current Liabilities	725,794	703,166
Deferred Credits	148,891	156,992
Deferred Gain on Series 1998A Bonds Swaption	-	25,955
Claims, Damages and Storm Reserves	148,461	106,411
Commitments and Contingencies	20,370	24,207
Total Capitalization and Liabilities	\$ 8,663,362	\$ 8,873,006

Consolidated Statement of Cash Flows
(Thousands of Dollars)

	Nine Months Ended September 30,	
	2003 (unaudited)	2002 (unaudited)
Cash Flows From Operating Activities		
Received for system sales and other operating revenues, net of refunds	\$ 1,943,303	\$ 1,759,071
Paid to suppliers and employees		
Operations and maintenance	(617,120)	(585,362)
Purchased power	(418,522)	(287,956)
Fuel oil and gas	(556,826)	(397,394)
Payments in lieu of taxes	(229,422)	(222,181)
Net cash provided by operating activities	<u>121,413</u>	<u>266,178</u>
Investing Activities		
Earnings received on investments	6,610	9,620
Other	4,998	539
Net cash provided by investing activities	<u>11,608</u>	<u>10,159</u>
Cash Flows from Capital and related Financing Activities		
Capital and nuclear fuel expenditures	(150,164)	(175,823)
Insurance proceeds	-	1,444
Proceeds from the issuance of swaption, net	29,892	-
Proceeds from KeySpan promissory note	447,000	-
Proceeds from bond issuance	1,605,552	27,565
Bond issuance costs	(25,470)	(336)
Interest paid, net	(164,690)	(155,834)
Redemption of long-term debt	(1,970,157)	(115,145)
Net cash used in capital and related financing activities	<u>(228,037)</u>	<u>(418,129)</u>
Net decrease in cash, cash equivalents and investments	(95,016)	(141,792)
Cash, cash equivalents and investments at beginning of period	610,326	688,369
Cash, cash equivalents and investments at end of period	<u>\$ 515,310</u>	<u>\$ 546,577</u>
Reconciliation to Net Cash Provided by Operating Activities		
Excess of operating revenues over operating expenses	\$ 231,141	\$ 272,650
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities		
Depreciation and amortization	172,422	163,521
Nuclear fuel burned	4,393	3,995
Shoreham Credits	(14,100)	(62,872)
Provision for claims and damages	7,875	7,665
Accretion of asset retirement obligation	2,736	-
Change in the fair market value of fuel related derivatives	23,855	(46,518)
Other	(3,091)	4,515
Changes in operating assets and liabilities		
Accounts receivable, net	(111,062)	(130,324)
Fuel and Material & supplies inventory	(15,313)	7,217
Fuel and purchased power costs recovered related to prior periods	113,764	97,365

Excess fuel and purchased power costs deferred	(273,697)	(99,465)
Prepaid assets	(8,410)	(2,560)
Accounts payable and accrued expenses	1,250	57,439
Accrued taxes	(10,363)	(7,305)
Other, net	13	855
Net cash provided by operating activities	<u>\$ 121,413</u>	<u>\$ 266,178</u>