

**LONG ISLAND POWER AUTHORITY  
MINUTES OF THE 146th MEETING  
HELD ON AUGUST 29, 2002**

**Pursuant to notice dated August 26, 2002, the Long Island Power Authority (the "Authority") was convened for the one hundred and forty-sixth time at 9:20 AM at Omni Teleconference Center in Uniondale, NY.**

**The following Trustees of the Authority were present:**

**Richard M. Kessel, Chairman  
Patrick Foye, Deputy Chairman  
Michael Affrunti  
Nancy A. Akeson  
Harvey Auerbach  
Thomas A. Doherty  
James Herrmann  
Edna Gerrard  
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, Anastasia Song, Acting Chief Financial Officer, Bert Cunningham, Vice President - Communications, Bruce Germano, Vice President – Retail Services, Kenneth Kane, Controller, and Kathleen Stella, Secretary to the Board of Trustees.**

Upon determining that a quorum was present, Chairman Kessel called the meeting to order.

Chairman Kessel stated that the first item on the agenda is approval of the minutes of the June 27 Board meeting. Upon motion duly made and seconded, the following resolution was approved unanimously:

**598. APPROVAL OF MINUTES AND RATIFICATION OF ACTIONS TAKEN AT THE JUNE 27, 2002 MEETING OF THE BOARD OF TRUSTEES OF THE LONG ISLAND POWER AUTHORITY**

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**RESOLVED, that the Minutes of the meeting of the Authority held on June 27, 2002, 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 Board consideration of a resolution to approve a floating to fixed rate swap agreement and the issuance of refunding bonds. The Chairman indicated that the Board is being requested to authorize a LIPA agreement with UBS AG, the parent corporation of UBS PaineWebber Inc., to provide UBS AG an option to enter into a floating to fixed rate swap agreement, and to give preliminary approval of related refunding bond transactions. He stated that this deal will afford LIPA the opportunity to utilize the low market interest rates to access cash without adding to LIPA's level of debt and with only minimal risks.

Chairman Kessel asked Ms. Song to deliver a presentation concerning the proposal.

Ms. Song stated that she regretted this agenda item was accelerated, but the transaction is both time and interest rate sensitive. She noted that a detailed presentation was recently given to the Board's Finance and Audit Committee, which recommended that the matter be accelerated. She thanked Ms. Horigan, as well as Mr. Fink of Morgan Stanley (LIPA's financial advisor), for their work in expeditiously preparing the matter for Board consideration.

Ms. Song stated that the proposal must also be approved by a number of regulatory bodies, including the Office of New York State Comptroller and the Public Authorities Control Board. She continued that if the resolution is approved by LIPA's Board, LIPA plans to brief the Comptroller's Office and the Division of Budget, and LIPA will promptly file an application with the Public Authorities Control Board, which is scheduled to meet on September 18, 2002.

Ms. Song stated that the challenge to LIPA concerns how LIPA monetizes the value embedded in its financial structure under current interest rate and timing conditions without the benefit of some traditional financial tools. She continued that LIPA issued a request for proposals from six senior underwriters, with four banks responding with a "swaption" proposal, and UBS AG was selected.

Ms. Song stated that the transaction involves a sale to UBS AG of a right to put LIPA into an interest rate swap at the call date of the 2029 bonds, which is in June of 2003. She further stated that in exchange for that right, UBS AG would pay LIPA approximately \$78 million (based upon current market conditions) upon the closing of the deal. She noted that this number fluctuates with the interest rate, and it will change by the time LIPA is able to consummate this proposal. She indicated that LIPA had previously completed other interest rate swaps, and that the proposal is not as complicated as it may seem.

Ms. Song indicated that there are three key risks, in addition to some lesser risks, namely a basis risk in connection with the LIBOR swap, counterparty risk, and the risk associated with immediate action as opposed to waiting. She explained that the basis risk is the risk that the payment received by LIPA will not match LIPA's floating payments on its bonds, and that this risk exists in LIPA's current portfolio.

Ms. Song explained that the counterparty risk is the risk that another party will fail to perform its obligations, which is not substantial in this case because UBS AG is a AAA/AA+ rated counterparty with a strong credit rating.

With respect to the third type of risk, Ms. Song emphasized that LIPA has the opportunity to monetize a substantial sum due to the very low interest rates. She added that interest rates are likely at the low end of the current cycle, and the value of this deal would diminish as interest rates rise. She indicated that the

risk that LIPA may not maximize value by acting immediately is outweighed by the risk that the value of the deal will decline to near zero if LIPA were to wait.

Deputy Chairman Foye asked what the effect of a decline in UBS AG credit rating would be for an instrument that is outstanding until 2029. Ms. Song answered that there are collateralization provisions in the event of a downgrade of counterparty, and LIPA has the right to enter into an offsetting swap to remove itself from the swap position at any time, although there are associated costs.

Trustee Polimeni asked whether UBS AG would remain the counterparty to the swap. Ms. Song responded that UBS AG would remain the counterparty for the duration of the swap and its credit will be at stake, although UBS AG would likely hedge its position immediately to avoid a large open position.

Trustee Polimeni inquired what will occur if the credit of parties to the UBS AG hedges is downgraded. Ms. Song answered that UBS AG would be responsible, but UBS AG is backed by a Swiss parent with the strongest credit in the mutual derivative market.

Deputy Chairman Foye asked what the transaction costs will be. Mr. Fink responded that there are a number of costs involved in the transaction, including the cost for underwriting the bonds and the fee for entering into the swaption.

Deputy Chairman Foye asked whether the proposed transaction would be considered reasonable and customary by industry standards. Mr. Fink answered

that the transaction is normal by industry standards, but it is somewhat unique in that it is an off-market swap where LIPA will pay for the right to monetize the present savings against the risk that UBS AG will take. He added that this type of transaction has become common, and Morgan Stanley has entered into numerous similar transactions as a principal. He indicated that the size of the transaction is unusual, but that this is not a negative factor.

Mr. Fink stated that the counterparty risk is a lesser concern due to the fact that UBS AG will be paying such a large amount up front and paying all the costs of the transaction, although it would normally be a concern to have counterparty risk for approximately 27 to 29 years.

Deputy Chairman Foye asked whether the gains and losses on the transaction are marked to market. Mr. Fink responded that they are so marked for UPS AG. Ms. Song added that LIPA will book the income over the life of the underlying bonds. Mr. Kane indicated that LIPA can potentially receive \$88 million amortized against interest expense over the life of the bonds.

Trustee Polimeni asked how LIPA will book the income. Mr. Kane responded that the income would be deferred until such point as UBS AG either exercises or declines to exercise the option in June of 2003, and LIPA may recognize approximately \$88 million if the option is not exercised. Ms. Song indicated that if the option is exercised, the income will be pro-rated over the life of the underlying bonds, amounting to approximately \$2 to \$3 million per year.

Trustee Polimeni asked whether LIPA would have any reserves against its potential exposure. Mr. Fink replied that LIPA's only exposure between the present and June 1, 2003, will be if UBS AG elects to exercise the option and LIPA defaults, in which case LIPA will owe PaineWebber money. He added that it is highly unlikely LIPA would default, and UBS AG has accordingly not required any reserve.

Deputy Chairman Foye asked whether the transaction is permitted under LIPA's existing agreements and covenants. Ms. Song answered that LIPA bond counsel has drafted the resolution and fully reviewed the matter. Chairman Kessel noted that the resolution includes a one-time waiver of limits previously adopted by the Board.

Trustee Herrmann asked whether LIPA's consultants agreed with this evaluation. Mr. Fink responded affirmatively, and he noted that there are negatives to waiting until June 1, 2003 given the volatility of the market.

Trustee Polimeni asked whether it is possible to lock in the rate before September. Mr. Fink responded that LIPA cannot enter into the proposed swaption until PACB approval is obtained.

Chairman Kessel stated that LIPA will immediately apply for PACB approval if the Board approves the resolution, but LIPA must wait for the necessary approvals before entering into the transaction.

Trustee Polimeni asked who will decide when the deal is to close. Ms. Song responded that once the PACB gives its approval, LIPA will schedule the closing based upon the market conditions, preferably within 24 to 48 hours after obtaining PACB approval.

Deputy Chairman Foye inquired as to what, if any, the reactions of the rating agencies will be. Mr. Fink responded that their reaction is believed to be positive, but they may have questions relating to the credit exposure to UBS AG over a protracted period of time. He continued that this concern is mitigated by the large up-front payment to LIPA.

Trustee Doherty asked whether other alternatives are available to LIPA. Ms. Song responded that other potential alternatives to extract value are not feasible for LIPA. She explained that the tool of refunding operates similarly to a mortgage refinancing, in that debt cost may be lowered by calling in old bonds and issuing new ones, but LIPA cannot use this method because LIPA's bonds are not callable at this time. She continued that another possible option would be to hold an advance refunding where LIPA would issue new bonds with a lower interest rate, and invest the proceeds until the first call date when LIPA would retire those bonds. Ms. Song stated that the shape of the yield being steep and low on the short end creates a situation known as negative arbitrage, where LIPA could not earn enough in the short term interest rate markets to cover the cost of the long term debt. Ms. Song indicated that should interest rates substantially spike between the closing date and the call date, the option may expire unexercised, and LIPA would keep the entire premium.

Chairman Kessel thanked Ms. Song and LIPA's financial team and advisors for their innovative and creative proposal. The Chairman stated that several promising proposals were submitted to LIPA by investment banking firms in response to LIPA's RFP, and that these proposals were reviewed by Ms. Song, LIPA's financial staff and advisors. The Chairman indicated that the UBS AG proposal was selected because it maximizes LIPA's financial benefits and has the most merit. He stated that LIPA should proceed with this transaction since it is a unique opportunity to maximize value in the current interest rate environment, and hopefully add nearly \$80 million without increasing LIPA's debt.

Chairman Kessel indicated that after the transaction closes, he plans to conduct a review with Ms. Song and LIPA's financial team, and presentations will be given to the Finance and Audit Committee and the Board in either September or October concerning the use of the added cash. The Chairman stated that there are numerous possibilities, including the retirement of debt, capital expenditures, addressing the Shoreham debt issue, maintaining the rate freeze and a host of other issues. He added that no action will be taken until a full plan is presented to the Board.

Trustee Polimeni stated he was amazed at the creativity of the unique transaction and he sees little if any downside. He added that the Board is comfortable with this transaction, having been briefed several times.

Trustee Doherty also noted that the Finance and Audit Committee had been thoroughly briefed on the matter. He added that this transaction is not unusual in the gigantic swap market involving billions of dollars, although it is unique in some ways. He stated he is comfortable with the transaction, and LIPA's staff and advisors have been professional and thorough.

Chairman Kessel thanked Trustees Doherty and Polimeni, Deputy Chairman Foye and the Finance and Audit Committee for dedicating their time to review this complicated transaction.

Trustee Gerrard also thanked Ms. Song and the Finance and Audit Committee for their clear and concise presentation of the matter to LIPA's Board.

Trustee Akeson stated that a full detailed analysis was presented to the Board, and the benefits of the transaction greatly exceed the risks. She thanked Ms. Song for her proactive approach to the matter.

Trustee Polimeni inquired whether there is a point at which an increase in basis points will force LIPA to not proceed with the transaction. Ms Song responded that there could be many technical factors that affect daily rates and longer term risks, but a floor of \$42 million is included to ensure that LIPA would not simply proceed with the transaction under any circumstances. She added that the Board will be contacted if there are any material changes in circumstances.

Deputy Chairman Foye stated that the presentation was creative, clear and candid in terms of its assessment of the potential benefits and risks.

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

**599. APPROVAL OF FLOATING TO FIXED RATE SWAP AGREEMENTS AND RELATED OPTION AGREEMENT; PRELIMINARY APPROVAL FOR THE ISSUANCE OF REFUNDING BONDS**

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**WHEREAS, the Electric System General Revenue Bond Resolution (the "General Bond Resolution") adopted by the Long Island Power Authority (the "Authority") on May 13, 1998 permits the Authority to enter into Financial Contracts (as defined therein), which include, among other agreements or arrangements, interest rate caps or collars and forward rate, future rate and certain swap agreements with Qualified Counterparties (as defined therein); and**

**WHEREAS, the Authority has determined that the use of such agreements is appropriate in certain circumstances but recognizes that certain risks can arise in connection with their use; and**

**WHEREAS, under current market conditions it is expected that the Authority may be paid a significant cash premium by entering into an agreement with UBS AG, the parent corporation of UBS PaineWebber, relating to a planned refunding of the Authority's Series 1998 A Bonds maturing in 2029 (the "2029 Bonds"), which agreement would permit UBS AG to elect to enter a so-called "floating to fixed rate" interest rate exchange agreement or swap agreement (the "Swap Agreement") providing for an obligation by the Authority to make payments to the other party thereto based upon a fixed rate equal to that of the 2029 Bonds (5.50%) and for such other party to make payments to the Authority based upon a floating rate index specified therein; and**

**WHEREAS, to implement such Swap Agreement it will be necessary to refund the 2029 Bonds through the issuance of variable rate refunding bonds and to refund certain other maturities of those Series 1998 A Bonds, Series 1998 B Bonds and Series 2000 A Bonds that are insured by FSA (the "FSA Insured Bonds") in order to assure that sufficient credit enhancement and liquidity facilities will be available to support such refunding bonds which will be approved by separate resolution for which certain approvals will be required;**

**NOW, THEREFORE, BE IT RESOLVED BY THE TRUSTEES OF THE LONG ISLAND POWER AUTHORITY, AS FOLLOWS:**

1. The Authority hereby determines that entering into a floating to fixed rate swap agreement and the related option agreement with UBS AG for the purposes and in the manner described above would assist the Authority in meeting its objectives under the Long Island Power Authority Act (the "Act"). In so determining, the Authority acknowledges that agreements such as the floating to fixed rate swap agreement and related option agreement authorized hereby entail the acceptance of certain risks, such as (i) basis risk (e.g., where the relationship between the interest rates applicable to any variable rate portion of the refunding Bonds and the interest rate index which forms the basis of the payments to the Authority by the other party to the floating to fixed rate swap agreement diverges from the relationship assumed at the time of the agreement), (ii) tax risk, which could occur if there were to be a change in law or other event affecting all tax-exempt bonds, all public power bonds, or the Authority's bonds in particular resulting in the variable rate refunding bonds trading at higher than a tax-exempt rate, in which event the payment by the counterparty of 67% of LIBOR could be insufficient to pay the debt service on the variable rate refunding bonds, (iii) counterparty risk (e.g., a default by a counterparty to a floating to fixed rate swap agreement), (iv) the risk of escalated costs for ancillary services in connection with variable rate bond issues (e.g., cost of credit and liquidity support, remarketing or dealer costs and similar costs), and (v) if the option is exercised by the counterparty, the Authority will have foregone the right to refund the 2029 Bonds at a lower interest rate than that which is reflected by the upfront cash premium. The Authority has considered and agrees with the advice of the Authority's staff and the Authority's financial advisor, Morgan Stanley & Co. Incorporated, that such risks (i) are manageable and (ii) are reasonable in relation to the benefits achievable by entering into floating to fixed rate swap agreements in the manner contemplated herein.

2. The Chairman and Chief Financial Officer are each hereby authorized to execute and deliver one or more floating to fixed rate swap agreements and related option agreements with UBS AG based upon the proposal received, which floating to fixed rate swap agreements and related option agreements shall be consistent with the Authority's guidelines relating to such agreements, provided that the limitations applicable to the maximum notional amount on agreement with any single party shall not be applicable to the agreements hereby authorized, and shall be in such form as such officer shall approve, such execution to be conclusive evidence of such approval. All such floating to fixed rate swap agreements and related option agreements in the aggregate shall (i) be in a notional amount that is equal to the principal amount of the variable rate bonds expected to be issued to refund the 2029 Bonds, (ii) shall have a term approximately equal to the expected term of the variable rate bonds expected to be issued to refund the 2029 Bonds or such shorter term as the Chairman or Chief Financial Officer shall specify, and (iii) result in a cash payment to the Authority of not less than \$42 million. The Chairman and Chief Financial Officer are further authorized to execute and deliver an International Swap Dealers Association Master Agreement with UBS AG, together with such schedules and confirmations relating thereto in substantially the form presented to this meeting and with such changes and additions to and omissions from such form as the

officer executing the same deems necessary or appropriate, such execution to be conclusive evidence of such approval.

3. The Chairman and Chief Financial Officer are directed to make provision for the application of any moneys received by the Authority under any floating to fixed rate swap agreement and related option agreement in a manner consistent with the Act and the General Bond Resolution and to make provision for payments to be made by the Authority under any floating to fixed rate swap agreement with moneys available therefor under the General Bond Resolution.

4. The Chairman and Chief Financial Officer are hereby authorized to submit an application to the Public Authorities Control Board in connection with the transactions described herein including the issuance of bonds for the purpose of refunding the 2029 Bonds and the FSA Insured Bonds, provided that the terms of such refunding bonds shall be approved by separate resolution of the Trustees.

5. The Chairman and Chief Financial Officer are hereby authorized to execute and deliver any and all documents and instruments and to do any and all acts they deem necessary, convenient or appropriate in order to implement the terms of, and the transactions contemplated by, this resolution and each of the agreements authorized hereby.

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Chairman Kessel stated that the next item on the agenda is Board consideration of a resolution to approve LIPA's participation in the retirement incentive program. The Chairman indicated that the New York State Legislature enacted a retirement incentive law which makes available a 2002 targeted retirement incentive program to eligible State employees and employees of participating employers (including LIPA) in the New York State and Local Employees' Retirement System. He continued that the legislation permits participating employers to elect to provide special retirement incentive benefits to regular retirement plan members who are at least age fifty with ten years of service credit or at least age fifty-five with five years of service credit, commencing on or before December 2, 2001 and extending no later than December 31, 2002. He stated that the incentive program provides an additional

month of service credit for each year of service, up to a maximum of 36 months credit.

Trustee Doherty asked whether the program terminates for eligible employees who do not elect to retire by December 31, 2002. Chairman Kessel answered yes.

Trustee Doherty asked whether many LIPA employees would avail themselves of the incentive program. Chairman Kessel responded that there are several eligible LIPA employees, but it is unlikely that more than a couple will retire.

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

**600. RESOLUTION APPROVING LIPA'S PARTICIPATION IN 2002 TARGETED RETIREMENT INCENTIVE PROGRAM**

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**BE IT RESOLVED** that the Board of Trustees of the Long Island Power Authority does hereby elect to provide the benefits of Part A of Chapter 69 of the Laws, 2002, commencing on December 1, 2002 for all eligible employees who retire with an effective date of retirement set during the 31 day period beginning with and immediately following the commencement date and who are otherwise eligible as specified by Part A of Chapter 69, Laws of 2002.

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Chairman Kessel thanked the Trustees for their efforts to attend this meeting given the bad weather and the fact it was not a regularly scheduled Board meeting. The Chairman indicated that the meeting was scheduled to deal with pressing matters on a timely basis.

Chairman Kessel indicated that a complete report will be given concerning the summer at the September Board meeting. The Chairman stated that Long Island would have experienced rolling blackouts this summer had LIPA's Board not proceeded with the ten generation projects and the 200 MW of emergency generation from General Electric. He indicated that electric usage on Long Island has grown to an extraordinary level and LIPA cannot stand pat for next summer.

Chairman Kessel stated that he will address some overall issues that relate to demand and LIPA's direction for the future. The Chairman noted that LIPA's July 2002 sales were 21% higher than in July of 2001. He indicated that LIPA's margin of excess power supply would have disappeared had there been major plant or transmission system malfunctions. He noted that LIPA's margins were better this summer than last, although there were malfunctions to the Y-49 and Y-50 cables, and there was also a substation fire which caused damage to a major transmission line. He noted that blackouts would have occurred this summer if LIPA had stayed pat from last summer.

Chairman Kessel indicated that preliminary data indicates that LIPA may see additional growth in demand in 2003, exceeding the growth for 2002. The Chairman stated that revenues were higher than budgeted for the summer, but some of that will be offset by higher fuel costs. He continued that LIPA must deal with short and long term policy issues, including the encouragement of conservation. He indicated that LIPA must also examine the additional load caused by expanded development, especially on the East End of Long Island.

Chairman Kessel stated that the Board wisely approved the installation of a 22-mile underground transmission line, which extends from Riverhead to Southampton, and without which blackouts would have occurred on the South Fork. He noted that LIPA anticipated that the capacity of the line will be doubled from 69 to 138 kV and LIPA is considering accelerating that project to this winter based upon the growth in South Fork usage this summer.

Chairman Kessel indicated that LIPA issued a special East End energy alert for the first time. The Chairman thanked the Long Island Rail Road, the Hampton Jitney and all others who helped to encourage conservation. He continued that despite LIPA's conservation efforts using radio advertisements, signs, leaflets and other means, usage set an all-time record this summer.

Chairman Kessel stated that the Board will have to develop a number of strategies to deal with the growth in demand for electricity. The Chairman indicated that the proposed baseload generation projects may not be enough and LIPA cannot continue to simply build small generation units.

Chairman Kessel indicated that the cross-Sound Cable was ordered operational by the Department of Energy in emergency situations, and LIPA is obtaining clarification from the ISOs regarding its deployment. The Chairman noted that LIPA must be prepared for an additional heat wave, since summer is not yet over.

**Chairman Kessel stated that the next scheduled Board meeting will be at The Beach Club in the Rockaways at 1:00 PM on September 26, 2002. He noted that is will be the first LIPA meeting in the Rockaways, which is an important part of LIPA's community.**

**Chairman Kessel entertained a motion to adjourn. Upon motion duly made and seconded, the Board voted unanimously to adjourn the meeting at 10:06 AM.**

**Respectfully submitted,**

**Stanley B. Klimberg**