

**LONG ISLAND POWER AUTHORITY
MINUTES OF THE 139th MEETING
HELD ON DECEMBER 18, 2001**

Pursuant to notice dated December 11, 2001, the Long Island Power Authority (the "Authority") was convened for the one hundred and thirty-ninth time at 10:20 AM at Omni Teleconference Center in Uniondale, NY.

The following Trustees of the Authority were present:

**Richard M. Kessel, Chairman
Michael Affrunti
Nancy A. Akeson
Harvey Auerbach
James Hermann
Robert Maimoni
Nancy Nugent
Vincent Polimeni
Jonathan Sinnreich**

Also representing the Authority were Stanley Klimberg, General Counsel, Edward Grilli, Chief of Staff, Seth Hulkower, Chief Operating Officer, Diana Taylor, Chief Financial Officer, Edward Murphy, Jr., Chief Administrative Officer, Bert Cunningham, Vice President - Communications, Richard Bolbrock, Vice President - Power Markets, Christopher Furlong, Director of Customer Relations, Bruce

Germano, Vice President - Retail Services, Kenneth Kane, Controller, David Feldman, Budget Director, Michael Hervey, Director of Transmission and Distribution, and Kathleen Stella, Secretary to the Board of Trustees.

Upon determining that a quorum was present, Chairman Kessel called the meeting to order. He noted that the Board did not have a Deputy Chairman for this meeting.

Upon motion duly made and seconded, the following resolution was approved unanimously:

574. APPOINTMENT OF ACTING DEPUTY CHAIRMAN FOR THE DECEMBER 18, 2001 MEETING OF THE BOARD OF TRUSTEES OF THE LONG ISLAND POWER AUTHORITY

RESOLVED, that Mr. Harvey Auerbach is appointed as the Acting Deputy Chairman for the Long Island Power Authority Board of Trustees for its meeting of December 18, 2001.

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Chairman Kessel indicated that the first item on the agenda is approval of the minutes of the November 29 Board meeting.

Upon motion duly made and seconded, the following resolution was approved unanimously:

575. APPROVAL OF MINUTES AND RATIFICATION OF ACTIONS TAKEN AT THE NOVEMBER 29, 2001 MEETING OF THE BOARD OF TRUSTEES OF THE LONG ISLAND POWER AUTHORITY

RESOLVED, that the Minutes of the meeting of the Authority held on November 29, 2001, are hereby approved and all actions taken by the Trustees present at such meeting, as set forth in such Minutes, are hereby in all respects ratified and approved as actions of the Authority.

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Chairman Kessel stated that the next item on the agenda is the Operating Report, to be delivered by Mr. Hulkower.

Mr. Hulkower reported that LIPA is projecting year-end added annual revenues of \$15.9 million, and an annual energy savings of 44,503 megawatt hours that nearly meets the target savings of 46,780 megawatt hours.

Mr. Hulkower reported with respect to the reliability performance that over the course of the year the System Average Interruption Frequency Index (SAIFI) has drifted downwards from just under seventeen months between interruptions in service to approximately 15 months, due primarily to a storm in November. He stated that LIPA's SAIFI should remain between approximately fourteen and one-half to sixteen and one-half months on average.

Chairman Kessel stated that the next item on the agenda is the Financial Report, to be delivered by Ms. Taylor.

Ms. Taylor reported that LIPA does not currently have closing numbers for the month of November. She stated that she hopes to have the end of year statements for the Board by the January meeting. She then commented on the recent collapse of Enron Corp., noting that LIPA and its counterparties had no direct exposure to Enron and that LIPA remains in a good position.

Chairman Kessel indicated that the next item on the agenda is a resolution to approve the 2002 operating budget and the capital budgets for 2002 and 2003. The Chairman stated that the budgets incorporate the continuation of current operation and maintenance programs as well as initiatives planned for 2002 that address system growth, safety and reliability.

Chairman Kessel noted that LIPA's electric sales in 2002 are forecasted to be 18,793,819 megawatt hours, an increase of approximately two percent from 2001. He further stated that LIPA's fuel and purchased power costs are budgeted at \$1.02 billion for 2002, an increase of more than \$78 million from the 2001 budget. The Chairman indicated that the increased fuel and purchased power costs in the 2002 operating budget are based upon the forecasted prices of natural gas, fuel oil, nuclear fuel and the cost of purchased power.

Chairman Kessel noted that the operation and maintenance expenses are budgeted at \$653.4 million, and are comprised primarily of costs associated with the management of the transmission and distribution system, the Energy Management Agreement and the Power Supply Agreement with KeySpan.

The Chairman stated that general and administrative expenses for 2002 are budgeted at \$39.6 million, and consist primarily of outside engineering, consulting services, salaries, benefits and other employee related costs. He indicated that depreciation and amortization has been budgeted at \$216.5 million for 2002. He also noted that revenue taxes, which are based upon gross revenues received from the sale of electricity and tax assessments levied on other sources of revenues, are budgeted at \$72.4 million for 2002. The Chairman stated that Payments in Lieu of Taxes (PILOTs) for 2002 are budgeted at \$143.4 million.

Chairman Kessel remarked that other income and expenses are budgeted at \$45.2 million for 2002, and consist of earnings on LIPA's short term investments, the Nine Mile Point Two decommissioning trust fund balances and deferred balances related to the Shoreham property tax settlement.

The Chairman indicated that interest expense is budgeted at \$324 million, reflecting the cost of debt forecast to be outstanding in 2002. He noted that LIPA has reduced its interest expense by more than \$40 million as compared to the 2001 budget by taking advantage of the current lower interest rates. Chairman Kessel commended Ms. Taylor, Mr. Murphy, the LIPA financial staff and LIPA's investment bankers and advisors for LIPA's interest savings at this critical time.

The Chairman indicated that cash flow from operations is forecast to be \$132.9 million.

Chairman Kessel stated that the capital budgets for 2002 and 2003 amount to \$331.8 million and 240.2 million, respectively. He remarked that the essential difference between the capital budgets for 2002 and 2003 is the increase in capital costs associated with LIPA's aggressive pursuit of projects for new resources in 2002, including the construction, operation and interconnection of ten small generating facilities on Long Island, as well as the cross-Sound cable project.

Chairman Kessel complimented Mr. Feldman, Mr. Hervey, Ms. Taylor, Mr. Kane, Mr. Murphy and the LIPA financial staff for their work in the preparation of the budgets. The Chairman commented that the budgets will allow LIPA to continue to hold electric rates at the same level for another year. The Chairman thanked Governor Pataki for his commitment to hold rates down and for ensuring that LIPA also keeps to this same commitment. He further commented that LIPA confronts challenges in maintaining its base electric rates for five years, particularly in the current marketplace. The Chairman remarked that few other utilities in this country, if any, would be able to go through the same period of time without raising electric rates.

Chairman Kessel noted that the budget does not contain a final decision concerning fuel costs or the temporary surcharge. He indicated that a decision on this matter is to be made in the first quarter of 2002 based upon a review of all of LIPA's fuel costs for 2001. The Chairman further commented that although current fuel costs are slightly lower than anticipated, the fuel costs are still

significantly higher than initially budgeted when the LIPA transaction occurred. He expressed his hope that electric bills including the current fuel surcharge will not increase in 2002.

Chairman Kessel stated that a special committee, chaired by Mr. Polimeni, the Board's finance chairman, will be formed in 2002 to investigate LIPA's fuel and purchased power cost adjustment policy, including whether the policy needs to be changed to better reflect fuel costs on a more regular basis. The Chairman indicated that LIPA currently examines fuel costs for the entire prior year in the first quarter of the next year, although fuel costs impact cash flow throughout the year. He explained that the timing is such that budgets must be adopted without knowing final fuel costs for the preceding year, and fuel adjustments are made later which impact the budgets.

Chairman Kessel indicated he hopes to be in a position to make recommendations to the Board at the January or February 2002 meetings concerning fuel costs and the fuel surcharge. He stated that the Board should review its fuel policy and seriously consider reflecting actual costs on a more timely basis.

Chairman Kessel stated that while LIPA faces the same significant financial pressures as other businesses and institutions due to the nationwide economic downturn, LIPA is working to maintain its rate freeze and keep its fuel costs down. He noted that LIPA has not been immune from the pressures of rising

costs, but LIPA has been able to maintain the freeze on electric rates because it obtained favorable interest rates on its bonds, managed its money well, and has kept its expenses down. He stressed that LIPA must be extremely careful to control expenditures in 2002, which he has already communicated to LIPA's staff.

Chairman Kessel reported that LIPA has a cash position of more than \$700 million, but \$250 million must be allocated for rate stabilization fund purposes, additional monies must be applied for the Shoreham credits and further amounts are being drawn upon for the 2002 capital budget, leaving little room to maneuver. He remarked that the capital budget is approximately double the original projections since the system that was inherited from the former LILCO was in worse condition than expected.

Chairman Kessel noted that LIPA leads the State in reliability among overhead electric utilities, and LIPA's reliability statistics have been extraordinary in comparison to those of the former LILCO. He indicated that LIPA has been rated highest due to the work of its employees and due to LIPA's reinvestment in the system. He thanked Mr. Ranghelli and the International Brotherhood of Electrical Workers Union for their extraordinary contribution to LIPA's success. The Chairman observed that projects such as aggressive tree trimming, pole replacement, transformer replacement, wiring and the upgrade of substations have also contributed to LIPA's success, but have impacted the capital budget and put tremendous financial pressure upon LIPA.

Chairman Kessel remarked that the proposed budget would leave LIPA with revenues greater than expenditures by only one half million dollars, a relatively small figure for a budget exceeding two billion dollars. He indicated that LIPA is attempting to keep the rate of growth of the budget as low as possible in these difficult fiscal times.

Chairman Kessel then requested Mr. Feldman to make a presentation on the operating budget.

Mr. Feldman commended the budget staff, namely Ms. Mahotra and Mr. Conroy, for their assistance in the preparation of one of the toughest budgets he has ever seen. Mr. Feldman stressed that the 2002 budget is balanced.

Mr. Feldman mentioned that LIPA is forecasting a modest sales growth of approximately two percent in comparison to the 2001 budget, which reflects the economic slowdown. He stated that gas and oil prices have decreased significantly, but other components of the fuel and purchased power budget are driving up those costs, such as costs related to the new power plants, the ISO and the Long Island Choice program. He indicated that the 2002 budget reflects a small increase in fuel and purchased power costs compared to the 2001 budget.

Mr. Feldman indicated that operation and maintenance expenses have increased a modest \$658,000. He noted that the budget reflects cost decreases associated with the Management Services Agreement with KeySpan due to higher

synergy savings that have been passed to LIPA. He further noted that the Power Supply Agreement component has contributed additional costs of approximately \$5 million resulting from increased property taxes.

Mr. Feldman stated that the general and administrative expenses have increased, and this is primarily related to the construction of new power plants and consulting costs in connection with the Generation Purchase Right Agreement. He added that depreciation and amortization expenses have also increased due to an increase in the capital expenditures.

Mr. Feldman noted that revenue taxes have decreased significantly by \$11 million, corresponding to a five-year phase down plan enacted by the Legislature, and this savings is being passed along to LIPA's customers. He stated that PILOTs are showing a decrease of approximately \$900,000, primarily reflecting reduced PILOTs with respect to the old Shoreham plant which eventually will be phased out.

With respect to other income and deductions, Mr. Feldman remarked that LIPA has benefited from lower interest rates. He noted that interest expenses have also significantly decreased by \$41 million. He stated that LIPA expects to earn much lower interest on its cash investments due to the rate differential.

Trustee Maimoni inquired as to whether the consultant expenses related to the new power generation and other projects are to be paid out of the capital or

operating budget. Mr. Feldman answered that they will be paid from the operating budget since the costs cannot be capitalized due to the fact that the underlying plants and equipment will not be owned by LIPA.

Chairman Kessel inquired as to the amount of capital cost for the interconnection of the ten new plants and the cross-Sound cable. Mr. Feldman responded that the cost will be approximately \$115 million.

Trustee Sinnreich questioned whether the information supplied by KeySpan for LIPA's budget was complete and reliable. Mr. Feldman responded that he was satisfied with the data received from KeySpan which he uses to make periodic forecasts and prepare the budget, other than some small discrepancies with respect to the capital budget.

Trustee Sinnreich inquired as to the potential savings with respect to consulting expenses that could be realized by bringing the expertise in-house. Ms. Taylor answered that the possibility of increasing staff to obviate the use of outside consultants is being examined by LIPA. Trustee Sinnreich requested that a report on the subject be provided to the Board in the future. Ms. Taylor agreed to do so.

Chairman Kessel stated that LIPA has grown extensively in personnel, largely due to the Repowering Long Island Project for 2002. He commented that LIPA is attempting to achieve a balance when hiring additional staff. Mr. Feldman

added that many of the outside consulting costs relate to one-time projects, which would not necessitate that LIPA hire additional staff. Chairman Kessel suggested that Mr. Feldman compile an outline of consulting costs which breaks down the application of expenditures, indicates how the expenditures are applied for projects in 2002, and shows how such expenditures will subside in subsequent years as the projects are completed.

Chairman Kessel then requested Mr. Hervey to deliver a presentation concerning the capital budgets.

Mr. Hervey stated that \$83 million has been allocated toward the interconnection costs associated with the power projects. He indicated that the remaining \$32 million relates to other interconnection projects, including the replacement of the existing cross-Island cable beginning in 2002. He stated that the balance of the budget relates to customary transmission and delivery expenditures.

Mr. Hervey remarked that LIPA's primary concern in addressing the capital budget is to maintain the high level of reliability within the LIPA system. He indicated that in order to maintain reliability, LIPA looks to prevent large outages and to provide for expected customer growth and public works projects. He stated that in 2001 LIPA developed a prioritization process for capital projects based upon the common industry practice, which LIPA then used to balance the

capital expenditure requests with the financial constraints associated with the continuing rate freeze.

Mr. Hervey added that in November of 2000 LIPA provided KeySpan with a reliability model that focuses on weighing distribution expenditures in the capital budget against reliability. He further added that in May of 2000 LIPA introduced a new capital budgeting procedure, which requires additional documentation for each capital budget project. He noted that LIPA requested KeySpan at that time to allocate approximately \$160 million for the capital budget of T&D expenditures.

Mr. Hervey stated that LIPA developed a T&D business model with the aid of a consultant, and that model was implemented in 2001. He explained that the model accounts for all capital O & M expenditures on the T&D system. He further explained that a value rating is extracted for each of the expenditures, and that value is compared with the LIPA financial model to ensure that the T&D expenditures are consistent with LIPA's financial condition.

Mr. Hervey indicated that KeySpan proposed a capital expenditure budget of approximately \$318 million in July of 2001, when not all of the generation projects were fully developed. He stated that additional capital expenditures were added to the budget after the capital projects were examined and prioritized, numerous budget meetings were held and the potential impact of the funding on customers was analyzed. He added that on or about October 30, 2001, the budget

was revised to increase the recommendation from KeySpan to \$381 million; however, the budget was later pared to \$313 million after projects were reviewed and selected for funding in 2002. He noted that the original \$160 million guideline was consistent with the reliability model and the T&D business model, and therefore it was consistent with the continuing rate freeze.

Mr. Hervey stated that LIPA ensured that the financial targets for the T&D expenditures were consistent with the existing information published in the 2001-A bond issuance indicating \$271 million total for capital expenditures, including \$73 million for interconnects. He indicated that LIPA allowed the budget recommendation to grow to approximately \$198 million for capital T&D expenditures due to the funding of additional projects, which were prioritized based upon an industry accepted process recommended by the Electric Power Research Institute.

Mr. Hervey explained that the planning projects, which are related to system contingencies or capacity, were assessed and ranked based upon the exposed load to the customers, the hours of possible exposure, the probability of the event occurring and the cause of the exposure. He added that funding for budget items related to ongoing projects, such as service restoration and new customer connection, was appropriated to primarily address the most prevalent outage causes based upon a sliding scale that weighs the anticipated impact of the funding against the impact upon the customer.

Mr. Hervey indicated that additional funding was included to provide for the interconnection costs for generating plants and for the upgrade of transmission lines. He noted that although the largest concentration of reliability dollars has historically been allocated for the distribution system due to the higher probability of outages there, LIPA also needs to address the transmission system because transmission related outages have a larger impact. He remarked that the largest portion of the added expense of these projects relates to substation and system spares, including transmission system and substation high voltage level spare transformers and cable switches that LIPA and formerly LILCO did not possess. He indicated that these items would be purchased in 2002 and 2003, with an outlay of \$22 million in 2002. He further indicated that a projected expenditure for 2004 regarding the replacement of a transformer at the Lake Success facility was advanced to 2002 to reduce the exposure to a potentially large scale outage.

Chairman Kessel emphasized that this presentation is meant to inform the Board of the intricacies of the capital budget formulation process, including the interaction with KeySpan for the prioritization of projects. The Chairman commended Mr. Hervey and Mr. Hulkower and his staff for their contributions to the preparation of the capital budget. He also commended Mr. Nozzolillo and the employees at KeySpan for their contributions to the process.

Chairman Kessel requested that Trustee Polimeni, the Chairman of the Board's Finance Committee, make a statement concerning the budget.

Mr. Polimeni thanked Ms. Taylor, Mr. Murphy, Mr. Feldman, Mr. Horowitz and all involved in the budget process. He also thanked Trustee Doherty for his input into the process. Trustee Polimeni indicated he wished that revenue would be greater, but he acknowledged that he felt comfortable with this balanced budget. He indicated that the budgeting process began with a major deficit, but now the budget appears to be feasible. He recommended that the Board adopt the budget.

Chairman Kessel also thanked the Finance Committee, and Trustees Auerbach, Doherty and Faltischeck. The Chairman remarked that the process is detailed and involved. He noted that this budget was created after LIPA made the difficult decision to make cuts in some desired programs to balance the budget, which is necessary for the future health of LIPA. He also commended LIPA's budget staff for its conservative sales estimate for 2002. The Chairman noted that projected sales revenues are uncertain, particularly in this slow economy. He remarked that a revenue shortfall should not occur within this budget, even if the economy continues its downturn.

Mr. Sinnreich commended his fellow Trustees, including Trustees Polimeni and Doherty for their expertise and commitment. Chairman Kessel concurred.

Upon motion duly made and seconded, the following resolution was approved unanimously:

576. APPROVAL OF THE 2002 OPERATING BUDGET AND 2002 AND 2003 CAPITAL BUDGETS

WHEREAS, the Long Island Power Authority (“Authority”), through its wholly owned subsidiary, LIPA, owns and operates the electric transmission and distribution system (“T&D System”) serving the counties of Nassau and Suffolk and a small portion of the county of Queens known as the Rockaways; and

WHEREAS, the Board of Trustees is required to approve annual budgets for the operation and maintenance of the T & D System and for capital improvements; and

WHEREAS, the Authority released its proposed 2002 Operating Budget and 2002 and 2003 Capital Budgets on December 6, 2001; and

WHEREAS, the Authority conducted a public hearing on the proposed 2002 Operating Budget and 2002 and 2003 Capital Budgets on December 13, 2001; and

WHEREAS, the proposed 2002 Operating Budget and 2002 and 2003 Capital Budgets have been reviewed and approved by the Finance Committee of the Board of Trustees;

NOW, THEREFORE, BE IT RESOLVED, that the 2002 Operating Budget and 2002 and 2003 Capital Budgets, which are attached hereto, are hereby approved; and be it further

RESOLVED, that the Authority intends to finance the requirements of the 2002 and 2003 Capital Budgets through a combination of internally-generated funds and the issuance of tax-exempt debt of the Authority, to the extent permitted by law.

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Chairman Kessel requested that the LIPA staff and consultants deliver a presentation containing their analyses and recommendations on LIPA’s right under the Generation Purchase Right Agreement to acquire KeySpan Generation, the company that owns the former LILCO generating assets. The Chairman stated that in the LIPA transaction LIPA acquired the T&D system and the retail portion

of the LILCO electric system; and that KeySpan, which was formed by a merger between LILCO and the Brooklyn Union Gas Company, became the gas company, but it also owns the generation assets. He indicated that the issue as to whether LIPA should also assume control of the generation assets was greatly debated at that time.

Chairman Kessel added that through the input of Governor Pataki and former LIPA Chairman Frank Zarb, the Generation Purchase Right Agreement was entered into to afford LIPA the right to purchase all of the generation of the former LILCO now belonging to KeySpan. The Chairman noted that the time to exercise that right began in May of 2001 and ends in May of 2002. He remarked that the LIPA staff with the help of outside consultants has spent months analyzing this important issue.

Chairman Kessel stressed that the decision concerning whether to exercise the purchase right is the most significant decision to be made by LIPA since the acquisition of LILCO. He noted that the staff and team that analyzed the issue recommends that LIPA exercise the right to purchase the KeySpan generation. The Chairman stated he concurs with the recommendation under current circumstances, but more work is needed before a final decision is made. He remarked that today's discussion will begin a public evaluation process, and that following public discussion, information sessions and hearings at which the advantages and disadvantages of exercising the right will be weighed, the Chairman expects that the matter would be presented to the Board for a vote at

the February 2002 meeting. He invited the Board members to attend these forums.

Chairman Kessel commended Mr. Brennan, Mr. Nozzolillo and the KeySpan employees for their extraordinary performance under difficult circumstances in operating the power plants for LIPA and its customers, most notably in the summer of 2001 when they operated the plants at full capacity. He remarked that the decision to exercise the purchase right will be purely a business decision, not a comment on KeySpan's ability to run the power plants. He indicated that several factors must be considered before LIPA exercises the purchase right, including whether the acquisition provides cost savings to LIPA's ratepayers, enhances the reliability of the power plants, and promotes wholesale competition; and whether it is important for LIPA, as a public authority beholden to the public, to own the plants; and the effects on LIPA's debt and finances, and any impacts on the management, operation and labor force for the plants.

Chairman Kessel commented that there is a debate involving whether LIPA's Trustees should be appointed or elected, and he indicated that he was comfortable with elected Trustees. However, the Chairman indicated that whether Trustees are appointed or elected, they have an important responsibility to act on behalf of LIPA's customers, many of whom may not be well-informed on the specific functions of LIPA and KeySpan. He noted that the Board must make a greater effort to act on behalf of the customers, whose primary concerns are lower rates and continued service. The Chairman thanked the Trustees for their

uncompensated service, particularly in connection with this impending and extraordinary decision.

Trustee Sinnreich reinforced the Chairman's statement that this purchase right decision is the most significant issue faced by LIPA's Board since the decision to acquire the T&D system. Trustee Sinnreich stated that there are advantages and disadvantages to the acquisition, but from a financial perspective there are obvious cost savings that can be realized by LIPA's purchase of KeySpan's generation due to LIPA's status as a public entity.

Trustee Sinnreich identified two potential disadvantages that could offset the financial savings, namely the reliability of the operation and maintenance of the plants under new management, and whether a governmental entity has the capability to assume control of the plants and effectively run them. He stated that he was initially skeptical, but he has seen several proposals for the management of the generation that have satisfied him, and he noted that LIPA successfully accomplished such a task in assuming control of the T&D system, which LIPA has operated in the public interest. He affirmed his support for the acquisition of the KeySpan generation assets given current circumstances.

Chairman Kessel next requested a presentation from the LIPA staff and consultants concerning LIPA's right to purchase the KeySpan generation assets.

Mr. Klimberg opened the presentation and introduced Mr. Foran of Bear Stearns and Mr. Carter of Navigant Consulting, Inc., LIPA's respective financial and engineering consultants. Mr. Klimberg identified the areas that will be addressed by the presentation, namely an overview of the Generation Purchase Right Agreement (GPRA), a discussion of LIPA's GPRA evaluation process, overviews of the generation market on Long Island and the current Power Supply Agreement between LIPA and KeySpan, a discussion of the advantages and disadvantages of exercising the generation purchase right, a discussion of the considerations that determine the fair market value, a comparison of LIPA's and KeySpan's costs of capital, a discussion of the selection of a generation manager, a summary recommendation concerning the exercise of the purchase right and a discussion of LIPA's next steps.

Mr. Klimberg explained that the GPRA was one of several agreements between LIPA and LILCO as part of the merger agreement, and that the GPRA affords LIPA a one-time right to acquire KeySpan Generation, LLC, which owns the former LILCO generating assets. He indicated that the purchase price of the KeySpan subsidiary would be at its fair market value. He added that a generation manager would also have to be selected.

Mr. Klimberg stated that the right may be exercised on or before May 27, 2002, but only after LIPA's Board approves it by a two-thirds majority and the Public Authorities Control Board issues its approval. He observed that the acquisition price would not be determined until after notice of the decision to

exercise the right is issued, and the acquisition must occur within ninety days of the determination of the price. He indicated that the acquisition price would be determined through a negotiation process between investment bankers hired by LIPA and KeySpan. He added that if an agreement is not reached by those bankers, then a third, jointly selected investment banking firm would make the final price determination.

Mr. Klimberg indicated that a team consisting of LIPA's staff and consultants, including Bear Stearns, Navigant Consulting, Price Waterhouse Coopers and O'Melveny & Meyers, has diligently evaluated the advantages and disadvantages of the proposed acquisition since October of 2000. He noted that the team evaluated the physical condition of the plants, reviewed the operating performance of the plants, interviewed personnel, examined KeySpan's financial statements with supporting documentation and met with KeySpan management. He noted that Bear Stearns developed a financial model to aid in the determination of fair market value. He further noted that LIPA issued a Request for Proposals (RFP) for generation management services in February of 2001, and the team has been evaluating the proposals and conducting interviews of generation manager candidates.

Mr. Carter of Navigant Consulting, Inc. stated that for many reasons the current electric system on Long Island does not support competition. He indicated that the peak demand on Long Island in 2001 was approximately 4900 megawatts; this is expected to grow to 5500 megawatts by 2010. He added that

KeySpan owns approximately ninety-two percent or approximately 4000 megawatts of the available supply on Long Island. He noted that the Island faces transmission constraints through limited interconnections to the mainland, and that there are transmission constraints across the Island and load pockets throughout the Island where power must be generated due to the difficulty in transferring power to those locations. He also attributed the lack of competition to the difficulty in siting new generation.

Mr. Carter stated that KeySpan's ownership of the 4000 megawatts gives it market power, which invokes the oversight of the Federal Energy Regulatory Commission (FERC). He noted that when LIPA acquired the LILCO assets, LIPA executed the Power Supply Agreement (PSA) with KeySpan to ensure a sufficient supply of electrical power at a reasonable price. He indicated that subject to the FERC regulations, the PSA provides for KeySpan to sell to LIPA all of the capacity and, to the extent that LIPA requests, energy from the KeySpan generation. He indicated that KeySpan maintains the facilities and operates them in accordance with LIPA's dispatch instructions.

Mr. Carter noted that pursuant to the PSA, LIPA maintains virtually all of the ownership risks, including the cost of major equipment failures, environmental compliance and fuel costs. He stated that LIPA may approve the capital budgets, but KeySpan must concur in the decisions. He added that the PSA expires in 2013, leaving LIPA with an option to renew on similar terms for an additional fifteen years with either KeySpan or its successor.

Mr. Foran indicated that the GPRA provides LIPA with a favorable methodology for determining the fair market value of KeySpan Generation, LLC. He noted that the GPRA requires that all of the terms of the existing PSA must be reflected when determining the value. He added that LIPA ownership brings an advantage of cost savings due to LIPA's lower cost of capital, since LIPA, as a public entity can issue tax-free municipal bonds as opposed to taxable debt. He also commented that LIPA does not have to provide a return to shareholders, nor does it pay Federal income taxes on its excess revenue.

Mr. Foran stated that ownership would afford LIPA the ability to decide all plant operational and investment issues. He also indicated that LIPA would have complete control with regard to the ability to retire units, to expand and to make more effective use of the generation sites. Mr. Foran explained that LIPA would be able to decide such matters as the measures and expenditures needed to control emissions. He added that LIPA would realize an advantage concerning repowering, i.e., the improvement of a plant's efficiency through investment. He noted that after it determined whether the investment was in the best interest of its ratepayers, LIPA could invest at its lower cost of capital. He indicated that LIPA may derive additional benefits from the favorable terms obtained as a result of the services of a generation manager being competitively bid. Lastly, he noted that LIPA would have greater ability to directly influence the course of competition in the Long Island power market, in the best interest of its ratepayers, including the sale of generation assets to third parties.

Mr. Foran outlined potential disadvantages from the acquisition, such as LIPA's assumption of new operational responsibilities, and possible problems related to the transition to another generation manager or related to KeySpan operation in a new role. He also observed that the fair market value determined by the investment bankers may be higher than LIPA would expect, and there would be significant time, commitment and cost associated with the exercise of the right.

Mr. Carter restated that LIPA currently bears responsibility for the costs of the assets as if LIPA owned them. He indicated that LIPA pays for the routine maintenance and insurance, and LIPA pays for the costs associated with capital improvements at KeySpan's cost of money, including such costs as those for environmental compliance, refurbishment and life extensions. He added that LIPA must also pay for any uncovered catastrophic losses.

Mr. Carter noted that LIPA must pay KeySpan at present value for the remaining capacity charges associated with a plant that LIPA may choose to retire. He observed that the KeySpan facilities have significant value to LIPA's ratepayers, and comparable alternatives are not currently available. He added that many of the existing facilities are located in load pockets and must be run to supply electricity to the local areas. He highlighted that the ownership of the assets would facilitate repowering, an approach whereby existing boilers would

be replaced by state of the art equipment to be used with the existing steam turbines and generators.

Mr. Carter indicated that repowering would increase the capacity of the facility, improve upon the environmental emissions and improve upon the fuel costs as a result of increased efficiency. He also stated that the exercise of the purchase right will not preclude the construction of future capacity involving conventional and alternative technologies to meet increasing loads on Long Island.

Mr. Foran reaffirmed that the GPRA has defined fair market value as a negotiated value that must reflect the terms of the existing PSA, and such valuation assumes the existence of a willing buyer and seller. He added that the PSA specifically limits the value of the assets. He noted that the rates paid by LIPA under the PSA are set by the FERC, and the rates may only be reset every five years on a cost of service basis, which means that they may recover their investment and the cost of running the assets, including a regulated rate of return. He also stated that the PSA limits opportunities that a new buyer may have to increase its profits, as a new buyer could not modify or expand the facilities without LIPA approval. He indicated that operational efficiencies which should increase profits would result in a lower cost of generation which would be reflected in rates reset by the FERC every five years. He observed that accordingly the savings would accrue back to LIPA and its ratepayers.

Mr. Foran remarked that there is little, if any, opportunity for a third party who desires to purchase KeySpan's generation to profit as compared to other sales of generation assets around the country. He indicated that in those other sales the buyers could profit because they could sell power at market rates. Thus, he noted, the constraints set by the PSA have made the fair market value of the KeySpan assets more closely resemble their book value.

Mr. Foran noted that KeySpan has been investing capital in an amount less than depreciation going forward; and therefore the amount of assets upon which a return could be received under FERC regulation is decreasing, gradually reducing the net income. He reiterated that there are considerable cost savings available from LIPA ownership due to LIPA's lower cost of capital and avoidance of Federal income taxes. He then demonstrated what the projected costs through 2003 to LIPA and its ratepayers would be under the status quo as opposed to the status after the acquisition of KeySpan Generation at book value. He noted that, unlike KeySpan, LIPA's capital structure consists of only two components: first the interest payments on the issuance of debt via tax free municipal bonds; and second, the repayment of the principal of the debt. He indicated that LIPA could borrow at the lower interest rate of approximately 4 ½ percent as opposed to the 7 ¼ percent borrowing cost to KeySpan. He noted that LIPA's customers would receive an annual savings of about \$25 million if LIPA purchased the assets at book value as opposed to KeySpan's ownership of them at book value.

Mr. Carter commented that LIPA issued a Request For Proposals (RFP) in February of 2001 for a new manager of generation for an initial two year period on a managed cost basis, with a subsequent five year term to include incentives. He added that LIPA has received many excellent proposals from reputable and experienced firms in this area. He stated that the firms have made proposals to the LIPA staff, that LIPA has begun an interviewing process, and that a recommendation for a new generation manager will be forthcoming.

Mr. Klimberg stated that after extensive and very careful evaluation of the advantages and disadvantages of the acquisition of KeySpan's on-Island generation, the LIPA staff and consultants now recommend that the Board exercise its right under the GPRA to acquire KeySpan Generation, LLC. Mr. Klimberg suggested that in the following two months, LIPA conduct public outreach and public hearings, as well as complete its evaluation of the generation manager candidates. He added that LIPA's staff and consultants recommend that at LIPA's February meeting the Board decide whether to approve giving notice to KeySpan of the exercise of the purchase right and that the Board select the generation manager. He reiterated that the Public Authorities Control Board must give its approval for the exercise of the right to be effective, and that there is a deadline of May 27, 2002 on the exercise of the right.

Mr. Kessel questioned whether the potential existed for wholesale competition on Long Island given its unique geographical configuration and its load pocket constraints. Mr. Klimberg responded that other areas of the country,

particularly California, have experienced difficulties when attempting to implement effective competition. He noted that Long Island has additional difficulties that would make competition less likely, since it is an island with limited physical electrical transmission interconnections, and there are substantial load pockets and limitations on moving power around the Island. He added that competition would be less likely if KeySpan were to continue to own the generation, because the 4000 megawatts is such a substantial part of the total generation on Long Island. He noted that in order to have the flexibility to implement competition, LIPA would need to own the generation and over time sell plants to develop a competitive market while further developing its transmission facilities. He remarked that KeySpan would not be similarly inclined to sell generation assets or otherwise promote competition.

Chairman Kessel asked whether the substantial addition to LIPA's debt portfolio would adversely affect LIPA's financial rating. Mr. Foran explained that the primary issue is whether the assumption of the debt results in the reduction of the rates and charges passed through to the customers, causing a positive impact to LIPA's rating. He further explained that should the amount of debt that LIPA had to issue lead to increased costs, the result to LIPA's rating could be negative. He remarked that other factors would also be considered when evaluating the effect of the debt upon LIPA's financial rating, namely factors related to LIPA's control of its destiny.

Chairman Kessel asked whether discussions have been held with the major agencies that rate LIPA bonds concerning the effects of adding to LIPA's debt portfolio. Mr. Foran answered that those conversations would be held.

Chairman Kessel inquired as to whether there is the potential for rate savings beyond the estimated \$25 million based upon a purchase at book value of KeySpan Generation. Mr. Carter responded that savings may be realized in regard to the overhead costs that are passed through from KeySpan to LIPA under the current arrangement, and savings may be realized from future approaches to the operation and maintenance of the plants. He also indicated that there would be savings from repowering, not only due to LIPA's lower cost of money, but also from improved efficiency and reduced fuel costs. He indicated that additional savings could be obtained from LIPA's engagement of a generation manager based upon the competitive bid process.

Chairman Kessel asked whether there would be financial benefits or penalties if LIPA chooses not to exercise the right. Mr. Carter indicated that KeySpan could repower and achieve improved efficiencies, but this would be at higher cost of money than LIPA, and LIPA would not receive the other benefits that he had addressed.

Mr. Foran emphasized that the GPRA gives LIPA a favorable methodology in determining fair market value. He added that while LIPA could negotiate a purchase of the same generation business from KeySpan in the future, LIPA

would forego its current favorable terms and negotiating position under the GPRA.

Trustee Polimeni remarked that he felt positive about the acquisition, but there are some negatives. He asked whether LIPA's experts could identify the generation facilities that could be sold off to promote competition without impacting the transmission. He requested that the issue be further analyzed to consider the relative interest rates in LIPA's determination of the economic value of the exercise of the purchase right. Mr. Foran agreed. Trustee Polimeni requested that additional information be provided concerning other benefits and savings that LIPA could anticipate through the installation of new equipment at existing plants without the creation new generation. Mr. Klimberg responded that the Board would be briefed on the matter.

Trustee Akeson thanked Mr. Foran and the consultants for providing their expertise on the matter. She noted that the purchase right is a one time option which must be exercised. She added that although the matter has been evaluated in a thorough and timely manner, the Board would be asked to approve exercise of the right prior to ascertaining the fair market value of the generation. She expressed concern that although the PSA offers a favorable method of evaluation of KeySpan Generation, the respective investment bankers may not reach an agreement on the value, which would result in a third party investment banker being called upon to decide the issue. She asked whether the process set forth pursuant to the GPRA for the investment bankers to either negotiate terms or for

a third party to be selected to make the decision, could take years. Mr. Klimberg answered that it would not.

Trustee Affrunti inquired whether there will be assurance on the reliability of a new generation manager. He asked whether a savings to the ratepayers is required for approval by the Public Authorities Control Board, as LIPA would have to exercise the right without knowing the price. Mr. Klimberg responded that the Public Authorities Control Board is responsible for the approval of LIPA projects, and one of the criteria that the PACB considers in that regard is whether the project provides ratepayer savings.

Trustee Auerbach stated that LIPA should probably proceed with the purchase of the generation assets based upon his evaluation after serving on the investigative committee, meeting with potential plant operators, analyzing the economics and considering the staff recommendations. He recommended that KeySpan be notified of LIPA's intent to proceed, but that LIPA should consider deferring the decision if KeySpan agreed to extend the time to exercise the right. He expressed concern regarding the complicated and politically charged nature of the decision.

Trustee Hermann indicated that he has numerous questions pertaining to the effect of the acquisition upon competition. He stated that his questions relate to the tax savings to LIPA, the maintenance costs that LIPA currently pays to KeySpan, uninsured exposures LIPA could face upon the exercise of the right,

and the costs to LIPA should LIPA opt to apply the same money to stimulate competition via the construction of new plants as opposed to acquiring the KeySpan generation. He also inquired whether LIPA and KeySpan could negotiate a price for the purchase of the generation, while maintaining KeySpan as the operator. He noted that he would submit his questions in written form.

Chairman Kessel requested that any questions be submitted to Mr. Klimberg by the first or second week of January 2002. He indicated that all questions and requests by the Board would be answered completely.

Trustee Nugent expressed concern regarding the short period of time within which the Board must make its decisions on exercise of the right and selection of a generation manager, and within which the approval of the Public Authorities Review Board must be obtained. She requested further information concerning the qualifications of the prospective generation managers. She noted the importance of maintaining confidence in those responsible to deliver energy to the people of Long Island for LIPA.

Mr. Klimberg responded that the Board would be afforded the opportunity to meet with operation manager candidates and review their submissions in order to obtain any additional information that may be needed. He noted that the GPRA committee has already met with and interviewed the proposers.

Trustee Sinnreich indicated that Trustee Doherty had expressed the most reservations as to the acquisition, and he was not present at this meeting. Trustee Sinnreich asked on behalf of Trustee Doherty why LIPA should undertake all of the risks inherent in the ownership of the plants, given that LIPA has another 25 years under an existing agreement (PSA) which is regulated by the FERC and many of the plants are old; and where there is potential for changes in the technology, marketing and production of energy. He noted that the long-term dangers could outweigh what may be short-term and minor economic gains.

Mr. Klimberg answered that under the current arrangement, LIPA does not control the assets, and KeySpan's approval is required for improvements, expansions or repowering. He stated that, accordingly, LIPA does not control the vast portion of resources that it relies on daily. He added that the generation comprises approximately 92% of the on-Island supply, and LIPA would forego the benefits of controlling that generation if it did not exercise the purchase right.

Mr. Klimberg reiterated that if the current arrangement with KeySpan were to continue, LIPA would forego the opportunity to facilitate competition on Long Island; and a competitive market would not develop on Long Island for the next twelve years under the current PSA, plus potentially an additional fifteen years thereafter.

Mr. Klimberg stated that although the current PSA arrangement with KeySpan is beneficial to LIPA, and the decision to enter into a long-term PSA with

KeySpan in 1998 was sound, the benefits available under LIPA ownership of the generation will exceed the current benefits.

Mr. Foran stressed that a key consideration is evaluating the advantages of buying the KeySpan Generation, depending upon the price paid, is the repowering in the future. He noted that KeySpan's disadvantage in repowering is clear compared to LIPA, since LIPA could use its lower cost of capital and avoid the payment of Federal income taxes.

Mr. Carter remarked that the annual savings would not be short-term. He added that one of the overriding considerations is that LIPA's ability to make decisions in the interest of its ratepayers will be enhanced by LIPA ownership of the generation.

Trustee Sinnreich commented that although the Board and Chairman Kessel appreciate the outstanding job that KeySpan and its workers have done, KeySpan has been a difficult business partner in some important ways. He noted that LIPA is completely dependent upon KeySpan for the generation of power. He further noted that KeySpan, as a private entity, has a mission that is different from LIPA. He added that KeySpan is also a competitor of LIPA, and that the competition would likely increase in the future. He stated that the close relationship whereby KeySpan has been both a business partner and a competitor of LIPA has led to serious differences where LIPA could not always vigorously assert its rights. He commented that the disentanglement of the

relationship would offer LIPA the freedom to operate in the interest of its customers. Further, he noted that LIPA has previously had leverage against KeySpan due to the existence of the purchase right. He remarked that LIPA would lose this leverage if the right were not exercised.

Trustee Polimeni inquired as to the cost to LIPA to duplicate the generation on its own, given the problems with siting, the cost of duplication and the time limitations. He further queried whether the construction of new facilities would generate greater savings.

Mr. Klimberg answered that the duplication presented substantial practical and financial considerations. He reminded the Board that LIPA would have the continued financial obligation to pay the capacity charges on the existing plants under the PSA. He also indicated that LIPA would incur capital charges associated with the construction of additional plants, and there would be environmental concerns associated with the siting of additional generation. He noted that it would be understandable to investigate the matter further, but it did not seem to offer real potential.

Trustee Polimeni asked whether the valuation of the assets would be offset by the poor condition of some of the power plants. Mr. Foran answered that the PSA drives the value to LIPA and to KeySpan, and it defines what KeySpan and its shareholders can recover. He added that the potential value would be affected

to the extent that KeySpan has invested less in the old plants than they are depreciating.

Chairman Kessel requested that Mr. Cunningham and Ms. Stella during January and February set up a series of public sessions in Nassau and Suffolk Counties and the Rockaways, including public notices, in order to receive public input on this important matter. The Chairman invited all of the Trustees to attend those public sessions. He noted that further discussions would be held by the Board after the public sessions. The Chairman highlighted the importance of affording the public with the opportunity to understand the issues and to express their views.

Chairman Kessel indicated that this was also an important issue for KeySpan. He commended Mr. Catell, the Chairman and CEO of KeySpan, for his management skills, and he noted that Mr. Catell has remained in constant communication regarding this matter. Chairman Kessel remarked that uncertainty existed within KeySpan. He noted that LIPA must act responsibly even though there may be issues concerning KeySpan that have naturally occurred due to the close relationship and proximity of operation of the two energy companies. He commented that despite some tensions that exist, KeySpan continues to run LIPA's electric transmission and distribution system with great expertise. He reiterated his concern that the Board recognize and respect the existing sensitivities and concerns. He noted that the KeySpan employees are also LIPA's employees, and many having expressed their concerns to the Chairman.

The Chairman remarked that the decision process on the purchase right will be deliberative. He requested that the LIPA staff and consultants prepare an analysis of the advantages and disadvantages of KeySpan continuing to manage the generation in the event that the right is exercised as opposed to a new manager.

Chairman Kessel noted that beginning in January of 2002, the Board's policy to permit public comment on action items on the agenda prior to the Board's vote will take effect.

The Chairman reported that in a "straw vote" the Connecticut Siting Council approved the proposed cross-Sound cable from New Haven to Shoreham by a vote of six to one with one abstention. He stated that a final vote is scheduled for January 3, 2002, and he hopes that the Council will affirm the approval.

Chairman Kessel indicated that he hopes that the cross-Sound cable will be in operation by the summer of 2002, but he noted that approval by the Army Corps of Engineers is also pending. He thanked the Board for staying with this project after its initial rejection. The Chairman commended Mr. Grilli, LIPA's Chief of Staff, for his contributions to the project. He noted that Mr. Grilli was hired to oversee the day-to-day activities of the LIPA staff, but he has also done an extraordinary job regarding the power plant and cross-Sound cable projects.

Chairman Kessel further commended Mr. Bolbrock, Mr. Klimberg and LIPA's consultants for their contributions to the cross-Sound cable project. He stressed the importance of the project to the reliability of the system on Long Island.

Chairman Kessel reported that progress has been made on LIPA's Powering Long Island turbine project. He noted that recent hearings were held by the Department of Public Service and the Department of Environmental Conservation. He further noted that construction was about to begin in Far Rockaway on a unit that could be operational by spring of 2002. Chairman Kessel thanked Mr. Grilli for administering the project, without which LIPA may not have enough electricity to meet next summer's demand.

The Chairman commended Mr. Bolbrock, Mr. Zaweski and LIPA's Clean Energy Team for assembling the \$37 million Clean Energy Initiative budget. He noted that LIPA is increasingly seeing results from this program. He invited the Trustees to visit the fuel cell farm in West Babylon where seventy-five fuel cell units are now generating electricity into the grid.

Chairman Kessel indicated that LIPA has announced the second phase of the Solar Pioneer Program, in which LIPA has become one of the only utilities to pay for the installation of solar roofs on residences to provide electricity. The Chairman indicated that LIPA has announced a new lottery for installation of thirty additional residential solar roofs and twenty more solar roofs for low-income homes, in addition to the Falla project. He added that the rebate available

for solar energy has been doubled from \$3 to \$6 per watt, so that the maximum incentive is \$60,000. He acknowledged that more could be done for solar energy, and he invited those who feel that LIPA could contribute more to help LIPA by promoting the new programs and contributing funds to add additional roofs. He noted that LIPA's goal continues to be for Long Island to have 10,000 solar roofs by 2010.

Chairman Kessel wished all in attendance, the Board and LIPA's customers a happy and healthy holiday season.

Chairman Kessel entertained a motion to go into executive session to discuss litigation and personnel issues.

Upon motion duly made and seconded, the following resolution was approved unanimously:

577. EXECUTIVE SESSION - PURSUANT TO SECTION 105 OF THE PUBLIC OFFICERS LAW

RESOLVED, that pursuant to Section 105 of the Public Officers Law, the Trustees of the Long Island Power Authority shall convene in Executive Session for the purpose of discussing litigation and personnel matters.

* * *

At 12:55 p.m. the open session of the Board of Trustees was temporarily adjourned and an executive session of the Board of Trustees was convened.

At 1:15 p.m. the executive session was adjourned and the open session was reconvened.

Chairman Kessel entertained a motion to adjourn. Upon motion duly made and seconded, the Board voted unanimously to adjourn the meeting at 1:16 PM.

Respectfully submitted,

Stanley B. Klimberg