

## NEW ISSUE—Full-Book-Entry

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



## LONG ISLAND POWER AUTHORITY \$323,380,000 Electric System General Revenue Bonds, Series 2003C

### **Date of Delivery**

### **Maturity: As shown on inside cover page**

The Electric System General Revenue Bonds, Series 2003C (the "Offered Securities") will be issued only as fully registered bonds registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York, which will act as securities depository for the Offered Securities under the book-entry-only system described herein. Individual purchases of beneficial ownership interests in the Offered Securities may be made in the principal amount of \$5,000 or any integral multiple thereof. Beneficial Owners of the Offered Securities will not receive physical delivery of bond certificates. The Bank of New York, New York, New York, is the Trustee under the Resolution.

The Offered Securities are being issued for various capital purposes and for refunding purposes as described herein.

Interest on the Offered Securities is payable on September 1, 2003 and semiannually thereafter on each March 1 and September 1.

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

The scheduled payment of principal of and interest on the Offered Securities maturing on September 1, 2027 (4.7% coupon) and September 1, 2028 (5% coupon) when due will be guaranteed under an insurance policy to be issued by FINANCIAL SECURITY ASSURANCE INC. concurrently with the delivery of the Offered Securities.

The scheduled payment of principal of and interest on the Offered Securities maturing on September 1, 2015 (5% coupon), September 1, 2016 (5% coupon), September 1, 2028 (4.75% coupon), September 1, 2029 and September 1, 2033 when due will be guaranteed under an insurance policy to be issued by CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. concurrently with the delivery of the Offered Securities.

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### **MATURITY SCHEDULE — See Inside Cover Page**

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

The Offered Securities are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Hawkins, Delafield & Wood, New York, New York, Bond Counsel. Certain legal matters with respect to the Authority and LIPA will be passed upon by Stanley B. Klimberg, Esquire, General Counsel to the Authority and LIPA, and by Clifford Chance US LLP, New York, New York, Disclosure Counsel to the Authority and LIPA. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York, counsel to the Underwriters. It is expected that the Offered Securities will be available for delivery in book-entry-only form through The Depository Trust Company in New York, New York on or about May 15, 2003.

### **Citigroup**

#### **Bear, Stearns & Co. Inc**

**ABN AMRO  
Financial Services, Inc.**

**CIBC World Markets**

**Jackson Securities**

**Merrill Lynch & Co.**

**Quick & Reilly**

**RBC Dain Rauscher Inc.**

**UBS PaineWebber Inc.**

#### **Goldman, Sachs & Co.**

**Advest, Inc./Lebenthal & Co.**

**A.G. Edwards & Sons, Inc.**

**David Lerner Associates, Inc.**

**JPMorgan**

**Ramirez & Co., Inc.**

**Roosevelt & Cross, Inc.**

#### **Lehman Brothers**

**M•R•Beal & Company**

**First Albany Corporation**

**McDonald Investments, Inc.**

**Prager, Sealy & Co., LLC**

**Raymond James & Associates, Inc.**

**Siebert Brandford Shank & Co., LLC**

**Wachovia Bank, National Association**

Dated: May 7, 2003

## Maturity Schedule

**\$323,380,000**

### LONG ISLAND POWER AUTHORITY

#### Electric System General Revenue Bonds, Series 2003C

#### \$137,860,000 Serial Bonds

<b>Maturity September 1</b>	<b>Principal Amount</b>	<b>Interest Rate</b>	<b>Price or Yield</b>	<b>CUSIP*</b>
2013	\$ 8,875,000	4.250%	4.32%	542690UG5
2014	3,475,000	4.375	4.43	542690UJ9
2014	5,400,000	5.500	4.43 <sup>1</sup>	542690UK6
2015	1,345,000	4.500	4.51	542690UL4
2015 <sup>2</sup>	8,150,000	5.000	4.00 <sup>1</sup>	542690UM2
2016	1,715,000	4.500	4.59	542690UN0
2016 <sup>2</sup>	8,620,000	5.000	4.10 <sup>1</sup>	542690UP5
2017	10,030,000	5.500	4.67 <sup>1</sup>	542690UQ3
2018	11,365,000	5.500	4.72 <sup>1</sup>	542690UR1
2019	11,325,000	5.500	4.82 <sup>1</sup>	542690US9
2020	12,365,000	5.500	4.35 <sup>3</sup>	542690UT7
2021	4,080,000	5.000	100	542690UU4
2021	8,745,000	5.500	4.98 <sup>1</sup>	542690UV2
2022	13,710,000	5.000	5.03	542690UW0
2023	14,745,000	5.000	5.08	542690UX8
2024	10,625,000	5.000	5.13	542690UH3
2027 <sup>4</sup>	2,260,000	4.700	100	542690UZ3
2028 <sup>2</sup>	1,030,000	4.750	4.80	542690VB5

#### \$185,520,000 Term Bonds

- \$ 35,580,000 5% Term Bonds due September 1, 2027 – Yield 5.18%  
(CUSIP No. 542690VA7)
- \$ 17,740,000 5% Term Bonds due September 1, 2028 – Yield 4.69%<sup>1,4</sup>  
(CUSIP No. 542690VC3)
- \$ 36,645,000 5¼% Term Bonds due September 1, 2029 – Yield 4.64%<sup>2</sup>  
(CUSIP No. 542690UY6)
- \$ 95,555,000 5% Term Bonds due September 1, 2033 – Yield 4.82%<sup>1,2</sup>  
(CUSIP No. 542690VD1)

<sup>1</sup> Priced to first par call on September 1, 2013.

<sup>2</sup> Insured by CDC IXIS Financial Guaranty North America, Inc.

<sup>3</sup> Priced to first par call on March 1, 2008.

<sup>4</sup> Insured by Financial Security Assurance Inc.

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

## **LONG ISLAND POWER AUTHORITY**

333 Earle Ovington Blvd.  
Uniondale, New York 11553  
Telephone: (516) 222-7700  
Facsimile: (516) 222-9137

### **BOARD OF TRUSTEES**

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

Michael J. Affrunti  
Nancy Ann Akeson  
Harvey Auerbach  
Edna Gerrard  
Harriet A. Gilliam

James C. Herrmann  
Robert S. Maimoni  
Nancy Nugent  
Vincent Polimeni  
Jonathan Sinnreich

### **AUTHORITY MANAGEMENT**

Richard M. Kessel—*President and Chief Executive Officer*  
Seth D. Hulkower—*Chief Operating Officer*  
Anastasia Song—*Chief Financial Officer*  
Stanley B. Klimberg—*General Counsel*  
Edward J. Grilli—*Chief of Staff*  
Edward P. Murphy, Jr.—*Chief Administrative Officer*  
Richard J. Bolbrock—*Vice President of Power Markets*  
Bert J. Cunningham—*Vice President of Communications*  
Bruce Germano—*Vice President of Retail Services*  
Kenneth Kane—*Controller*

#### **Financial Advisor**

Morgan Stanley & Co. Incorporated  
New York, New York

#### **Bond Counsel**

Hawkins, Delafield & Wood  
New York, New York

#### **Independent Consultant**

Navigant Consulting, Inc.  
New York, New York

#### **Independent Accountant**

PricewaterhouseCoopers LLP  
Melville, New York

#### **Corporate Counsel**

O'Melveny & Myers LLP  
New York, New York

#### **Federal Energy Regulatory Counsel**

Van Ness Feldman P.C.  
Washington, D.C.

#### **Disclosure Counsel**

Clifford Chance US LLP  
New York, New York

#### **Trustee**

The Bank of New York  
New York, New York

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

The information set forth herein has been furnished by the Authority, LIPA and Navigant Consulting, Inc. and includes information obtained from other sources, all of which are believed to be reliable. The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, LIPA, KeySpan or the matters covered by the report of Navigant Consulting, Inc. included as Appendix A to Part 2 of this Official Statement since the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party.

Other than with respect to information concerning Financial Security Assurance Inc. ("FSA") and CDC IXIS Financial Guaranty North America, Inc. ("CIFG NA"), respectively, contained under the caption "Bond Insurance" and "Appendix 3 to Part 1—Specimen Municipal Bond Insurance Policies" herein, none of the information in this Official Statement has been supplied or verified by FSA or CIFG NA and neither FSA nor CIFG NA make any representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Offered Securities; or (iii) the tax exempt status of the interest on the Offered Securities.

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

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

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

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

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



## SUMMARY STATEMENT

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

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

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

**The Purpose of the Offered Securities**..... The Offered Securities are being issued (i) for various capital purposes including reimbursement to the Authority for prior capital expenditures, (ii) to refund certain outstanding Bonds of the Authority and (iii) to pay costs relating to the issuance of the Offered Securities.

**Outstanding Indebtedness**..... As of April 30, 2003, the Authority had senior lien Electric System General Revenue Bonds outstanding in the aggregate principal amount of \$5,632,595,538. The Offered Securities will be on a parity with these Bonds. The Authority also had outstanding, as of April 30, 2003, subordinate lien Electric System Subordinated Revenue Bonds in the aggregate principal amount of \$1,164,645,000. As of April 30, 2003, LIPA had outstanding \$155,420,000 of NYSERDA Financing Notes that the Authority is responsible for providing the funds to pay.

**Additional Indebtedness**..... Subsequent to the issuance of the Offered Securities the Authority expects to remarket approximately \$525 million of its outstanding \$700 million Electric System Subordinated Bonds, Series 1 through 3 as variable rate subordinate lien bonds and expects to refund approximately \$587 million of its senior lien bonds through the issuance of approximately \$600 million senior lien, variable rate bonds. In addition, in May the Authority plans to issue approximately \$100 million Notes pursuant to its Commercial Paper

	<p>program to redeem its outstanding Commercial Paper Notes.</p>
<b>Authority to Set Electric Rates .....</b>	<p>Under current New York law, the Authority is empowered to set rates for electric service in its service area without being required to obtain the approval of the New York State Public Service Commission ("PSC") or any other State regulatory body. However, the Authority has agreed with the Public Authorities Control Board of the State of New York ("PACB") that, among other things, it will not impose any permanent increase in average customer rates over a 12-month period in excess of 2.5% without approval of the PSC.</p>
<b>Rate Structure .....</b>	<p>The Authority has adopted a set of customer rates which include base rates, a fuel and purchased power adjustment clause, and certain riders and credits.</p>
<b>Service Area.....</b>	<p>LIPA's service area includes approximately 1.1 million customers and had a peak usage of approximately 4,929 MW in the summer of 2002. Approximately 51 percent of annual electric revenues are received from residential customers, with 47 percent coming from commercial/industrial customers, and the balance from sales to other municipalities and public authorities. LIPA's largest customer accounts for less than two percent of LIPA's electric sales.</p>
<b>Transmission and Distribution Facilities .....</b>	<p>LIPA's transmission system includes approximately 1,282 miles of overhead and underground lines with voltage levels ranging from 345kV to 23kV. The distribution system has approximately 58,611 cable miles of overhead and underground lines and approximately 205,685 line transformers.</p>
<b>Power Supply Resources .....</b>	<p>LIPA's power supply resources consist principally of various power purchase contracts. The principal power purchase contract is a Power Supply Agreement with GENCO under which LIPA obtains rights to and has obligations to pay for all of the capacity of KeySpan's existing fossil-fueled generating facilities formerly owned by LILCO. Such agreement entitles LIPA to purchase all of the energy produced by such facilities for its own customers or for resale to others. This Agreement has a term ending in 2013 and is renewable on similar terms. During 2002, approximately 35% of the fuel energy for the generating units subject to the Agreement came from oil and the remainder came from natural gas.</p>

LIPA has an 18% ownership interest in the 1,144 MW Nine Mile Point 2 nuclear unit currently operated by Constellation Nuclear LLC, which owns the remaining 82% interest.

**Plan of System Operation.....**

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

The day-to-day operations of the electric system are accomplished through three principal contracts: (i) a Management Services Agreement providing for operation of the transmission and distribution system, (ii) the Power Supply Agreement mentioned above and (iii) an Energy Management Agreement providing for the management of LIPA's power supply resources and fuel procurement. Each such agreement is with a subsidiary of KeySpan. KeySpan has guaranteed the performance, and any payments, by these subsidiaries.

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

**Independent Consultant's Report .....**

The Authority engaged Navigant Consulting, Inc. ("Navigant Consulting" or the "Independent Consultant"), an internationally recognized firm of engineers, economists and management consultants, for the purpose of conducting an evaluation of engineering, economic, system planning, operations, environmental and related matters for the Authority and LIPA and preparing an estimate of the annual operating results for the Authority and LIPA for the period January 1, 2003 through December 31, 2008 (the "Study Period"). The Independent Consultant's Report also contains analysis of the sensitivity of estimated operating results to changes in certain key variables. The Independent Consultant's Report, dated March 25, 2003, is included as Appendix A to Part 2 of this Official Statement and should be read in its entirety.

**Projected Revenues, Revenue  
Requirements and Debt Service  
Coverages.....**

Exhibit 1 to the Independent Consultant's Report sets forth Navigant Consulting's estimates for LIPA's revenues and revenue requirements for the Study Period. The Independent Consultant's Report also projects that the Authority's debt service coverages during the Study Period will be no less than approximately: (i) 1.8x on the senior lien debt (including the debt proposed to be issued in 2003)

outstanding and estimated to be outstanding; (ii) 1.7x on the senior lien debt (including the debt proposed to be issued in 2003) and the subordinated lien debt, in both cases outstanding and estimated to be outstanding; and (iii) 1.6x on the senior and subordinate lien debt mentioned in clause (ii) and on the NYSERDA Financing Notes.

**Accelerated Debt Retirement.....**

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

Current projections show that the plan approved by the Trustees as described herein will enable the Authority, in aggregate, to fund capital expenditures or retire an amount approximately equal to the original \$4.0 billion Acquisition Adjustment by the year 2013 while amortizing its remaining debt and future financings on a level debt basis.

**Security and Sources of Payment  
for Bonds.....**

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

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

The Bond Resolution requires compliance with a 1.2x historical or projected debt service coverage test on Bonds and other senior lien obligations as a condition to the issuance of additional Bonds, subject to certain exceptions. This requirement will be eliminated once the Authority retires approximately 25% of its Acquisition Debt. Refunding Bonds may be issued at any time without compliance with any coverage or savings test.

The Bond Resolution contains a rate covenant providing initially for 1.2x debt service coverage on Bonds and other senior lien obligations and 1.0x coverage of all other expenses, including Subordinated Indebtedness. This 1.2x coverage requirement for Bonds and other senior lien obligations will be reduced to 1.0x once the Authority retires approximately 25% of its Acquisition Debt. See "Accelerated Debt Retirement" in Part 2 of this Official Statement.

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## TABLE OF CONTENTS FOR PART 1

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COVER PAGE

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INSIDE COVER PAGE

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SUMMARY STATEMENT

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	Page		Page
INTRODUCTION .....	1	UNDERWRITING .....	11
USE OF PROCEEDS .....	2	CONTINUING DISCLOSURE	
PLAN OF FINANCE.....	2	UNDERTAKING .....	11
DEBT SERVICE .....	2	CREDIT RATINGS.....	12
DESCRIPTION OF THE OFFERED		APPROVAL OF LEGAL	
SECURITIES.....	5	PROCEEDINGS.....	12
General .....	5	MISCELLANEOUS .....	12
Securities Depository .....	5	Appendix 1 – Form of Bond Counsel	
Redemption .....	5	Opinion .....	App. 1-1
Notice of Redemption.....	6	Appendix 2 – List of Bonds to be	
BOND INSURANCE .....	6	Redeemed .....	App. 2-1
General .....	6	Appendix 3 – Specimen Municipal	
Bond Insurance Policies.....	7	Bond Insurance Policies .....	App. 3-1
Financial Security Assurance Inc.....	7		
CDC IXIS Financial Guaranty North			
America, Inc.....	8		
TAX MATTERS.....	9		
Opinion of Bond Counsel .....	9		
Certain Ongoing Federal Tax			
Requirements and Covenants.....	10		
Certain Collateral Federal Tax			
Consequences.....	10		
Original Issue Discount.....	10		
Bond Premium .....	11		
Legislation .....	11		
Corporate Income Tax Rulings.....	11		

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**PART 1**  
**of the**  
**OFFICIAL STATEMENT**  
**of the**  
**LONG ISLAND POWER AUTHORITY**  
**Relating to its**

**\$323,380,000 Electric System General Revenue Bonds, Series 2003C**

**INTRODUCTION**

The \$323,380,000 Electric System General Revenue Bonds, Series 2003C (the "Offered Securities"), are being issued by the Long Island Power Authority (the "Authority") pursuant to the Long Island Power Authority Act, being Title 1-A of Article 5 (§ 1020 et seq.) of the Public Authorities Law of the State of New York, as amended (the "Act"), and the Electric System General Revenue Bond Resolution of the Authority adopted on May 13, 1998 (the "Bond Resolution"), as supplemented by a resolution of the Authority adopted on February 27, 2003, as amended and restated on March 27, 2003, authorizing the Offered Securities (the "Supplemental Resolution"). The Bond Resolution, as supplemented to the date hereof, including as supplemented by the Supplemental Resolution and as it may be further supplemented or amended in the future, is herein called the "Resolution."

As of April 30, 2003, the Authority had outstanding \$5,632,595,538 of senior lien bonds (the "Outstanding Senior Lien Bonds"), all of which were issued under the Bond Resolution. The Offered Securities will be on a parity as to security and source of payment with the Outstanding Senior Lien Bonds. The Authority has the ability to issue under the Bond Resolution additional senior lien bonds, and other obligations ("Parity Obligations"), that will be on a parity as to security and source of payment with the Outstanding Senior Lien Bonds and the Offered Securities. As used in this Official Statement, the term "Bonds" means the Outstanding Senior Lien Bonds, the Offered Securities and all additional senior lien bonds, notes or other evidence of indebtedness and Parity Obligations of the Authority hereafter issued under the Resolution which are on a parity as to security and source of payment. The Bonds have priority as to security and payment over the Subordinated Indebtedness mentioned in the next paragraph and over the NYSERDA Financing Notes mentioned in the second following paragraph.

The Authority also had outstanding \$1,164,645,000 of subordinate lien bonds (the "Outstanding Subordinated Lien Bonds") as of April 30, 2003. The Outstanding Subordinated Lien Bonds were all issued under the Authority's Electric System General Subordinated Revenue Bond Resolution adopted on May 20, 1998 (the "General Subordinated Resolution") and various supplemental resolutions (the General Subordinated Resolution, as so supplemented, is herein called the "Subordinated Resolution"). The Authority has the ability to issue under the General Subordinated Resolution additional subordinated lien bonds and other obligations that will be on a parity as to security and source of payment with the Outstanding Subordinated Lien Bonds. As used in this Official Statement, the term "Subordinated Indebtedness" means the Outstanding Subordinated Lien Bonds and all other subordinated lien bonds, notes or other evidence of indebtedness of the Authority issued pursuant to the Subordinated Resolution which are on a parity as to security and source of payment. All Subordinated Indebtedness is, in all respects, on a junior and subordinate basis as to security and source of payment to the Bonds.

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

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

## USE OF PROCEEDS

The proceeds of the Offered Securities will be used (i) for various capital purposes including reimbursement to the Authority for prior capital expenditures, (ii) to refund the Outstanding Bonds of the Authority listed on Appendix 2 hereto and (iii) to pay costs (estimated to be \$6,990,086.75) relating to the issuance of the Offered Securities, including underwriters' discount and bond insurance premium.

## PLAN OF FINANCE

The Authority has approved a plan of finance that it expects to complete by June 2003 that includes various borrowings. First, the Authority remarketed on April 1, 2003, \$25.225 million of its Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds that are scheduled to mature on April 1, 2010. Next, the Authority issued on April 30, 2003 approximately \$622 million Electric System General Revenue Bonds, Series 2003A and Series 2003B to refund certain maturities of the Electric System General Revenue Bonds, Series 1998A, 1998B and 2000A that are currently insured by Financial Security Assurance Inc. ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"). Next, the Authority plans to issue the Offered Securities. Subsequent to the issuance of the Offered Securities, in connection with the replacement of certain expiring letters of credit supporting the Authority's \$700 million Electric System Subordinated Bonds, Series 1 through Series 3, the Authority plans to remarket approximately \$525 million of such Bonds as subordinate lien variable rate bonds. Concurrently with the remarketing, the Authority plans to issue approximately \$587 million Refunding VR Bonds as variable rate and auction rate bonds to current refund approximately \$587 million Electric System General Revenue Bonds Series 1998A (2029 maturity, 5.5% coupon). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003. See footnote 5 to the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001 for a discussion of the swaption. In addition, in May the Authority plans to issue approximately \$100 million Notes pursuant to its Commercial Paper program to redeem its outstanding Commercial Paper Notes in connection with the issuance of new letters of credit to support such Notes.

The Authority expects to issue debt in the future for a variety of purposes, including the funding of capital expenditures and refinancing Bonds or Subordinated Indebtedness. See "Future Financing Activities" in Part 2 of this Official Statement. If the Authority elects to exercise its option to purchase the equity interest in GENCO from KeySpan, it is expected that additional bonds will be issued to fund the purchase price. See "LIPA's Retail Electric Service Business-Other Rights" in Part 2 of this Official Statement.

## DEBT SERVICE

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

# DEBT SERVICE

Twelve Months Ended	Series 2003C Bonds			Senior Lien (1)(2)(3)			Subordinate Lien (3)(5)			LESS:			Net Total Debt Service
	Series 2003C Principal	Series 2003C Interest		Principal	Interest	Total Debt Service (4)	Principal	Interest	Debt Service (6)	NYSDA Debt Service (7)	Promissory Notes (8)		
12/31/2003	\$ -	\$ 4,841,793	\$ 243,202,842	\$ 148,916,251	\$ 243,202,842	\$ 396,960,886	\$ -	\$ 35,601,273	\$ 11,500,500	\$ 13,862,685	\$ 25,363,185	\$ -	\$ 432,562,159
12/31/2004	-	16,443,826	256,534,107	155,818,564	256,534,107	428,796,497	-	44,327,891	-	8,075,230	8,075,230	-	473,124,388
12/31/2005	-	16,443,826	251,941,557	162,578,038	251,941,557	430,963,421	-	45,126,425	-	8,075,230	8,075,230	-	476,089,846
12/31/2006	-	16,443,826	244,304,747	198,090,295	244,304,747	458,838,869	-	45,135,147	-	8,075,230	8,075,230	-	503,974,016
12/31/2007	-	16,443,826	233,627,223	209,750,022	233,627,223	459,821,071	-	45,135,147	-	8,075,230	8,075,230	-	504,956,219
12/31/2008	-	16,443,826	224,278,110	220,863,886	224,278,110	461,585,822	-	45,143,870	-	8,075,230	8,075,230	-	506,729,692
12/31/2009	-	16,443,826	214,507,539	182,169,994	214,507,539	413,121,359	53,020,000	43,830,222	-	8,075,230	8,075,230	-	509,971,581
12/31/2010	-	16,443,826	213,868,426	186,333,110	213,868,426	416,645,363	52,525,000	41,184,935	-	8,075,230	8,075,230	-	510,355,297
12/31/2011	-	16,443,826	205,279,701	196,701,155	205,279,701	418,424,682	54,600,000	38,531,432	-	8,075,230	8,075,230	-	511,556,113
12/31/2012	-	16,443,826	203,400,479	202,013,675	203,400,479	421,857,980	54,500,000	35,880,904	-	8,075,230	8,075,230	-	512,238,884
12/31/2013	8,875,000	16,443,826	196,893,336	138,805,106	196,893,336	361,017,268	-	34,500,959	-	8,075,230	8,075,230	-	395,518,227
12/31/2014	8,875,000	16,066,639	193,153,378	142,910,947	193,153,378	361,005,964	-	34,509,682	-	8,075,230	8,075,230	-	395,515,645
12/31/2015	9,495,000	15,617,608	189,027,204	146,866,199	189,027,204	361,006,010	-	34,509,682	-	8,075,230	8,075,230	-	395,515,691
12/31/2016	10,335,000	15,149,583	183,757,109	151,758,634	183,757,109	361,000,326	-	34,500,959	-	8,075,230	8,075,230	-	395,518,731
12/31/2017	10,330,000	14,641,408	179,250,632	157,093,651	179,250,632	361,015,691	-	34,500,959	-	113,313,715	113,313,715	-	395,516,649
12/31/2018	11,365,000	14,089,758	172,813,853	162,740,903	172,813,853	361,009,514	-	34,509,682	-	2,512,200	2,512,200	-	395,519,195
12/31/2019	11,325,000	13,464,683	168,259,188	137,994,395	168,259,188	331,043,265	30,900,000	33,576,914	-	2,512,200	2,512,200	-	395,520,179
12/31/2020	12,365,000	12,841,808	143,026,458	143,026,458	162,744,327	330,977,593	32,400,000	32,141,204	-	2,512,200	2,512,200	-	395,518,797
12/31/2021	12,825,000	12,161,733	157,643,194	148,279,641	157,643,194	330,909,567	35,600,000	30,608,388	-	2,512,200	2,512,200	-	395,517,955
12/31/2022	13,710,000	10,791,258	145,338,098	160,073,523	151,746,255	330,886,465	37,200,000	29,029,292	-	2,512,200	2,512,200	-	395,515,757
12/31/2023	14,745,000	10,454,008	130,653,244	170,646,733	145,338,098	330,947,878	39,000,000	27,369,026	-	32,112,200	32,112,200	-	395,516,904
12/31/2024	10,625,000	9,522,758	173,872,169	173,872,169	130,653,244	330,818,170	40,900,000	25,638,996	-	3,543,400	3,543,400	-	395,516,642
12/31/2025	16,770,000	8,684,258	222,883,608	222,883,608	124,046,338	372,329,203	-	23,189,682	-	16,005,600	16,005,600	-	395,516,446
12/31/2026	16,715,000	7,848,508	232,735,137	232,735,137	112,460,230	372,328,874	-	23,189,682	-	-	-	-	395,518,885
12/31/2027	19,285,000	6,891,038	243,749,755	243,749,755	101,995,134	372,315,927	-	23,198,404	-	-	-	-	395,514,331
12/31/2028	20,805,000	5,870,013	265,970,237	265,970,237	79,689,516	372,334,766	-	23,180,959	-	-	-	-	395,515,724
12/31/2029	24,640,000	4,777,750	190,905,000	190,905,000	32,806,346	253,129,096	119,200,000	23,189,682	-	-	-	-	395,518,777
12/31/2030	24,200,000	3,545,750	198,730,000	198,730,000	24,897,788	251,373,538	126,200,000	17,944,706	-	-	-	-	395,518,244
12/31/2031	24,255,000	2,335,750	16,263,850	206,785,000	16,263,850	249,639,600	133,500,000	12,376,180	-	-	-	-	395,515,780
12/31/2032	22,460,000	1,123,000	3,536,161	219,580,000	3,536,161	246,699,161	146,100,000	2,718,238	-	-	-	-	395,517,459
	\$ 323,380,000	\$ 366,234,117	\$ 4,957,471,816	\$ 5,632,595,538	\$ 4,957,471,816	\$ 11,279,681,471	\$ 989,645,000	\$ 978,096,301	\$ 11,500,500	\$ 290,813,560	\$ 302,314,060	\$ -	\$ 13,247,422,772

(1) The debt service schedule assumes that the \$148,195,000 of Outstanding Senior Lien Bonds, Series 1998A purchased and retired in 1999 will be applied on a pro rata basis to all sinking fund payments on the term bonds of the series purchased. The debt service schedule also assumes that the auction rate bonds of Series 2001-B through 2001-K and 2001-M through 2001-P pay interest at an interest rate of 2.01% through December 2003 and 3.84% thereafter through maturity. The assumed interest rate includes broker-dealer fees and auction agent fees. In addition, on a portion of the Bonds, an insurance coverage charge is assumed on an annual basis from December 2005 through maturity.

(2) Accreted interest on capital appreciation bonds is shown in the year of maturity.

- (3) The debt service schedule assumes the completion of certain transactions planned for this year. See "Future Financing Activities" in Part 2 of this Official Statement. In addition to the Offered Securities, the Authority also plans to refund approximately \$587 million of its senior lien bonds pursuant to the swaption transaction entered into in 2002. For the purpose of this debt service schedule, the \$587 million of senior lien refunding bonds are assumed to be evenly split between variable rate demand obligations and auction rate bonds. The net debt service on the refunding bonds approximately equals that on the bonds refunded. The remaining \$525 million of the Electric System Subordinated Bonds, Series 1 through 3 not affected by the Offered Securities are assumed to be remarketed. The remarketed bonds are assumed to pay interest at an interest rate of 2.63% through December 2003 and 4.46% thereafter through maturity. The assumed interest rate includes remarketing and line of credit fees.
- (4) The aggregate principal and interest on the Offered Securities and the Senior Lien Bonds.
- (5) Series 7 are variable rate bonds, for which the interest rate is assumed to be 4.53% after taking into account liquidity fees, remarketing fees and payments to be received pursuant to certain interest rate swap agreements that the Authority has entered into to swap its variable rate interest obligations on Series 7 to a fixed rate of 4.208% (certain payments which may be owed by the Authority under these swap agreements are also subordinated indebtedness). Series 8 Bonds bear interest at fixed rates that range between 4.125% and 5.25%, exclusive of any annual insurance costs until their respective maturity or mandatory purchase dates. Subseries D-H of Series 8 is subject to mandatory purchase between April 1, 2004 and 2008. Each of these subseries of Series 8 are assumed to bear interest at their initial rates until their maturities, which range from April 1, 2010 to 2012. Interest amounts included in the table for the Series 8 Bonds include in each year certain insurance costs.
- (6) On March 22, 2003, LIPA redeemed all the then outstanding Debentures.
- (7) On March 31, 2003, LIPA redeemed \$177,005,000 of NYSERDA Financing Notes. All NYSERDA Financing Notes bear interest at fixed rates.
- (8) The Promissory Notes were issued by KeySpan and certain subsidiaries as part of the LIPA/LILCO Merger and evidence the obligation of these Promissory Note Obligors to pay to LIPA, 30 days prior to the applicable due dates thereof, an amount equal to the principal of and interest on the Debentures and the NYSERDA Financing Notes.

## DESCRIPTION OF THE OFFERED SECURITIES

### General

The Offered Securities will be dated May 15, 2003 and will mature at the times and in the principal amounts as set forth on the inside cover page of this Official Statement. Interest on the Offered Securities will be payable semiannually on March 1 and September 1 commencing September 1, 2003. The Offered Securities will be offered in authorized denominations of \$5,000 and integral multiples thereof.

### Securities Depository

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

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

### Redemption

*Optional.* The Offered Securities are subject to redemption prior to maturity, at the option of the Authority, on any date on and after September 1, 2013 in whole, or in part from time to time, at a redemption price of par together with the interest accrued on such principal amount to the redemption date; *provided, however*, that the Offered Securities maturing on September 1, 2020 are subject to such redemption at any date on and after March 1, 2008 and the Offered Securities maturing on September 1, 2029 are not subject to redemption.

*Sinking Fund.* The Offered Securities maturing on September 1, 2027 and bearing interest at a rate of 5.00% per annum, September 1, 2028 and bearing interest at a rate of 5.00% per annum, September 1, 2029 and September 1, 2033 (collectively, the "Term Bonds") are also subject to redemption in part on September 1 of the years and in the respective principal amounts set forth below at 100% of the principal amount thereof, plus accrued interest to the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem on September 1 of each year the principal amount of such respective Offered Securities specified for each of the years shown below:

Term Bonds Due September 1, 2027		Term Bonds Due September 1, 2028	
Year	Principal Amount	Year	Principal Amount
2025	\$16,770,000	2027	\$14,930,000
2026	16,715,000	2028 <sup>1</sup>	2,810,000
2027 <sup>1</sup>	2,095,000		

<sup>1</sup> Final Maturity.

Term Bonds Due September 1, 2029		Term Bonds Due September 1, 2033	
Year	Principal Amount	Year	Principal Amount
2028	\$15,840,000	2030	\$24,640,000
2029 <sup>1</sup>	20,805,000	2031	24,200,000
		2032	24,255,000
		2033 <sup>1</sup>	22,460,000

<sup>1</sup> Final Maturity.

*Credit Against Sinking Fund Installments.* In the event a principal amount of Offered Securities which are being issued as Term Bonds maturing on September 1, 2027, September 1, 2028, September 1, 2029 or September 1, 2033 is deemed to be no longer Outstanding, except by a redemption from moneys credited to the Debt Service Fund as sinking fund installments, such principal amount shall be applied to reduce the remaining sinking fund installments for such respective Offered Securities in such order and amounts as is determined by the Authority.

### Notice of Redemption

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

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

## BOND INSURANCE

### General

*It is a condition to the issuance of the Offered Securities that Financial Assurance Inc. ("FSA") issues its Municipal Bond Insurance Policy (the "FSA Policy") for the Offered Securities maturing on September 1, 2027 (4.7% coupon) and September 1, 2028 (5% coupon), and that CDC IXIS Financial Guaranty North America, Inc. ("CIFG NA" and, together with FSA, the "Insurers") issues its Municipal Bond Insurance Policy (the "CIFG NA Policy" and, together with the FSA Policy, the "Policies") for the Offered Securities maturing on September 1, 2015 (5% coupon), September 1, 2016 (5% coupon), September 1, 2028 (4.75% coupon), September 1, 2029 and September 1, 2033 (collectively, the "Insured Bonds"). FSA and CIFG NA have agreed to issue the Policies concurrently with the initial issuance of the Offered Securities.*

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

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

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

### **Bond Insurance Policies**

Concurrently with the issuance of the Offered Securities, the Insurers will issue the Policies for the Insured Bonds as described above. The Policies guarantee the scheduled payment of principal of and interest on the Insured Bonds when due as set forth in the form of the Policies included as Appendix 3 hereto.

The Policies are not covered by any insurance security or guaranty funds established under New York, California, Connecticut or Florida insurance law.

### **Financial Security Assurance Inc.**

FSA is a New York domiciled insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At December 31, 2002, FSA's total policyholders' surplus and contingency reserves were approximately \$1,876,117,000 and its total unearned premium reserve was approximately \$1,055,340,000 in accordance with statutory accounting principles. At December 31, 2002, FSA's total shareholders' equity was approximately \$1,971,325,000 and its total net unearned premium reserve was approximately \$892,552,000 in accordance with generally accepted accounting principles.

The financial statements included as exhibits to the annual and quarterly reports filed by Holdings with the Securities and Exchange Commission are hereby incorporated herein by reference. Also incorporated herein by reference are any such financial statements so filed from the date of this Official Statement until the termination of the offering of the Bonds. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 350 Park Avenue, New York, New York 10022, Attention: Communications Department (telephone (212)826-0100).

The Policy does not protect investors against changes in market value of the Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the Bonds or the advisability of investing in the Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the Issuer the information presented under this caption for inclusion in the Official Statement.

## **CDC IXIS Financial Guaranty North America, Inc.**

CIFG NA is a monoline financial guaranty insurance company incorporated in 2002 under the laws of the State of New York, with its principal place of business in New York City. CIFG NA is a wholly-owned subsidiary of CDC IXIS Financial Guaranty Services Inc., a Delaware corporation, which, in turn, is a wholly-owned subsidiary of CDC IXIS Financial Guaranty, a French reinsurance corporation ("CIFG"). CIFG is a wholly owned subsidiary of CIFG Holding ("Holding"), a French corporation, which is a wholly owned subsidiary of CDC IXIS, a French financial institution which is regulated by the French Banking Commission. Neither Holding nor CDC IXIS is obligated to pay the debts of or claims against CIFG NA.

CIFG NA received its license to write financial guaranty insurance in the State of New York on May 24, 2002. As of the date of this Official Statement, it is not authorized to transact insurance business in any jurisdiction other than the State of New York.

CIFG NA's "claims-paying ability" (also referred to as its "financial strength") is rated "Aaa" by Moody's, "AAA" by Standard & Poor's and "AAA" by Fitch, the highest rating assigned by each such rating agency. Each rating of CIFG NA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of CIFG NA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold the Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Bonds. CIFG NA does not guaranty the market price of the Bonds nor does it guaranty that the ratings on the Bonds will not be revised or withdrawn.

### *Insurance Regulatory Matters*

CIFG NA is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York, its state of domicile, and is subject to regulation by the New York State Insurance Department (the "NYSID"). As a financial guaranty insurance corporation licensed to do business in the State of New York, CIFG NA is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that each such insurer maintain a minimum surplus to policyholders, establishes contingency, loss and unearned premium reserve requirements for each such insurer, and limits the size of individual transactions ("single risks") and the volume of transactions ("aggregate risks") that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as CIFG NA regulate, among other things, permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings. CIFG NA is required to file quarterly and annual statutory financial statements with the NYSID, and is subject to statutory restrictions concerning the types and quality of its investments and the filing and use of policy forms and premium rates. Additionally, CIFG NA's accounts and operations are subject to periodic examination by the NYSID.

The insurance provided by the Policy is not covered by the property/casualty insurance security fund specified by the insurance laws of the State of New York.

CIFG NA will prepare audited annual financial statements in accordance with accounting principles applicable to insurance companies, as specified by applicable law. Copies of such financial statements may be obtained by writing to CIFG NA at 825 Third Avenue, 6th Floor, New York, New York 10022 Attention: Finance Department. The toll-free telephone number of CIFG NA is (866) CIFG-212. For further information about CIFG NA, see the selected financial and statistical information for CDC IXIS Financial Guaranty North America, Inc. at <http://www.cifg.com>.

### *Capitalization*

After CIFG NA's incorporation in the State of New York in 2002, it was capitalized with \$100 million of equity capital by its sole shareholder. CIFG NA is also supported by a net worth maintenance agreement, which provides that CIFG will maintain CIFG NA's U.S. statutory capital and surplus at no less than \$80 million. In



addition, through a facultative reinsurance agreement, CIFG NA will cede up to 75% of its exposure on each transaction to CIFG.

CIFG was initially capitalized with EUR 300 million and, at December 31, 2002, had capital of EUR 266.1 million. CIFG's "claims-paying ability" is rated "Aaa" by Moody's, "AAA" by Standard & Poor's and "AAA" by Fitch, the highest rating assigned by each such rating agency. CIFG is further supported by a \$220 million capital commitment from CDC IXIS. The capital commitment is a multi-year, annually renewable subordinated loan agreement that can be drawn down for growth or, if necessary, to maintain CIFG's "AAA" rating. Draws under this facility can be converted to equity at CIFG's option. In January 2003, Holding initiated a draw of 100 million euros on the subordinated loan facility, which was converted to equity. Holding then made a capital contribution of 99 million euros to CIFG.

As a result of its recent formation, CIFG NA has not yet issued an audited statement of its financial condition. The following table sets forth the capitalization of CIFG NA as of December 31, 2002, on the basis of accounting principles prescribed or permitted by the NYSID (in thousands):

Common capital stock	\$15,000
Gross paid in and contributed surplus	85,000
Unassigned funds (retained deficit)	(9,347)
Surplus as regards policyholders	\$90,653

There has been no material adverse change in the capitalization of CIFG NA from December 31, 2002 to the date of this Official Statement.

The Policy does not protect investors against changes in market value of the Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. CIFG NA makes no representation regarding the Bonds or the advisability of investing in the Bonds. CIFG NA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that CIFG NA has provided to the Authority the information presented under this caption for inclusion in the Official Statement.

## **TAX MATTERS**

### **Opinion of Bond Counsel**

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

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

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

### **Certain Ongoing Federal Tax Requirements and Covenants**

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Offered Securities in order that interest on the Offered Securities be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to the use and expenditure of gross proceeds of the Offered Securities, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the federal government. Noncompliance with such requirements may cause interest on the Offered Securities to become included in gross income for federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The Authority and LIPA have covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Offered Securities from gross income under Section 103 of the Code.

### **Certain Collateral Federal Tax Consequences**

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

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

### **Original Issue Discount**

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

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Discount Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income

received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

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

## **Bond Premium**

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

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

## **Legislation**

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

## **Corporate Income Tax Rulings**

For a description of certain private letter rulings obtained from the Internal Revenue Service ("IRS") in connection with the LIPA/LILCO Merger, see "Corporate Income Tax Rulings" in Part 2 of this Official Statement.

## **UNDERWRITING**

The Underwriters listed on the cover page of this Official Statement, for which Citigroup Global Markets Inc. is acting as the Senior Manager, have agreed, jointly and severally and subject to certain conditions, to purchase all, but not less than all, of the Offered Securities from the Authority at an underwriters' discount of \$2,016,403.38. The Underwriters will be obligated to purchase all of the Offered Securities if any of the Offered Securities are purchased. The initial public offering prices of the Offered Securities may be changed from time to time by the Underwriters.

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

## **CONTINUING DISCLOSURE UNDERTAKING**

The Offered Securities will be subject to the continuing secondary market disclosure requirements of Rule 15c2-12 of the Securities and Exchange Commission (the "Rule") and will be made subject to the Continuing Disclosure Certificate referred to in "Continuing Disclosure Undertakings for the Offered Securities" in Part 2 of

this Official Statement. The Offered Securities being made subject to the Continuing Disclosure Certificate is a condition precedent to the obligation of the Underwriters to purchase the Offered Securities.

### **CREDIT RATINGS**

It is a condition to the obligation of the Underwriters to purchase the Offered Securities that, at the date of delivery thereof to the Underwriters, the Offered Securities be rated "A-" by Fitch, "Baa1" by Moody's and "A-" by S&P, except for the Insured Bonds, which are to be rated "AAA" by Fitch, "Aaa" by Moody's and "AAA" by S&P. The Insured Bonds are expected to be assigned such long-term ratings upon, and solely as a result of, the issuance of the Policies by the Insurers.

The respective ratings by Fitch, Moody's and S&P of the Offered Securities reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by the rating agencies with respect thereto should be obtained from the rating agency furnishing the same, at the following addresses: Fitch, Inc., One State Street Plaza, New York, New York 10004; Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007; and Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041. Generally, a rating agency bases its rating and outlook (if any) on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings for the Offered Securities will continue for any given period of time or that any of such ratings will not be revised downward or withdrawn entirely by any of the rating agencies, if, in the judgment of such rating agency or agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Offered Securities.

### **APPROVAL OF LEGAL PROCEEDINGS**

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

### **MISCELLANEOUS**

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

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

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

LONG ISLAND POWER AUTHORITY

By: /s/ RICHARD M. KESSEL  
Chairman

**Form of Opinion of Hawkins, Delafield & Wood**

May , 2003

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

Ladies and Gentlemen:

We have examined a certified record of proceedings relating to the issuance of \$323,380,000 Electric System General Revenue Bonds, Series 2003C (the "Series 2003C Bonds"), of the Long Island Power Authority (the "Authority"), a corporate municipal instrumentality of the State of New York (the "State") constituting a body corporate and politic and a political subdivision of the State.

The Series 2003C Bonds are issued under and pursuant to the Constitution and statutes of the State, including the Long Island Power Authority Act, being Title 1-a of Article 5 of the Public Authorities Law, Chapter 43-A of the Consolidated Laws of the State of New York, as amended (herein called the "Act"), and under and pursuant to proceedings of the Authority duly taken, including a resolution adopted by the Trustees of the Authority on May 13, 1998 entitled "Electric System General Revenue Bond Resolution", as supplemented by a resolution of said Trustees adopted on February 27, 2003, as amended and restated by a resolution adopted on March 27, 2003 (collectively, the "Resolution").

The Authority has heretofore issued bonds (the "Outstanding Bonds") under the Resolution. The Resolution provides that the Authority may issue additional Bonds (as defined in the Resolution), and incur Parity Obligations (as defined in the Resolution), thereunder from time to time on the terms and conditions and for the purposes stated therein. The Outstanding Bonds, the Series 2003C Bonds, such additional Bonds, if issued, and such Parity Obligations, if incurred, will be equally and ratably secured under the Resolution, except as otherwise provided therein.

The Series 2003C Bonds are dated, mature, are payable, bear interest and are subject to redemption, all as provided in the Resolution.

We are of the opinion that:

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

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

3. The Resolution has been duly and lawfully adopted by the Authority, is in full force and effect, is valid and binding upon the Authority, and is enforceable in accordance with its terms. The Resolution creates the valid pledge which it purports to create of the Trust Estate (as defined in the Resolution), subject only to the provisions of the Resolution permitting the application thereof for the purposes and on the terms and conditions set forth in the Resolution.

4. The Series 2003C Bonds have been duly and validly authorized and issued in accordance with the laws of the State, including the Constitution of the State and the Act, and in accordance with the Resolution, and are valid and binding special obligations of the Authority, enforceable in accordance with their terms and the terms of the Resolution, payable solely from the Trust Estate as provided in the Resolution. The Authority has no taxing power, the Series 2003C Bonds are not debts of the State or of any municipality thereof, and the Series 2003C Bonds will not constitute a pledge of the credit, revenues or taxing power of the State or of any municipality thereof. The Authority reserves the right to issue additional Bonds and to incur Parity Obligations on the terms and conditions, and for the purposes, provided in the Resolution, on a parity of security and payment with the Series 2003C Bonds and the Outstanding Bonds.

5. Any registration with, consent of, or approval by, any governmental agency, board, or commission that is necessary for the execution and delivery and the issuance of the Series 2003C Bonds has been obtained.

6. The adoption of the Resolution, compliance with all of the terms and conditions of the Resolution and the Series 2003C Bonds, and the execution and delivery of the Series 2003C Bonds, will not result in a violation of or be in conflict with any term or provision of any existing law, or of any approval by any governmental agency, board or commission necessary for the adoption of, or performance of the Authority's obligations under, the Resolution.

7. The Financing Agreement, dated as of May 1, 1998, between the Authority and Long Island Lighting Company d/b/a LIPA (as successor by merger to LIPA Acquisition Corp.) (the "Subsidiary") has been duly authorized, executed and delivered by the Authority and the Subsidiary and is a valid and binding obligation of the parties thereto, enforceable in accordance with its terms. You have received a separate opinion of Clifford Chance US LLP, New York, New York, the Disclosure Counsel to the Authority and the Subsidiary, dated the date hereof, as to the valid existence of the Subsidiary and as to certain other matters relating to the Subsidiary, all of which we have assumed, without further investigation, in rendering the opinions in this paragraph 7.

8. Under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Series 2003C Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Series 2003C Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering the opinions in this paragraph 8, we have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Authority and the Subsidiary in connection with the Series 2003C Bonds, and we have assumed compliance by the Authority and the Subsidiary with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Series 2003C Bonds from gross income under Section 103 of the Code.

9. The original issue discount on the Series 2003C Bonds, if any, that has accrued and is properly allocable to the owners thereof under Section 1288 of the Code is excludable from gross income for federal income tax purposes to the same extent as other interest on the Series 2003C Bonds.

10. Under existing statutes, interest on the Series 2003C Bonds is exempt from personal income taxes imposed by the State or any political subdivision thereof, and the Series 2003C Bonds are exempt from all taxation directly imposed thereon by or under the authority of the State, except estate or gift taxes and taxes on transfers.

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

Except as stated in paragraphs 8, 9, and 10, we express no opinion regarding any other federal or state tax consequences with respect to the Series 2003C Bonds. We render our opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. We express no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for federal income tax purposes of interest on the Series 2003C Bonds, or under state and local tax law.

We express no opinion as to the accuracy, adequacy or sufficiency of any financial or other information which has been or will be supplied to purchasers of the Series 2003C Bonds.

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

Very truly yours,

*Very truly yours,*

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**BONDS TO BE REDEEMED**

The Authority expects to redeem the bonds described below on May 23, 2003 by applying a portion of the proceeds of the Offered Securities to provide for the payment of the principal of and interest and redemption premium, if any, on such bonds to the extent and to the payment dates set forth below. The refunding is contingent upon the delivery of the Offered Securities. The bonds to be redeemed are as follows:

1. \$75,000,000 of Subseries 1B (Cusip No. 542690RU8) Electric System Subordinated Revenue Bonds, Series 1 issued in 1998 will be redeemed. There are currently \$125,000,000 of such bonds outstanding.

2. \$75,000,000 of Subseries 2A (Cusip No. 542690SE3) Electric System Subordinated Revenue Bonds, Series 2 issued in 1998 will be redeemed. There are currently \$125,000,000 of such bonds outstanding.

3. \$25,000,000 of Subseries 2C (Cusip No. 542690SG8) Electric System Subordinated Revenue Bonds, Series 2 issued in 1998 will be redeemed. These are all of such bonds outstanding.

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## APPENDIX 3

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CDC IXIS Financial Guaranty North America, Inc.  
825 Third Avenue, 6<sup>th</sup> Floor  
New York, NY 10022  
For information, contact:  
(212) 909-3939  
Toll-free: (866) 243-4212

## BOND INSURANCE POLICY

**Policy Number:**

**Effective Date:**

**Issuer:**

**Bonds:**

**CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.**, a New York stock insurance company (the "Insurer"), in consideration of the payment of the premium and subject to the terms and conditions contained in this Policy (which includes each endorsement hereto), hereby unconditionally and irrevocably agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as designated in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of any Owner, or, at the election of the Insurer, directly to such Owner, that portion of the principal of and interest on the Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

The Insurer will make such payments to or for the benefit of each Owner on the later of the day on which such principal or interest becomes Due for Payment or the Business Day next following the Business Day on which the Insurer shall have received Notice of Nonpayment. The Insurer will disburse to or for the benefit of the Owner the face amount of principal of and interest on the Bond which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Insurer, in form reasonably satisfactory to it, of (i) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Owner's rights to payment of such principal or interest then Due for Payment shall thereupon vest in the Insurer. Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. Eastern prevailing time on such Business Day; otherwise, it will be deemed received on the next Business Day. Upon disbursement in respect of a Bond, the Insurer shall become the owner of the Bond, appurtenant coupon, if any, or right to payment of principal of or interest on such Bond and shall be fully subrogated to all of the Owner's rights thereunder, including the Owner's right to payment thereof to the extent of any payment by the Insurer hereunder. Payment by the Insurer to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of the Insurer under this Policy.

This Policy is non-cancelable for any reason and the premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity.

The following terms shall have the meanings specified for all purposes of this Policy. The term "Owner" means, as to a particular Bond, the person other than the Issuer or any party whose direct or indirect obligation constitutes the underlying security for the Bonds, who at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means (a) when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless the Insurer shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a bond, the stated date for payment of interest. "Nonpayment" with respect to a Bond means the failure of the Issuer to have provided sufficient funds to the Trustee or the Paying Agent for payment in full of all principal and interest Due for Payment on such Bond. "Nonpayment" shall also include any payment of principal or interest made to an Owner by or on behalf of the Issuer of such Bond which has been recovered from such Owner pursuant to a final, non-appealable order of a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law. "Notice" means telephonic or electronic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to the Insurer, which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Business Day" means any day other than a Saturday, Sunday or a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law to remain closed.

The Insurer may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee or the Paying Agent (a) copies of all notices required to be delivered to the Insurer pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to the Insurer and shall not be deemed received until received by both and (b) all payments required to be made by the Insurer under this Policy may be made directly by the Insurer or by the Insurer's Fiscal Agent on behalf of the Insurer. The Insurer's Fiscal Agent is the agent of the Insurer only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of the Insurer to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

There shall be no acceleration payment due under this Policy except at the sole option of the Insurer. This Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

IN WITNESS WHEREOF, CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. has caused this Policy to be affixed with its corporate seal and to be executed on its behalf by its duly authorized representative.

**CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.**

**[SEAL]**

---

**Authorized Representative**



**FINANCIAL  
SECURITY  
ASSURANCE®**

## **MUNICIPAL BOND INSURANCE POLICY**

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the

United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security, and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud, whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By \_\_\_\_\_

By \_\_\_\_\_  
Authorized Officer

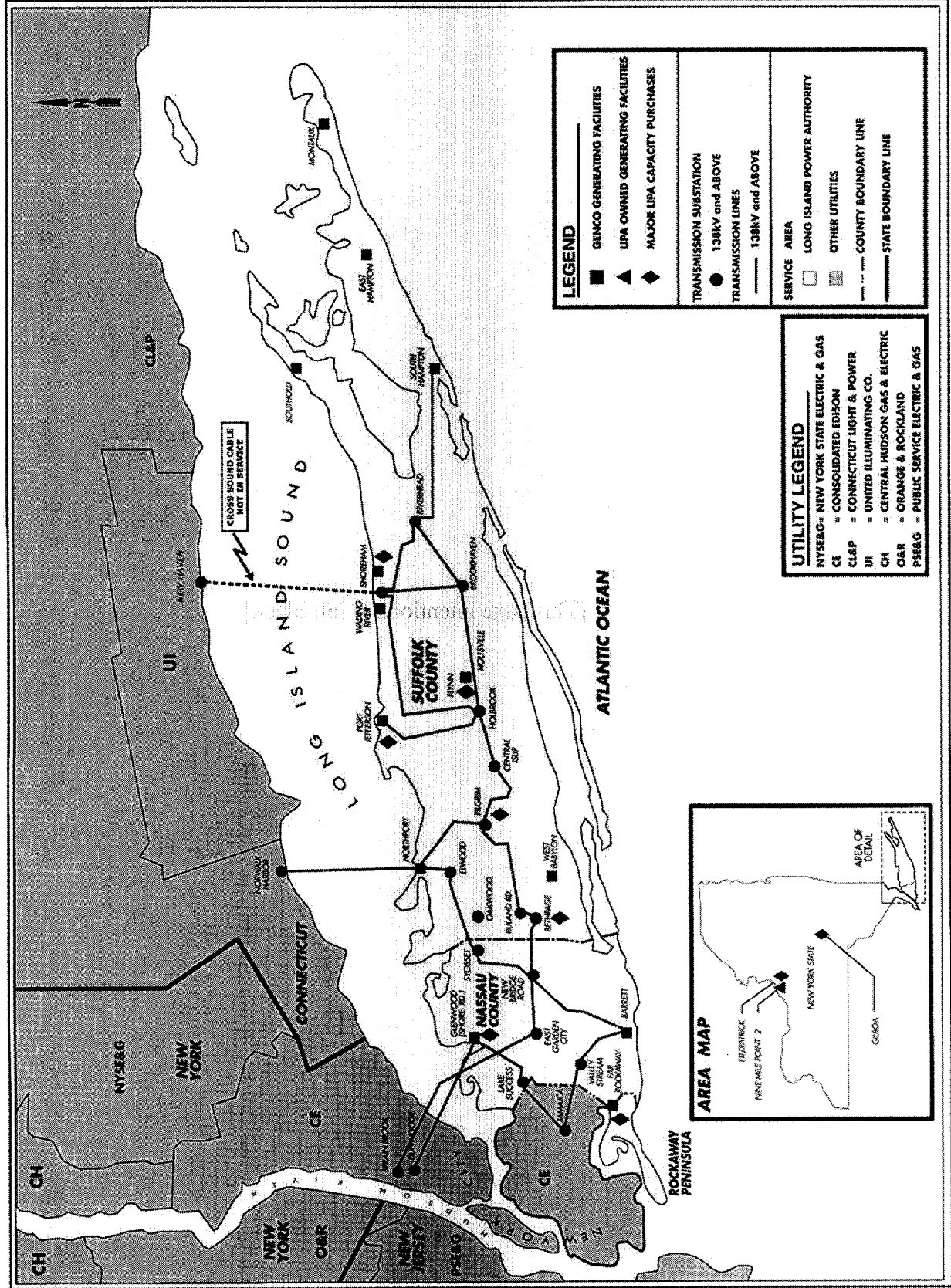
A subsidiary of Financial Security Assurance Holdings Ltd.  
350 Park Avenue, New York, N.Y. 10022-6022

(212) 826-0100

Form 500NY (5/90)



# LONG ISLAND POWER AUTHORITY SERVICE AREA



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

*as required by Article 10 of the Public Officers Law*

2017

2018

2019

2020

2021

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# TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION .....	2-1
LIPA'S RETAIL ELECTRIC SERVICE BUSINESS .....	2-2
Relationship of the Authority and LIPA .....	2-2
System Operation by the Authority .....	2-2
Operating Agreements .....	2-3
Other Rights .....	2-5
Guarantees and Indemnities .....	2-5
LIPA Assets and Liabilities .....	2-6
ACCELERATED DEBT RETIREMENT .....	2-7
FUTURE FINANCING ACTIVITIES .....	2-8
FINANCIAL INFORMATION .....	2-8
MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS	
OF OPERATIONS FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2003 .....	2-10
Consolidated Results of Operations .....	2-10
Excess of Revenues over Expenses .....	2-10
Revenue .....	2-10
Fuel and Purchased Power Costs .....	2-10
Operations and Maintenance Expense ("O&M") .....	2-11
Other Income .....	2-11
Interest Charges and Credits .....	2-12
Other Significant Items .....	2-12
DERIVATIVES AND HEDGE ACTIVITIES .....	2-12
PROJECTED REVENUE REQUIREMENTS AND DEBT SERVICE COVERAGE .....	2-12
SECURITY AND SOURCES OF PAYMENT FOR THE BONDS .....	2-13
Pledge of Trust Estate .....	2-13
Payment of Revenues Pursuant to Financing Agreement .....	2-14
Funds .....	2-15
Flow of Funds .....	2-15
Rate Covenant .....	2-16
Additional Bonds Test .....	2-17
Subordinated Indebtedness; Acceleration of Subordinated Indebtedness .....	2-18
LONG ISLAND POWER AUTHORITY .....	2-18
The Act .....	2-18
Trustees .....	2-19
Management and Operations of the System .....	2-19
THE SYSTEM .....	2-22
Service Area .....	2-22
The Transmission and Distribution System .....	2-22
Nine Mile Point Nuclear Power Station, Unit 2 .....	2-22
Capital Improvement Plan .....	2-23
Loads .....	2-23
Power Supply .....	2-24
New York Independent System Operator .....	2-24
Fuel Supply .....	2-27
RATES AND CHARGES .....	2-28
The Act .....	2-28
Authority to Set Electric Rates .....	2-28
Rate Tariffs and Adjustments .....	2-28

# TABLE OF CONTENTS

## (continued)

	<u>Page</u>
BILLING AND COLLECTIONS.....	2-29
General.....	2-29
Allocation of Cash .....	2-30
Collections .....	2-30
SHOREHAM PROPERTY TAX SETTLEMENT.....	2-30
CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY .....	2-31
General.....	2-31
Energy Policy Act of 1992.....	2-31
Certain FERC Initiatives.....	2-32
Competition .....	2-33
Proposed Federal Deregulation Legislation.....	2-34
New York State Electric Utility Industry Regulation .....	2-34
Environmental.....	2-34
Nuclear Plant Matters .....	2-35
ENVIRONMENTAL MATTERS .....	2-36
General.....	2-36
Environmental Liabilities.....	2-37
REGULATION.....	2-37
New York State.....	2-38
Federal .....	2-39
Other Jurisdictions .....	2-39
CORPORATE INCOME TAX RULINGS.....	2-40
LITIGATION.....	2-40
The Offered Securities .....	2-40
Shorcham Litigation .....	2-40
Other Litigation.....	2-41
Potential Litigation .....	2-41
AGREEMENT OF NEW YORK STATE .....	2-41
CONTINUING DISCLOSURE UNDERTAKINGS FOR THE OFFERED SECURITIES.....	2-41
ADDITIONAL INFORMATION.....	2-42
LEGALITY FOR INVESTMENT .....	2-42
FINANCIAL ADVISOR .....	2-42
INDEPENDENT CONSULTANT .....	2-42
Appendix A Independent Consultant's Report.....	A-1
Appendix B Consolidated Financial Statements of the Authority .....	B-1
Appendix C Glossary of Defined Terms.....	C-1
Appendix D Summary of Certain Provisions of the Resolution and the Financing Agreement.....	D-1
Appendix E Summary of Operating Agreements .....	E-1
Appendix F Form of Continuing Disclosure Certificate.....	F-1
Appendix G Book-Entry-Only System .....	G-1

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

**INTRODUCTION**

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

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

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

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

As part of the LIPA/LILCO Merger, the remainder of LILCO's electric service assets (including all of its fossil-fueled generating units), and its entire gas supply system, were transferred to certain wholly-owned subsidiaries (each a "KeySpan Sub" and, collectively, the "KeySpan Subs") of KeySpan Corporation. KeySpan Corporation is a publicly-traded, shareholder-owned corporation with its corporate headquarters located in Brooklyn, New York. KeySpan Corporation does business under the name KeySpan Energy ("KeySpan").

The cost to the Authority of the LIPA/LILCO Merger and the refinancing of most of LILCO's then-existing debt was funded through the issuance of Senior Lien Bonds and Subordinated Lien Bonds. These costs represented payments to the prior shareholders of LILCO for their common and preferred stock and the redemption of certain LILCO bonds. Subsequent to the completion of the LIPA/LILCO Merger, the Authority used other proceeds of Senior Lien Bonds and Subordinated Lien Bonds to retire certain previously issued debentures and other obligations of LILCO.

## **LIPA'S RETAIL ELECTRIC SERVICE BUSINESS**

### **Relationship of the Authority and LIPA**

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

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

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

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

### **System Operation by the Authority**

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

The Authority oversees the operation of the System and manages the Operating Agreements with a staff of approximately 80 and through the support of outside financial, engineering, accounting and legal advisors and consultants. KeySpan has guaranteed performance of each of the Operating



Agreements by the KeySpan Subs. Day-to-day operations and maintenance during the terms of the Operating Agreements are being performed by the workforce of the KeySpan Subs, which is largely the same workforce that performed such services for LILCO prior to the LIPA/LILCO Merger.

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

Assistance to be provided through these outsourcing arrangements includes, but is not limited to, the following: (i) review of actual costs incurred under the Operating Agreements; (ii) review of the incentive/disincentive compensation provisions under the Operating Agreements; (iii) review of the application of price escalation indices under the Operating Agreements; (iv) planning, implementing and monitoring Long Island Choice; (v) review of power and fuel purchases under the EMA; (vi) review and evaluation of annual operating and capital budgets; (vii) solicitations for new capacity and energy supplies; (viii) evaluation of ramp-down opportunities under the PSA; (ix) evaluation of generation purchase rights; and (x) review of fuel purchases, system dispatch and off-system sales and purchases.

See "Long Island Power Authority-Management and Operations of the System" in this Part 2, and "Appendix A to this Part 2 – Independent Consultant's Report" attached hereto.

### **Operating Agreements**

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

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

Under the MSA, the Manager is entitled to incentive payments for cost savings and is subject to penalties for cost overruns on both the operating and capital budgets. In addition to the cost savings incentives, the Manager is eligible annually for incentives for performance above certain threshold target levels and subject to penalties for performance below certain threshold minimum levels with regard to System reliability. The MSA also provides for additional performance incentives and penalties. The operational performance incentives described in this paragraph averaged approximately \$7.2 million in 2001 and 2002.

In 2002 the expiration date of the MSA was extended from 2006 to December 31, 2008. The provisions of the MSA provide that the management services for the T&D System performed by the Manager will be competitively bid after December 31, 2005 for a new management agreement beginning in 2008. See Appendix E to this Part 2 for a summary of the MSA.

*PSA.* The PSA provides for the sale to LIPA by KeySpan Generation LLC ("GENCO") of all of the capacity and, to the extent LIPA requests, energy from the existing oil and gas-fired generating plants on Long Island formerly owned by LILCO (the "GENCO Generating Facilities"). Such sales of capacity and energy from the GENCO Generating Facilities are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission ("FERC"). These rates may be modified in the future in accordance with the terms of the PSA for (i) agreed upon labor and expense indices applied to the base year; (ii) a return of and on net capital additions required for the GENCO Generating Facilities, which additions will require approval by the Authority; and (iii) reasonably incurred expenses that are outside the control of GENCO. This rate formula provides for the reasonable containment of GENCO costs.

The PSA provides incentives and penalties for GENCO of up to \$4 million annually to maintain the output capability of the GENCO Generating Facilities, as measured by annual industry-standard tests of operating capability, and to make capital improvements which benefit plant availability. The performance incentives described in this paragraph averaged approximately \$3.8 million in 2001 and 2002.

The PSA provides LIPA with all of the capacity from the GENCO Generating Facilities. However, LIPA has no obligation to purchase energy from the GENCO Generating Facilities and is able to purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the T&D System. The PSA expires on May 28, 2013 and is renewable on similar terms. However, the PSA provides LIPA the option of electing to reduce or "ramp-down" the capacity it purchases from GENCO beginning May 28, 2004, in accordance with schedules set forth in the PSA. In 2004 through 2008, if LIPA elects to ramp-down, GENCO is entitled to payment for 100 percent of the present value of the capacity charges otherwise payable over the remaining term of the PSA. If LIPA ramps-down the generation capacity in years 2009 through 2013 of the PSA, the capacity charges otherwise payable by LIPA will be reduced in accordance with a formula established in the PSA. The PSA will be terminated in the event that LIPA exercises its right to purchase at fair market value all of the GENCO Generating Facilities during the period beginning on November 28, 2004 and ending on May 28, 2005, subject to certain conditions. See Appendix E to this Part 2 for a summary of the PSA.

*EMA.* The EMA provides for the KeySpan Sub party thereto ("Energy Manager") to (i) procure and manage fuel supplies for LIPA to fuel the GENCO Generating Facilities, (ii) perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs, and (iii) make off-system sales of energy, capacity and other ancillary services from the GENCO Generating Facilities and other power supplies either owned or under contract to LIPA. LIPA is entitled to two-thirds of the profit from any off-system energy sales arranged by the Energy Manager. The term for the service provided in (i) above is until 2013, and the term for the service provided in (ii) and (iii) above is until 2006. The EMA also provides for a continuation of the present gas transportation rate for gas delivered over the gas distribution system to the GENCO Generating Facilities and to new generation resources until 2009, with cost-based adjustments to meet gas delivery system expansion needs.

The EMA provides for payment of the costs of sufficient professional and support staff for the Energy Manager to properly perform its functions thereunder. While LIPA pays for the actual fuel and electricity purchased, the EMA further provides incentives for control of the cost of fuel and electricity purchased on behalf of LIPA by the Energy Manager. See Appendix E to this Part 2 for a summary of the EMA. The electricity purchase incentive or penalty under the EMA, together with the net other performance incentives and penalties under the MSA, cannot exceed \$7.5 million for any year. The financial performance incentives described in this paragraph averaged approximately \$5 million in 2001 and 2002.

## **Other Rights**

Pursuant to certain other agreements between LIPA and KeySpan or KeySpan Subs, certain future rights are granted to LIPA. Subject to certain conditions, these rights include the right until 2097 to lease or purchase, or to allow its designee to lease or purchase, at fair market value, parcels of land and to acquire unlimited access to, as well as appropriate easements at, each parcel of land upon which an existing GENCO Generating Facility is situated and land contiguous thereto for the purpose of constructing new electric generating facilities to be owned by LIPA or its designee. Subject to LIPA's right of first refusal, KeySpan and its subsidiaries also have the right to sell or lease these properties to third parties.

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

When the Authority became the retail supplier of electric service in the Service Area through the acquisition of LILCO in May 1998, it obtained a one-time unilateral right (the "Generation Purchase Option") to acquire all the equity interests in GENCO at fair market value pursuant to the Generation Purchase Right Agreement (the "GPRA"). GENCO owns all of the former LILCO on-island generation consisting of 53 generating units at 13 locations totaling approximately 4,000 MW in capacity. The GPRA was amended in 2002 to provide that the Generation Purchase Option can be exercised only during the period beginning on November 28, 2004 and ending on May 28, 2005. The GPRA provides that notice of exercise of such option must be given by the Authority to KeySpan prior to determination of the acquisition price. The GPRA further provides that prior to issuing such notice, the Authority must have (i) the approval of the Trustees by at least a two-thirds vote; (ii) New York State Public Authorities Control Board (the "PACB") approval of the exercise of the right and related financing; and (iii) a decision as to who will manage GENCO after the purchase. The notice to acquire GENCO would be legally binding on the Authority, with certain exceptions, subject to third party approvals, including the New York State Comptroller's office, the New York State Attorney General's office and the PACB. The acquisition price is to be determined through negotiation by investment bankers retained by KeySpan and the Authority, or by a third investment banker if the first two cannot agree. The GPRA provides that the closing of the acquisition is to occur within 90 days of determination of the acquisition price, subject to third party approvals.

## **Guarantees and Indemnities**

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

KeySpan and various subsidiaries (the "KeySpan Parties") have entered into an indemnification agreement with the Authority and LIPA (the "LIPA Parties") pursuant to which the KeySpan Parties agreed to indemnify the LIPA Parties and hold them harmless from a variety of specified liabilities in connection with the LIPA/LILCO Merger, including, among others, the unpaid debts, liabilities or obligations relating to the LILCO assets transferred to the KeySpan Parties prior to the LIPA/LILCO Merger. The LIPA Parties have entered into a similar indemnification agreement with the KeySpan

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

### **LIPA Assets and Liabilities**

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

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

The LIPA Liabilities included (i) LILCO's obligation to pay the principal of and interest on certain unsecured debentures of LILCO that had been issued prior to the LIPA/LILCO Merger (the "Debentures") (there were \$270 million of the Debentures outstanding, all of which were redeemed as of March 22, 2003 from funds provided to the Authority from KeySpan for this purpose); (ii) LILCO's obligation to pay the principal of and interest on notes (the "NYSERDA Financing Notes") issued by LILCO to secure tax-exempt bonds issued on behalf of LILCO by the New York State Energy Research and Development Authority ("NYSERDA") prior to the LIPA/LILCO Merger (there were \$332.425 million of the NYSERDA Financing Notes outstanding as of March 1, 2003, of which \$177.005 million were redeemed on March 31, 2003 from funds provided to the Authority by KeySpan for this purpose); (iii) certain customer deposits and payables; and (iv) other liabilities, including environmental liabilities of LILCO not otherwise transferred to or indemnified by a subsidiary of KeySpan.

KeySpan is obligated to make payments to LIPA under the Promissory Notes equal to the principal and interest on all of the NYSERDA Financing Notes. If at any time during the term of the Promissory Notes, the long-term senior debt of KeySpan is not rated at least "A" by two or more nationally recognized rating services, then KeySpan is obligated to either: (i) deliver a letter of credit issued by a financial institution whose long-term senior debt is or would be rated "A" by at least two such rating services to secure the Promissory Notes; or (ii) economically defease the Promissory Notes by

delivering to LIPA U.S. treasury securities sufficient, as determined by LIPA, to pay all amounts due in respect of the debt related to the Promissory Notes. Payments under the Promissory Notes are general revenues of LIPA payable by LIPA to the Authority under the Financing Agreement and are not dedicated to the payment of any NYSERDA Financing Note. The Authority is obligated to pay to LIPA, from the Authority's general revenues, funds sufficient to pay the NYSERDA Financing Notes. This obligation of the Authority, however, is subordinate to the obligations of the Authority to pay, when due, operating expenses, and principal and interest on the Bonds and the Subordinated Indebtedness.

### **ACCELERATED DEBT RETIREMENT**

Since the acquisition of LILCO, the Trustees have sought to accelerate the retirement of a principal amount of Bonds, Subordinated Indebtedness, Debentures and NYSERDA Financing Notes in an amount approximately equal to the \$4.0 billion Acquisition Adjustment. Such plan is a matter of Authority policy and may be changed at any time. This accelerated debt retirement plan has both scheduled and optional elements and also takes into account the funding of capital expenditures with operating revenues. The Authority implemented the scheduled element through the scheduled amortization of approximately \$1.1 billion of certain of its outstanding Senior Lien Bonds and by increasing the scheduled amortization of certain of its Bonds in years 2000 through 2012 by approximately \$872 million. The optional element of the plan contemplates using excess cash flow over Debt Service and favorable budget variances to retire debt on a non-scheduled basis through a combination of (i) open market purchases and tender offers; (ii) cash defeasances; and (iii) the exercise of the Authority's optional redemption rights. In addition, the Authority considers the use of revenues to fund capital expenditures which otherwise could have been financed with borrowings as satisfying the optional element of the plan.

In accordance with the optional element of this plan, the Authority (i) in December 1999 successfully tendered for, purchased and retired \$148,195,000 of its then Outstanding Senior Lien Bonds, (ii) in March 2000 defeased \$54,166,000 of LIPA's high-coupon Debentures, (iii) in March 2003 redeemed \$270,000,000 of Debentures and \$177,005,000 of NYSERDA Financing Notes and (iv) funded \$116,762,000 of capital expenditures eligible for bonding in all cases using excess cash flow as discussed above.

Current projections show that the plan approved by the Trustees as described above will enable the Authority, in aggregate, to fund capital expenditures or retire an amount approximately equal to the original \$4.0 billion Acquisition Adjustment by the year 2013 while amortizing its remaining debt and future financings on a level debt basis.

Both the Rate Covenant and the additional Bonds test under the Resolution include coverage calculations based, in part, on 120% of Debt Service and payments under Parity Contract Obligations. This percentage coverage will be reduced to 100% when the Authority has retired, with funds other than proceeds of Bonds or Subordinated Indebtedness, Acquisition Debt (as defined in Appendix C to this Part 2) in an amount equal to 25% of total Acquisition Debt net of the then outstanding balance of the Promissory Notes. Through December 31, 2003, as a result of debt retired by the Authority, including the redemption of \$270 million of Debentures as of March 22, 2003 and the redemption of \$177,005,000 NYSERDA Financing Notes on March 31, 2003 from payments received from KeySpan, it is expected that the Authority will have retired 22% of Acquisition Debt net of the outstanding balance of the Promissory Notes. The Authority estimates, based upon the accelerated debt retirement program as described above, that the 25% level of retirements will be achieved in 2004.

## **FUTURE FINANCING ACTIVITIES**

The Authority has approved a plan of finance that it expects to complete by June 2003 that includes various borrowings. First, the Authority remarketed on April 1, 2003, \$25.225 million of its Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds that are scheduled to mature on April 1, 2010. Next, the Authority issued on April 30, 2003 approximately \$622 million Electric System General Revenue Bonds, Series 2003A and Series 2003B to refund certain maturities of the Electric System General Revenue Bonds, Series 1998A, 1998B and 2000A that are currently insured by Financial Security Assurance Inc. ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"). Next, the Authority plans to issue the Offered Securities. Subsequent to the issuance of the Offered Securities, in connection with the replacement of certain expiring letters of credit supporting the Authority's \$700 million Electric System Subordinated Bonds, Series 1 through Series 3, the Authority plans to remarket approximately \$525 million of such Bonds as subordinate lien variable rate bonds. Concurrently with the remarketing, the Authority plans to issue approximately \$587 million Refunding VR Bonds to current refund approximately \$587 million Electric System General Revenue Bonds, Series 1998A (2029 maturity, 5.50% coupon). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003. See footnote 5 to the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001 for a discussion of the swaption. In addition, in May the Authority plans to issue approximately \$100 million Notes pursuant to its Commercial Paper program to redeem its outstanding Commercial Paper Notes in connection with the issuance of new letters of credit to support such Notes.

The Authority expects to issue debt in the future for a variety of purposes, including the funding of capital expenditures and refinancing Bonds or Subordinated Indebtedness to the extent economically attractive. If the Authority elects to exercise its option to purchase the equity interest in GENCO from KeySpan, it is expected that additional bonds would be issued to fund the purchase price. See "LIPA's Retail Electric Service Business-Other Rights" in this Part 2.

## **FINANCIAL INFORMATION**

The Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001 are attached hereto as Appendix B. The Authority's Consolidated Financial Statements contain Management's Discussion and Analysis of the Consolidated Results of Operations for the year ended December 31, 2002. Certain prior period amounts have been reclassified in the financial information to conform to the current year presentation. In November 2002 after repeated notifications from the Authority to KeySpan that the revenue data being provided by KeySpan appeared erroneous, KeySpan notified the Authority that the financial information furnished to the Authority by KeySpan included an overstatement of the Authority's electric system revenues in various periods including 2002 and 2001. An independent review of this matter has been completed and the Authority has taken certain actions including the restatement of its financial statements for the year ended December 31, 2001. See "Management's Discussion and Analysis of the Consolidated Results of Operations for the Year Ended December 31, 2002" contained in Appendix B to this Part 2. The Authority has commenced a broad quality assurance review of KeySpan's performance under the various agreements pursuant to which KeySpan provides services to the Authority. It is currently expected that such review will be completed during the summer of 2003. The Authority cannot predict the outcome of such review.

The table below provides certain financial information with respect to the Authority. The information regarding the years ended 2001 and 2002 has been derived from the Authority's audited financial statements and should be read in conjunction with the notes accompanying the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001 contained in

Appendix B to this Part 2. The information for the three month periods ending March 31, 2003 and March 31, 2002 is unaudited.

	<b>Years Ended December 31</b>		<b>(Unaudited) Three Months Ended March 31</b>	
	<b>2001*</b>	<b>2002</b>	<b>2002*</b>	<b>2003</b>
(in thousands)				
<b>Electric Revenue</b>	\$ 2,356,351	\$ 2,459,210	\$ 505,169	\$ 550,709
<b>Expenses</b>				
Operations – fuel and purchased power.....	881,335	924,778	157,428	263,139
Operations and maintenance.....	719,853	767,217	168,258	175,813
General and administrative.....	36,746	49,780	9,188	9,324
Depreciation and amortization.....	212,283	220,654	53,919	54,884
Payments in lieu of taxes.....	219,579	218,156	50,786	50,575
Total Operating Expenses.....	<u>2,069,796</u>	<u>2,180,585</u>	<u>439,579</u>	<u>553,735</u>
<b>Excess of operating revenues over expenses.....</b>	<u>286,555</u>	<u>278,625</u>	<u>65,590</u>	<u>(3,026)</u>
<b>Other income, net</b>				
Investment income.....	23,638	14,860	4,441	2,682
Carrying charges on regulatory asset.....	36,192	29,290	7,105	7,497
Other.....	12,219	8,054	1,503	4,292
Total other income, net.....	<u>72,049</u>	<u>52,204</u>	<u>13,049</u>	<u>14,471</u>
<b>Excess of revenues over expenses before interest charges and (credits).....</b>	<u>358,604</u>	<u>330,829</u>	<u>78,639</u>	<u>11,445</u>
<b>Interest charges and (credits)</b>				
Interest on long-term debt, net.....	316,592	295,911	75,438	72,386
Other interest.....	25,914	23,812	5,939	6,093
Allowance for borrowed funds used during construction.....	(4,450)	(9,006)	(1,866)	(1,135)
Total interest charges.....	<u>338,056</u>	<u>310,717</u>	<u>79,511</u>	<u>77,344</u>
<b>Excess of expenses over revenues before Cumulative Effect of a Change in Accounting Principle.....</b>	<u>20,548</u>	<u>20,112</u>	<u>(872)</u>	<u>(65,899)</u>
<b>Cumulative Effect of a Change in Accounting Principle.....</b>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2,873</u>
<b>Excess of revenues over expenses.....</b>	<u>20,548</u>	<u>20,112</u>	<u>(872)</u>	<u>(63,026)</u>
<b>Accumulated deficit</b>				
Beginning balance as previously recorded.....	(61,670)	—	(31,365)	(11,253)
Correction of prior periods.....	9,757	—	—	—
Beginning balance as adjusted.....	<u>(51,913)</u>	<u>(31,365)</u>	<u>—</u>	<u>—</u>
Ending.....	<u>\$ (31,365)</u>	<u>\$ (11,253)</u>	<u>\$ (32,237)</u>	<u>\$ (74,279)</u>

\* Restated. See Note 3 to the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001, included in this Official Statement as Appendix B to Part 2.

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

**Consolidated Results of Operations**

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the three months ended March 31, 2003 and 2002. Note that the 2002 results of operations have been restated to correct the effects of the KeySpan error. See "Management's Discussion and Analysis of the Consolidated Results of Operations for the Year Ended December 31, 2002" contained in Appendix B to this Part 2.

**Excess of Revenues over Expenses**

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

**Revenue**

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

**Fuel and Purchased Power Costs**

Fuel and purchased power costs increased approximately \$106 million. This increase is due to \$51 million of costs in excess of those charged to customers in base rates established in 1998 ("excess fuel costs") which were not deferred, combined with a decrease in the mark-to-market valuations of LIPA's fuel hedges of approximately \$36 million and higher expense recognition of approximately \$19 million due to higher sales.

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

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



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

During the three months ended March 31, 2003 and 2002, excess fuel costs totaled approximately \$130 million and \$25 million, respectively. Of the \$130 million of 2003 excess fuel costs, LIPA collected in March 2003 \$2 million of the \$75 million to be collected through year-end. Of the remaining \$128 million, \$16 million of the \$70 million to be recovered in 2004 was deferred, and approximately \$60 million was deferred for collection over the 10-year period to begin January 1, 2004. These two deferral amounts were based upon the relative experience of actual sales generated in the first three months of 2003 relative to the annual sales forecast for the entire year. The remaining \$51 million was charged to expense, as LIPA's latest forecast supports a net income figure of \$20 million with that level of expense through March 31, 2003. The 2002 \$25 million excess fuel cost was deferred in full at March 31, 2002.

Included in fuel and purchased power expense for the three month period ended March 31, 2003, is an unrealized loss of approximately \$7 million necessary to comply with the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS No. 133"). FAS No. 133 requires fuel-related derivatives to be re-valued each period to their fair market value. The \$7 million mark-to-market unrealized loss resulted from the change in fuel related derivative values at March 31, 2003 when compared to their values at December 31, 2002. However, when compared to the mark-to-market values at March 31, 2002, the change in the valuation results in an approximate \$36 million variation effect on fuel and purchased power expense. The unrealized gains/losses are included in fuel and purchased power expense but because this valuation is unrealized, it is excluded from the FPPCA calculation.

Eliminating the effects of the accounting mechanisms used to comply with the Authority's tariffs and FAS No. 133 demonstrates that fuel and purchased power costs in 2003 increased by approximately \$125 million when compared to the three month period ended March 31, 2002. Approximately \$19 million is attributable to increased sales for the 2003 period compared to 2002, and approximately \$109 million is attributable to increased fuel and purchased power costs.

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

O&M increased approximately \$7.5 million for the three months ended March 31, 2003 when compared to the similar period in 2002. This increase is primarily attributable to higher costs associated with clean energy initiatives totaling approximately \$3 million; increased PSA costs totaling approximately \$3 million; increased costs related to incremental repair work on the T&D System totaling approximately \$1 million; and the recognition of approximately \$1 million related to the accretion of an Asset Retirement Obligation ("ARO") recognized in accordance with Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (as more fully discussed below under the caption "Other Significant Items"), partially offset by lower Nine Mile Point 2 ("NMP2") costs totaling approximately \$1 million.

### **Other Income**

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

## **Interest Charges and Credits**

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

## **Other Significant Items**

On January 1, 2003, the Authority adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations." An 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 has an ownership interest in NMP2 for which a legal obligation exists for its retirement. Accordingly, LIPA recognized an ARO which was primarily offset by the capitalization of such costs which are included in Utility plant, net.

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

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

## **DERIVATIVES AND HEDGE ACTIVITIES**

The Authority uses financial derivative instruments to manage the impact of interest rate, energy price and fuel cost changes on its earnings and cash flows. LIPA oversees its risk management activities through an executive risk management committee comprised of the Chief of Staff; General Counsel; Vice President – Power Markets; Chief Operating Officer; the Chief Financial Officer who chairs the committee and an independent risk management consultant. Effective January 1, 2001 the Authority adopted Statement of Financial Accounting Standards ("FAS") No. 133, "Accounting for Derivatives and Hedging Activities" as amended by FAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" to the extent appropriate under Governmental Accounting Standards. These financial accounting standards establish accounting and reporting requirements for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The standard requires that the Authority recognize the fair value of all derivative instruments as either an asset or liability on its balance sheet with the offsetting gains or losses recognized in earnings or deferred charges. Application of FAS No. 133 may increase the volatility of reported earnings. For a further discussion of these matters, see the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001, Note 5.

## **PROJECTED REVENUE REQUIREMENTS AND DEBT SERVICE COVERAGE**

The Independent Consultant's Report, dated March 25, 2003, and attached as Appendix A to this Part 2, presents projections and forward looking statements related to the Authority's annual revenues and revenue requirements for the period January 1, 2003 through December 31, 2008 (the "Study Period"). The Independent Consultant's Report also projects that the Authority's Debt Service coverages during the Study Period will be no less than approximately: (i) 1.8x on the senior lien debt (including the debt proposed to be issued in 2003) outstanding and estimated to be outstanding; (ii) 1.7x on the senior lien debt (including the debt proposed to be issued in 2003) and the subordinated lien debt, in both cases

outstanding and estimated to be outstanding; and (iii) 1.6x on the senior and subordinate lien debt mentioned in clause (ii) and on the NYSERDA Financing Notes outstanding after March 31, 2003. The Independent Consultant's Report is based on the information available at the time it was prepared including an estimate at such time of the results of the Authority's financing activities in 2003.

The prospective financial information included in this Official Statement has been prepared by, and is the responsibility of, the Authority and its Independent Consultant. These projections were not prepared by PricewaterhouseCoopers LLP and were not prepared with a view towards complying with and do not comply with the *American Institute of Certified Public Accountants Audit and Accounting Guide For Prospective Financial Information*. There is no requirement that such prospective financial information be prepared in accordance with such guide. PricewaterhouseCoopers LLP has neither examined nor compiled the accompanying prospective financial information, and accordingly, PricewaterhouseCoopers LLP does not express an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report included in this Official Statement relates to the Authority and LIPA's historical financial information as of December 31, 2001 and 2002 and the years ended December 31, 2001 and 2002. It does not extend to the prospective financial information and should not be read to do so.

THE PROJECTIONS IN THE INDEPENDENT CONSULTANT'S REPORT ARE PREDICATED UPON ASSUMPTIONS PRESENTED IN THEIR REPORT. NEITHER THE INDEPENDENT CONSULTANT, THE AUTHORITY NOR THE REMARKETING AGENT MAKE ANY REPRESENTATION THAT THESE ASSUMPTIONS WILL, IN FACT, OCCUR. THESE PROJECTIONS MAY BE AFFECTED FAVORABLY OR UNFAVORABLY BY UNFORESEEN FUTURE EVENTS, AND THEREFORE, TO THE EXTENT CONDITIONS DIFFER FROM THOSE ASSUMED IN THE INDEPENDENT CONSULTANT'S REPORT, THE RESULTS THAT WILL BE ACHIEVED BY THE AUTHORITY WILL VARY FROM THOSE PROJECTED. THE ASSUMPTIONS WHICH FORM THE BASIS FOR THESE PROJECTIONS AND THE CONCLUSIONS DRAWN BY THE INDEPENDENT CONSULTANT ARE DISCUSSED IN THE INDEPENDENT CONSULTANT'S REPORT WHICH SHOULD BE READ IN ITS ENTIRETY FOR AN UNDERSTANDING OF THESE PROJECTIONS, ASSUMPTIONS, AND CONCLUSIONS.

### **SECURITY AND SOURCES OF PAYMENT FOR THE BONDS**

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

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

#### **Pledge of Trust Estate**

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

The Resolution authorizes the application of Revenues to certain purposes free and clear of the lien of the pledge. These applications include payment of Operating Expenses from the Operating Expense Fund prior to the deposit of Revenues in the Debt Service Fund. In addition, the Resolution

provides that amounts on deposit in the Rate Stabilization Fund may be used for any lawful purpose of the Authority or LIPA, and amounts retained in the Revenue Fund may be used for any lawful purpose of the Authority or LIPA, as determined by the Authority.

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

- (i) all payments received by the Authority from LIPA under the Financing Agreement, and all rights to receive the same;
- (ii) all Revenues and all right, title and interest of the Authority in and to Revenues, and all rights of the Authority to receive the same;
- (iii) the proceeds of sale of Bonds until expended for the purposes authorized by the Supplemental Resolution authorizing such Bonds; and
- (iv) all funds, accounts and subaccounts established by the Resolution, including securities credited thereto and investment earnings thereon.

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

#### **Payment of Revenues Pursuant to Financing Agreement**

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

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

## **Funds**

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

## **Flow of Funds**

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

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

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

(B) to the Parity Contract Obligations Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Parity Contract Obligations;

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

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

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

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

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

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

## Rate Covenant

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

- (i) 120% (except, after the Authority retires, other than from the proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the Promissory Notes, 100%; see "Accelerated Debt Retirement" in this Part 2) of Debt Service, and amounts under all Parity Contract Obligations, payable by the Authority in such Fiscal Year;
- (ii) 100% of the Operating Expenses payable in such Fiscal Year;
- (iii) 100% of the amount necessary to pay all PILOTs payable in such Fiscal Year; and
- (iv) 100% of the amount necessary to pay other Required Deposits, all other payments required pursuant to the Resolution and the Financing Agreement, and all other payments required for the System, for such Fiscal Year.

If at any time such fees, rates, rents, charges and surcharges are or will be insufficient to meet the Rate Covenant, it will not constitute an Event of Default if and to the extent the Authority promptly takes action reasonably expected by the Authority to cure or avoid any such deficiency or to cause the same to be cured or avoided. In addition, the failure in any Fiscal Year to comply with the covenant in clauses (i) (but only to the extent of the excess, if any, over 100% of Debt Service and amounts under all Parity Contract Obligations), (iii) and (iv) above (the "non-debt service and operating expense rate covenant"), will not constitute an Event of Default if the Authority retains a Rate Consultant and a Consulting Engineer for the purpose of reviewing System fees, rates, rents, charges and surcharges and reviewing the System Budget and complies with the following sentence. If the Rate Consultant (relying upon a certificate of the Consulting Engineer) is of the opinion that a schedule of fees, rates, rents, charges and surcharges for the T&D System which would provide funds to meet the requirements specified in the non-debt service and operating expense rate covenant is impracticable at that time and the Authority therefore cannot comply with the non-debt service and operating expense rate covenant, then the Authority will fix and establish such schedule of System fees, rates, rents, charges and surcharges as is recommended in such certificate by the Rate Consultant to comply as nearly as practicable with the non-debt service and operating expense rate covenant, and in such event the failure of the Authority to comply with the non-debt service and operating expense rate will not constitute an Event of Default.

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

In addition, the Authority covenants in the Resolution to review, or cause LIPA to review, the adequacy of System fees, rates, rents, charges and surcharges at least annually. Except to the extent required by law, the Authority covenants not to permit LIPA to furnish or supply or cause to be furnished

or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private, unless the Authority determines that other adequate consideration has been, or is expected to be, received in connection therewith, and to cause LIPA to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

### **Additional Bonds Test**

The Resolution requires that, as a condition to the delivery of additional Bonds, except Refunding Bonds, the Authority shall deliver to the Trustee the Certificate referred to in either subparagraph (A) or (B), unless not required as described below, as follows:

(A) A Certificate of any Authorized Representative of the Authority setting forth (i) the Revenues for any 12 consecutive calendar months out of the 18 calendar months immediately preceding the month in which such Bonds are to be issued, (ii) the Debt Service, and the amount payable under all Parity Contract Obligations, during such 12 month period for which Revenues are set forth pursuant to clause (i), excluding in each case any amount thereof paid from sources other than Revenues, and (iii) the sum of the Required Deposits for such 12 month period (excluding Required Deposits for the payment of Outstanding Bonds and Parity Obligations), and showing that the amount set forth in clause (i) is at least equal to the sum of (x) 120% of the amount set forth in clause (ii) and (y) 100% of the amount set forth in (iii).

(B) A Certificate of a Rate Consultant setting forth (i) the estimated Revenues for each of the full Fiscal Years in the period beginning with the Fiscal Year in which such Bonds are authenticated and delivered and ending with the fifth full Fiscal Year after such date of authentication and delivery, (ii) the estimated Debt Service, and estimated amounts payable under all Parity Contract Obligations, during each Fiscal Year for which Revenues are estimated pursuant to clause (i), (iii) the projected Debt Service, and projected amounts payable under Parity Contract Obligations, projected to be required for any purpose during each Fiscal Year for which Revenues are estimated pursuant to clause (i), and (iv) the sum of the estimated and projected Required Deposits for each such Fiscal Year (excluding Required Deposits for the payment of Outstanding Bonds and Parity Obligations), and showing that for each such Fiscal Year the amount set forth in clause (i) is at least equal to the sum of (x) 120% of the sum of the amounts set forth in clauses (ii) and (iii), and (y) 100% of the amount set forth in clause (iv). The Rate Consultant may base its estimates and projections upon such factors as it shall consider reasonable, a statement to which effect shall be included in the Certificate.

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

The above provisions shall not apply at any time after the Authority first shall have retired, other than from proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the Promissory Notes. See "Accelerated Debt Retirement" in this Part 2.

### **Subordinated Indebtedness; Acceleration of Subordinated Indebtedness**

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

Subordinated Indebtedness is subject to acceleration prior to maturity upon the occurrence of certain events.

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

## **LONG ISLAND POWER AUTHORITY**

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

### **The Act**

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

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

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



## Trustees

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

## Management and Operations of the System

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

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

*Management.* The present officers, and senior management of the Authority, with information covering their background and experience, are listed below.

*Richard M. Kessel* (53) is the Chairman, President and Chief Executive Officer of the Authority. Mr. Kessel has served as a Trustee of the Authority since the Authority's inception. Mr. Kessel, who first served as Chairman of the Authority from 1989 to 1995, was reappointed Chairman in April 1997 by Governor George Pataki. Mr. Kessel was appointed as Executive Director and Chairman of New York State's Consumer Protection Board in January 1984 and served until January 1995. Mr. Kessel served as an ex-officio member of Governor Cuomo's Advisory Commission on Liability Insurance. Mr. Kessel is a member of the Board of Directors of the Nassau County Interim Finance Authority. He received his Masters in Political Science from Columbia University.

*Patrick Foye* (46) is a Deputy Chairman of the Authority. Mr. Foye became a Trustee in September 1995. Mr. Foye is Executive Vice President of Apartment Investment and Management Company, a real estate investment trust and the nation's largest owner and manager of multifamily apartment properties. He was a partner from 1989 to 1998 in the law firm of Skadden, Arps, Slate, Meagher & Flom LLP. Mr. Foye serves as the Chairman of the New York Public Asset Fund (the "Fund"), overseeing the multi-year disposition of the shares of WellChoice, Inc. (formerly known as Empire Blue Cross Blue Shield) that were transferred to the Fund as part of the conversion of WellChoice to a for-profit company. Mr. Foye is a graduate of Fordham College and Fordham Law School.

*Howard E. Steinberg* (58) is a Deputy Chairman of the Authority. Mr. Steinberg became a Trustee in April 1999. He is Executive Vice President and General Counsel at Prudential Securities, Inc. Mr. Steinberg served as Chairman of the New York State Thruway Authority and Chairman of the New York State Canal Corporation from 1996 to 1999. He currently serves on the Federal Regulation Committee of the Compliance and Legal Division of the Securities Industry Association. Mr. Steinberg is a member of the Board of Regents of Georgetown University and is a member of the Board of Directors of Sheltering Arms Children's Services, and has been a member of the Board of Overseers of the University of Pennsylvania School of Arts and Sciences. He holds a B.A. from the University of Pennsylvania, and a J.D. from Georgetown University Law Center.

*Seth D. Hulkower* (45) is the Chief Operating Officer of the Authority. He was appointed to this position in June of 1999. Prior to this appointment, he was the Authority's Executive Director, a position he held beginning in July 1996. Prior to his association with the Authority, Mr. Hulkower was a Vice President of Merrill International Ltd., an energy project development and consulting company. Prior to Merrill International, Mr. Hulkower was a Vice President of JFG Associates, Inc. a financial advisory and management consulting firm. He has also held positions with the consulting firm of Putnam, Hayes, & Bartlett, Inc., New England Power Company and Stone & Webster Engineering Company. Mr. Hulkower received his S.M. in Technology and Policy from the Massachusetts Institute of Technology and his B.S. in Mechanical Engineering and B.A. in Economics from Tufts University.

*Anastasia Song* (42) is the Chief Financial Officer of the Authority. She was appointed to this position in May 2002 and is responsible for all financial activities of the Authority. Prior to this appointment, Ms. Song was a Director at Credit Suisse First Boston's Global Asset Finance Group. Earlier in her career, Ms. Song was Vice President of Corporate Finance at Sithe Energies, Inc. involved in numerous mergers and acquisition transactions for large-scale power generation transactions. Ms. Song's experience also includes work for the State of New York, where she served as Assistant Secretary of Energy to Governor George E. Pataki. In 1998, Governor Pataki appointed her a Commissioner of the Port Authority of New York and New Jersey, where she chairs the Finance Committee, and serves on the Audit, Operations and Security Committees. Ms. Song serves on the Board of the New York Public Asset Fund. Ms. Song received a BA degree from Bryn Mawr College, an MBA from Fordham University (honors in Finance) and has passed the CPA examinations.

*Stanley B. Klimberg* (58) is the General Counsel of the Authority. He joined the Authority in 1987 as its General Counsel and Acting Executive Director. Before joining the Authority, Mr. Klimberg was General Counsel of the New York State Energy Office from 1979-1987, and before that he was Assistant General Counsel and Staff Counsel of the New York State Public Service Commission. Mr. Klimberg received his law degree (J.D.) from the New York University School of Law and his undergraduate degree (B.A.) in history with high honors from Lehigh University.

*Edward P. Murphy, Jr.* (59) is the Chief Administrative Officer of the Authority. He joined the Authority in May 1998. Prior to his employment at the Authority, Mr. Murphy held several management positions at Brooklyn Union Gas Company. From 1995-1997, he was Vice President for Business Transformation. Mr. Murphy was Vice President for Public Affairs from 1988-1994. From 1982-1987, he served as General Auditor and was Budget Director from 1976-1982. Prior to this, Mr. Murphy held

various positions in operations and accounting at Brooklyn Union Gas Company. Mr. Murphy received his B.S. in Accounting from Clarkson University and attended the Executive Program in Business Administration at Columbia University.

*Kenneth Kane* (42) is the Controller of the Authority. He joined the Authority in 1999 as its Director of Financial Reporting. Prior to joining the Authority, Mr. Kane held the position of Manager of Regulatory and Financial Reporting for LILCO. Prior to this, Mr. Kane held positions at Mitchell Hutchins Institutional Investors and Ernst & Young, LLP. Mr. Kane is a Certified Public Accountant in the State of New York, is a member of the American Institute of Certified Public Accountants and holds a B.A. from Pace University.

*Edward J. Grilli* (51) is the Chief of Staff of the Authority. He was appointed to this position in November of 2000. Prior to joining the Authority, Mr. Grilli for twenty-one years served as the Director of Public Relations for the Nassau County District Attorney's Office. In addition to supervising the dissemination of all information from an office of over 300 attorneys and support staff, Mr. Grilli directed the Crime Victims Program for the Office and served as a key advisor to the District Attorney. Prior to this, he worked as the Press Secretary to the New York State Assembly Ways and Means Committee. Mr. Grilli has also worked as an Adjunct Professor at several universities and colleges, a media consultant and journalist. Mr. Grilli holds a B.F.A. in Communications from the New York Institute of Technology.

*Richard J. Bolbrock* (56) is Vice President of Power Markets for the Authority. He joined the Authority in May 1998. Prior to his employment at the Authority, Mr. Bolbrock held several positions at New England Power Pool over a 24-year period including Director-Planning and Information Technology for ISO New England, Inc., Director of New England Power Planning from 1983-1997, and Manager of Billing for the New England Power Exchange from 1979-1983. Prior to this, Mr. Bolbrock held various positions at Northeast Utilities and American Electric Power. He serves on the Boards of the New York Energy Group, Inc., the Northeast Power Coordinating Council, and the New York State Reliability Council, LLC. Mr. Bolbrock received his B.S. in Electrical Engineering and his M.E. in Electric Power Engineering from Rensselaer Polytechnic Institute and is a Registered Professional Engineer.

*Bert J. Cunningham* (55) is Vice President of Communications for the Authority. He joined the Authority in September 1998. Prior to joining the Authority, Mr. Cunningham was President/Chief Operating Officer of The Blankman Cunningham Group, LLC (formerly Howard Blankman Incorporated), a regional public relations and marketing communications firm that represents clients in the fields of energy, telecommunications, transportation, banking, and government. Before that he served as Chief of Staff and Executive Director of Government and Community Affairs of The Long Island Rail Road, an operating agency of the Metropolitan Transportation Authority. Mr. Cunningham has also served as Chief of Staff to the Supervisor of the Town of North Hempstead in Nassau County, and Director of Public Affairs for both the New York State Senate Standing Committee on Transportation and the New York State Legislative Commission on Critical Transportation Choices. Mr. Cunningham holds a B.F.A. in Communications from the New York Institute of Technology.

*Bruce Germano* (51) is Vice President of Retail Services for the Authority. He joined the Authority in 1999. Mr. Germano has worked in the energy field both domestically and internationally for almost 30 years, holding positions with KeySpan Energy, Long Island Lighting Co., American Electric Power, and Gibbs and Hill Inc. Mr. Germano holds a Bachelor of Science Degree in Engineering from Manhattan College and a Master of Science Degree in Industrial Management from SUNY Stonybrook. He is Chairman of the Steering Committee of CEIDS, an international electric utility consortium whose mission is to develop the electric infrastructure required to fulfill the needs of a digital society in the 21<sup>st</sup> century. He is also Co-Chairman of the Long Island Business Development Council, a Vice President of the Board for the Advancement of Commerce, Industry and Technology, and a member of the Board of the Hauppauge Industrial Association.

## **THE SYSTEM**

See the Independent Consultant's Report attached hereto as Appendix A to this Part 2 for a further discussion of the System.

### **Service Area**

The Service Area consists of Nassau and Suffolk Counties (with certain limited exceptions) and a small portion of Queens in New York City known as the Rockaways. The population of the Service Area was estimated by LIPA at 2.8 million as of January 1, 2002. As of December 31, 2002, the Authority had approximately 1.1 million customers in the Service Area.

In the year ending December 31, 2002, approximately 51% of LIPA's annual retail revenues were received from residential customers and 47% from commercial and industrial customers with the balance derived from sales to other municipalities and public authorities. Individual commercial and industrial customers are relatively small with approximately 94% of these customers having peak demands less than 75kW. The largest customer in the Service Area accounted for less than two percent of total electric sales.

### **The Transmission and Distribution System**

The T&D System is an integrated electric transmission and distribution system with electricity delivered to and from the Service Area over five transmission interconnections that are owned in part by or are under contract to LIPA. Two of the T&D System's transmission interconnections are to the transmission system of Consolidated Edison Inc. of New York ("Con Edison") in Queens, New York and three extend across Long Island Sound to Westchester County, New York or to Connecticut. These interconnections connect the T&D System to utilities outside of the Service Area and enable delivery of (i) capacity and energy produced by NMP2; (ii) additional off-system capacity resources needed to meet the peak demands of LIPA's electric customers; (iii) favorably-priced energy to supplement or displace generation from generating resources within the Service Area; and (iv) excess generation from generating facilities within the Service Area to purchasers outside of the Service Area when market conditions merit.

As of December 31, 2002, LIPA's transmission system includes approximately 1,282 miles of overhead and underground lines with voltage levels ranging from 345kV to 23kV. As of December 31, 2002, the 13kv and 4kv distribution system has approximately 58,611 cable miles of overhead and underground lines and approximately 205,685 line transformers.

For a discussion of the System's transmission interconnections, see "Appendix A to this Part 2 – Independent Consultant's Report."

### **Nine Mile Point Nuclear Power Station, Unit 2**

LIPA owns an 18 percent interest in NMP2, which is part of a two-unit nuclear power station located at a 900-acre site on Lake Ontario near the Town of Scriba, New York ("Nine Mile Point"). Constellation Nuclear, L.L.C. ("Constellation") owns the remaining 82 percent interest in NMP2. NMP2 is rated at 1,144 MW of capacity and is operated by Constellation under the terms of an operating agreement with LIPA which provides for a management committee comprised of one representative from each co-tenant. The annual NMP2 business plan and the operating and capital budgets are prepared by Constellation and submitted to LIPA for review and approval. LIPA receives output from NMP2 and is responsible for operating and capital costs in proportion to its ownership interest. LIPA employs an on-site nuclear oversight consultant to provide additional support to protect LIPA's interests.

NMP2 is scheduled for decommissioning in 2026. The Authority's share of the decommissioning costs, based on a site specific study conducted in 1995, is estimated to be \$145 million in 1996 dollars. LIPA maintains an external trust fund for the decommissioning of the contaminated portion of the NMP2 plant. At year-end 2002, the fund for decommissioning the contaminated portion of NMP2 had a value of approximately \$37.5 million. LIPA has determined that an annual contribution of approximately \$2.1 million will be required through 2026 to fully fund its 18 percent share of the decommissioning of the contaminated portion of NMP2. Total costs in 1996 dollars for LIPA's share of decommissioning the contaminated portion of NMP2 are estimated to be \$111 million. In May 2000, LIPA established a separate external trust fund for the decommissioning of the non-contaminated portion of the NMP2 plant. At year-end 2002, the fund for decommissioning the non-contaminated portion of NMP2 had a value of \$5.8 million. LIPA has determined that an annual deposit of approximately \$1.0 million will be necessary to fully fund LIPA's 18 percent share of the decommissioning of the non-contaminated portion of NMP2. The total estimated cost of LIPA's 18 percent share of NMP2's non-radioactive decommissioning costs in 1996 dollars is approximately \$34 million.

LIPA is considering a proposal by Constellation to make an application to the Nuclear Regulatory Commission ("NRC") to extend the operating license of NMP2 beyond its current term. LIPA cannot predict what the outcome of the filing will be if submitted to the NRC.

### **Capital Improvement Plan**

During the period 1998 through 2002, an average of approximately \$180 million per year was spent on capital additions and improvements including NMP2 expenditures. Such expenditures included reliability enhancements, capability expansion, new customer connections, facility replacements and public works. Capital expenditures for 2001 and 2002 were \$206 million and \$247 million, respectively. Capital expenditures for 2003 are estimated to total approximately \$245 million. The 2003 capital expenditure program provides for a continuation of the historical programs to improve reliability and quality of electric service, as well as appropriate levels of expenditure for capability expansion, new customer connections, facility replacements and public work projects that are comparable to historical levels.

LIPA's 18 percent share of capital expenditures for NMP2 during the period 1998 through 2002 averaged \$9.4 million annually for plant modifications and nuclear fuel purchases. LIPA's 18 percent share of NMP2's calendar year 2001 capital expenditures totaled approximately \$5.0 million for plant modifications and \$1.8 million for nuclear fuel. For calendar year 2002 LIPA's 18 percent share of NMP2's capital expenditures was approximately \$4.0 million and LIPA's share of capitalized nuclear fuel costs was approximately \$8.3 million. For calendar year 2003 LIPA's 18 percent share of budgeted capital expenditures for NMP2 is approximately \$3.8 million and LIPA's share of the budget for capitalized nuclear fuel cost is approximately \$1.3 million. Budgeted capital expenditures for calendar year 2003 reflect expenditures for routine projects along with improvements and additions in connection with plant improvement initiatives. Expenditures in 2003 are less than those in 2002 due to the fact that a refueling outage was conducted in 2002, with a number of capital modifications installed.

See "Appendix A to this Part 2 – Independent Consultant's Report" attached hereto.

### **Loads**

The Service Area is characterized by customer usage patterns and weather conditions that result in peak usage during the summer and relatively low annual load factors. The peak usage in the summer of 2002 was approximately 5,059 MW for the Long Island Control Area (the Service Area together with three municipalities within the Service Area served by their own utilities).

Under the MSA, the Manager prepares load growth forecasts annually. The Manager's most recent estimate of annual peak demand and energy requirements within the Service Area shows annual compound growth of approximately 1.6 percent over the 2003 to 2008 period. This growth rate would increase the summer peak demand in the Service Area, net of the effects of demand side management, to approximately 5,329 MW in 2008.

See "Appendix A to this Part 2 – Independent Consultant's Report – Power and Energy Requirements" attached hereto.

### **Power Supply**

LIPA currently expects to rely on existing power supply resources, additional power supply resources being developed, additional purchases, and demand side management programs to meet its capacity and energy requirements during the 2003 through 2008 period. During 2002, LIPA's 18% interest in NMP2 and its rights to the capacity of the GENCO Generating Facilities provided approximately 4,243 MW of generating capacity. Other purchases, including on-island IPPs and off-island purchases from NYPA (including Power for Jobs) and other suppliers, provided approximately 1,070 MW of additional capacity. In aggregate, these resources provided approximately 5,313 MW in 2002.

To satisfy the growing capacity needs of its electric customers, LIPA expects to enter into additional power purchase agreements. The Independent Consultant's Report assumes, for purposes of the financial projections contained therein, these agreements will provide net increases over 2002 capacity resources of about 696 MW of additional capacity by 2008. The estimated power supply plan also anticipates customer peak load reductions through demand side management programs, cogeneration projects and NYPA's Power for Jobs program of 237 MW by 2008. With these resource additions, total capacity available to the Authority to meet the needs of its customers is estimated to be 6,009 MW by 2008.

For a discussion of the LIPA's power supplies, see "Appendix A to this Part 2 – Independent Consultant's Report."

### **New York Independent System Operator**

#### *General*

The members of the New York Power Pool ("NYPP"), consisting of the investor-owned utilities in the State, together with NYPA and LIPA (collectively, the "Transmission Owners"), have become members of an independent transmission system operator called the New York Independent System Operator ("NYISO"). NYISO is a not-for-profit corporation formed to provide for non-discriminatory open-access transmission over electric transmission systems belonging to the Transmission Owners, maintain the reliability of the combined systems and operate electric power markets within the State. NYISO has responsibility for scheduling the use of certain transmission lines of the Transmission Owners. LIPA and the NYISO have agreed to coordinate scheduling and use of LIPA's transmission system.

A significant feature of the NYISO's tariffs is its operation of an electric power market that uses a schedule of flexible transmission rates to take account of the cost of congestion along the transmission network. The NYISO is also responsible for collecting charges from the market participants that consume electric power and paying market participants that provide electric power.

Each Transmission Owner retains ownership, and is responsible for maintenance, of its respective transmission system. The customers of NYISO pay charges to NYISO and pay the Transmission Service

Charge ("TSC") to the Transmission Owners under the NYISO Open Access Transmission Tariff ("OATT").

LIPA's transmission revenue requirement is collected by LIPA through the formula-based TSC included as an attachment to the OATT and through certain grandfathered transmission agreements between LIPA and third parties. The NYISO OATT allows each Transmission Owner to file with FERC its own revenue requirement for transmission services. For non-grandfathered contracts, LIPA directly bills the TSC, a per kilowatt-hour charge, to transmission customers withdrawing energy from the System, and collects the TSC revenue directly from the customers. Grandfathered contract rates are collected by LIPA pursuant to the contract terms.

In addition to the creation of NYISO, a New York State Reliability Counsel ("NYSRC") was also created. The NYSRC determines the reliability rules that the NYISO must operate under and monitors the NYISO's compliance with the reliability rules. The NYPP was replaced by NYISO and the NYSRC.

#### *FERC Northeastern RTO Order*

On December 20, 1999, FERC issued Order No. 2000 ("Order 2000") regarding the development of Regional Transmission Organizations ("RTOs"). Order 2000 established certain minimum characteristics an RTO must meet and functions an RTO must provide. Order 2000 required jurisdictional transmission entities to file with FERC a proposal to either participate in an RTO or, in the case of an independent transmission operator (such as the NYISO), address the extent to which such operator conforms to the minimum functions and characteristics of an RTO, any plans to make such operator conform, and any obstacles to conformance with Order 2000. The FERC filing was made on January 16, 2001, by the NYISO jointly with the State's jurisdictional transmission owners.

In an Order issued July 12, 2001, FERC rejected the NYISO filing as "not minimally [satisfying] several of the characteristics and functions set forth in Order No. 2000, which FERC deemed necessary to achieving RTO status." FERC found that the Northeast United States constitutes a single region that should not be divided up into multiple RTOs, and the NYISO's proposed size does not meet the Scope and Regional Configuration Characteristic of Order 2000. FERC also found that the NYISO's proposed governance structure does not satisfy the Independence Characteristic of Order 2000. In addition, FERC found that the NYISO failed to comply in other respects with the criteria for RTOs established by FERC, including the areas of operational authority, tariff administration and design, and planning and expansion. FERC concluded that the NYISO "must work" with its neighbors, the PJM Independent System Operator (covering Pennsylvania, New Jersey and Maryland) ("PJM ISO") and the ISO New England, Inc. ("ISO-NE"), and trading partners to form a single, fully-integrated Northeastern RTO with a single set of market rules and one market design in the Northeast. In a contemporaneous order relating to the PJM ISO's RTO proposal, FERC concluded that while the PJM ISO's proposed scope and configuration are provisionally consistent with Order 2000, it represents only a first step, "a platform which must be built upon." FERC encouraged the three ISOs to look at the best practices in all three ISOs to develop market rules for a Northeastern RTO.

In order to facilitate formation of a single RTO in the Northeast, FERC also issued, in July 2001, a separate order that directed the parties in the NYISO proceeding and the parties in other relevant proceedings to participate in settlement discussions for 45 days before a mediator and appropriate consultants to assist and provide advice during the mediation. The order directing mediation required the mediator to file a report within 10 days after the 45 day period, including an outline of a proposal to create a single Northeastern RTO, milestones for completion of intermediate steps and a deadline for submitting the joint proposal.

On September 17, 2001, the FERC Administrative Law Judge issued his report on the results of the mediation process. The report sets forth a business plan (the "Business Plan") for the implementation of the Northeastern RTO and certain issues that remain to be resolved by FERC.

FERC has not yet issued an order on the Business Plan and related issues. After the RTO mediation process, the Transmission Owners engaged in direct discussions with the PJM ISO, the ISO-NE and the NYISO to determine whether a comprehensive settlement could be reached on the substantive issues related to the formation of a Northeastern RTO. However, these discussions failed to achieve an agreement on a common plan for the formation of an RTO. The three ISOs abandoned the effort to form a single Northeastern RTO.

In January 2002, the NYISO and the ISO-NE announced a plan to establish a common market, and explore the establishment of a Northeastern RTO ("NERTO"), that would encompass New York and New England but not the PJM ISO (the "NERTO proposal"). A process was established to develop a plan for the formation of the NERTO, in parallel with an analysis of whether the proposal for an RTO encompassing only New York and New England would provide sufficient benefits. On August 23, 2002, the NYISO and the ISO-NE filed their NERTO proposal with FERC. The Transmission Owners, among others, vigorously opposed the proposal before the FERC. In the late Fall of 2002, the NYISO and the ISO-NE, noting the opposition to the proposal, withdrew the NERTO application before the FERC ruled on it. Subsequently, in January 2003, the Board of Directors of the ISO-NE announced that it would attempt to form a New England-only RTO.

#### *FERC Standard Market Design*

In September, 2001, FERC initiated consideration of the development of a Standard Market Design ("SMD") for use by the FERC jurisdictional systems throughout the United States. On December 17, 2001, FERC issued an initial discussion paper for an electric industry transmission and market rule and invited public comments through written submissions as well as participation in technical conferences in January, February and July, 2002. On July 31, 2002, FERC issued a Notice of Proposed Rulemaking ("NOPR") which would require all public utilities (as defined under the Federal Power Act (the "FPA")) with open access transmission tariffs to file modifications to their tariffs to "reflect non-discriminatory standardized transmission service and standardized wholesale electric market design." The FERC held an additional series of technical conferences on the NOPR in November and December and July, 2002. Initial written comments on the NOPR were filed by parties on November 15, 2002 and supplemental comments were filed on January 10, 2003 regarding issues relating to the Western interconnection, transmission planning and pricing, regional and state coordination; resource adequacy and financial transmission rights and transition rules. Reply comments on the NOPR were filed on February 17, 2003. In response to extensive comments, FERC issued a revised white paper on SMD on April 28, 2003 which is said to be a preview of the final rule that will likely require Transmission Owners and ISOs to adopt the SMD. There is no final timetable for FERC action on the NOPR at this time.

The current NYISO structure, functions and market design complies with the majority of the features contained in FERC's April 28, 2003 white paper and NOPR. The most significant differences between the current NYISO design and the NOPR are: (i) the process for planning the transmission system, and (ii) the SMD proposal to eliminating transmission rates charged for exporting power from the NYISO system. If the final SMD rule is similar to the April 28, 2003 white paper, most of the features of the NYISO will remain unchanged. If these changes are implemented, LIPA will see offsetting impacts.

For example, a new transmission planning process could lead to a reduction in LIPA's power supply costs, but could also lead to increased transmission rates. However, FERC's proposal to require participant funding of transmission upgrades to accommodate the interconnection of new generation would benefit Transmission Owners.



The proposal for eliminating export fees would, over the course of a yet to be defined transition period, reduce LIPA's revenue from exporting power from Long Island to neighboring systems. These revenues have averaged approximately \$1,000,000 per year over the 2000 to 2002 period. These revenues would be offset by the reduction in transmission fees paid for importing power and the anticipated reduction in wholesale electricity supply costs resulting from increased imports to Long Island. Overall, LIPA would expect a net reduction in costs because imports of power to Long Island are expected to exceed exports from Long Island.

#### *FERC Seams Resolution Process*

In parallel to the SMD process and NERTO process, FERC directed the NYISO, the ISO-NE and the PJM ISO to report regularly on their progress in eliminating the so-called "seams" issues at the borders of the Independent System Operators' service areas that impede or increase the costs of cross-border transactions. Seams issues include: consistent treatment of transmission service products, deliverability of installed capacity, transaction scheduling and curtailment, transmission and generation interconnection procedures, elimination of export charges, congestion and parallel flow management.

The PSC and the Transmission Owners have requested that FERC require the PJM ISO to participate with the NYISO and the ISO-NE to expedite the establishment of a single day-ahead and real time energy market in the Northeast region. The Public Service Commissions of Maryland and Delaware have opposed this proposal.

The NYISO has begun discussions with ISO-NE to establish a coordinated real-time market between NYISO and ISO-NE. It is anticipated that a coordinated market would reduce Long Island's power supply costs. The NYISO has also initiated a process to eliminate export fees. See discussion in the FERC Standard Market Design section above for potential impacts of export fee elimination.

#### **Fuel Supply**

The Energy Manager procures fuel needed for generation by GENCO and certain other non-GENCO generating units pursuant to the EMA. LIPA directly pays for fuel used at the GENCO Generating Facilities. The particular fuel used for generation will depend on generation plant fuel capability, fuel supply and transportation availability, and fuel cost, subject to environmental constraints. Most of the GENCO steam units can burn either natural gas or residual oil and certain units are required to burn lower sulfur residual oil or natural gas. Natural gas or distillate fuel is burned in the gas turbines. In 2001 and 2002, approximately 36 percent and 35 percent, respectively, of the fuel energy for electric generation came from oil, the remainder in both years coming from natural gas.

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

Oil is stored on site or at locations accessible by each generation facility. Existing oil storage capacity plus an active oil management program is employed by the Energy Manager to help LIPA avoid a fuel oil supply disruption at the GENCO facilities and certain other non-GENCO generating units. Conversion of additional generating units to burn natural gas in the future, if economic, will further reduce exposure to potential oil interruptions. See "Appendix A to this Part 2 – Independent Consultant's Report" attached hereto.

Constellation is responsible for the fuel requirements of NMP2.

## **RATES AND CHARGES**

### **The Act**

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

### **Authority to Set Electric Rates**

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

The Estimated Operating Results set forth in Exhibit 1 to the Independent Consultant's Report demonstrate that, based on the assumptions set forth therein (including the Authority's interpretation of the PACB conditions) and absent emergency conditions and extraordinary unforeseeable events, the Authority is expected to achieve an average rate reduction of no less than 14% over the ten-year period commencing on the date when the Authority began providing electric service, and that the Authority is not expected to need to increase average customer rates in excess of 2.5% over any 12-month period during the Study Period. For purposes of determining compliance with the 2.5% and 14% PACB conditions described in the preceding paragraph, the Authority has interpreted the PACB conditions as allowing the exclusion of increases in the cost of electricity paid by the Authority's customers related to the Shoreham Property Tax Settlement Agreement and other pass-through adjustments. The Authority believes that it will be able to satisfy the 14% PACB condition and that it will be able to obtain any PSC approvals necessary to comply with its obligations under the Act and under the Resolution. If either the PSC or the PACB were to disagree with the Authority's interpretation of the PACB conditions, it may influence the timing and size of rate increases implemented by the Authority and/or require (i) the modification of the plan to accelerate retirement of debt (see "Accelerated Debt Retirement" in this Part 2), (ii) the withdrawal of funds from the Rate Stabilization Fund to avoid or minimize rate increases, or (iii) other action necessary to meet the conditions of the PACB approval.

For a description of the actions taken and planned by the Authority to comply with these PACB conditions, see "Appendix A to this Part 2 – Independent Consultant's Report – Estimated Operating Results" attached hereto.

### **Rate Tariffs and Adjustments**

The Authority's rates are largely based on LILCO's former rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, the

Authority's rates include a Fuel and Purchased Power Cost Adjustment (the "FPPCA"), a PILOT payments recovery rider, a rider providing for the Shoreham Credits and the Suffolk Surcharge and a rider providing for the RICO Credits. LIPA's rates include the FPPCA mechanism whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs.

In February 2003, the Authority announced that in 2002 it had incurred fuel and purchased power costs in excess of those charged to customers in base rates established in 1998 ("excess fuel costs") of approximately \$254 million. Pursuant to the provisions of the FPPCA, such additional cost would be recovered in full from customers beginning in 2003. However, on February 27, 2003, the Trustees approved a waiver of the FPPCA that would allow recovery in 2003 of approximately \$129 million of the 2002 excess fuel costs commencing in March 2003 for a ten-month period. The remainder of such excess fuel costs were charged to fuel and purchased power expense as the Authority has no current plans to seek future recovery from customers for those amounts. In order to begin to transition to current year recovery of costs for fuel and purchased power, the Trustees also approved recovery in 2003 of \$75 million of estimated 2003 excess fuel costs commencing in March 2003 for a ten-month period which would increase the Authority's surcharge for such period from 5.8% to approximately 8.8% of base rates. The Authority will also defer \$70 million of 2003 excess fuel costs for recovery over a twelve-month period beginning in January 2004. An additional amount of 2003 excess fuel costs will be deferred for collection commencing in January 2004 for a ten-year period. In February 2001 and February 2002 waivers of the FPPCA were approved by the Trustees which limited recovery of excess fuel costs for the prior year to approximately \$126 million of approximately \$307 million of 2000 excess fuel costs and approximately \$124.5 million of approximately \$207 million of 2001 excess fuel costs (in each case amounting to a fuel surcharge of approximately 5.8 percent of base rates).

The Trustees also approved the recovery of 2004 and future years' costs on a current basis through the FPPCA in an amount sufficient for the Authority to achieve a financial target of \$20 million of net income annually. There can be no assurance that the Authority will not waive or change the requirements of the FPPCA in the future and recover less than the amount of any excess fuel costs which could be recovered under the current FPPCA.

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

For a description of the Shoreham Credits and the Suffolk Surcharge, see "Shoreham Property Tax Settlement" in this Part 2.

## **BILLING AND COLLECTIONS**

### **General**

LIPA customers are billed on a cycle basis, some monthly, others bi-monthly. There are 20 billing cycles within each month. The bills are prepared and mailed by the Manager. At December 31, 2002, the Authority had approximately 1.1 million customers in the Service Area. Of these customers, approximately 438,000 customers (401,000 residential and 37,000 commercial) receive both electric service from LIPA and gas service from KeySpan and receive one bill covering the costs of both services.

The billing system is being revised so that by mid-2003 the Authority expects that customers will receive a separate bill for electric service.

### **Allocation of Cash**

The Manager collects and processes daily customer remittances for LIPA. Cash and checks received each day are deposited to an Authority bank account for overnight clearing. The Manager processes receipts on a one day lag to determine the amount collected with respect to electric service provided by LIPA and gas service provided by KeySpan. Partial payments from dual service customers are allocated to electric and gas based upon agreements with individual customers or historical usage. On the morning of the second business day, the Authority bank account is swept to the Revenue Fund and to a separate KeySpan account based upon the prior five days' average of actual electric and gas receipts.

### **Collections**

At the time of the LIPA/LILCO Merger, May 28, 1998, the 12 month revolving write-off of electric accounts amounted to 0.72% of sales on a six month lag basis. Since then the experience has shown a steady and sustained improvement. The write-off rate at December 2001 was 0.46% and as of December 2002 it went down further to 0.37%.

## **SHOREHAM PROPERTY TAX SETTLEMENT**

In 2000, the Authority, Suffolk County and certain Suffolk County political subdivisions (collectively the "Suffolk Taxing Jurisdictions") reached an agreement settling certain litigation in which LILCO and the Authority had contested the assessment of the Shoreham plant. That litigation had concluded in a judgement ordering the Shoreham Taxing Jurisdictions to refund an amount exceeding \$868 million as a result of the over-assessment of the Shoreham plant. The settlement reached by the Authority and the Suffolk Taxing Jurisdictions in 2000 is contained in the Shoreham Settlement Agreement among the Authority, LIPA, the Suffolk Taxing Jurisdictions and Nassau County (the "Shoreham Property Tax Settlement Agreement") which was effective as of January 11, 2000.

Under the Shoreham Property Tax Settlement Agreement, the Authority and the Suffolk Taxing Jurisdictions agreed, among other things, to a settlement amount of \$620 million, or such lesser amount as has been rebated and credited to the ratepayers pursuant to the Shoreham Rebates and Credits described below (the "Settlement Amount").

The Authority recognized that enforcement of the Settlement Amount against the Suffolk Taxing Jurisdictions would cause them and their residents serious financial hardship. Accordingly, the Shoreham Property Tax Settlement Agreement provided for the Authority to assist the Suffolk Taxing Jurisdictions in funding the Settlement Amount and that the benefits of the settlement will go to the ratepayers in Suffolk County, Nassau County and the Rockaways, many of whom bore the expense of the original overpayment of property taxes and PILOTs, through certain rebates (the "Shoreham Rebates") and credits (the "Shoreham Credits"). The Shoreham Property Tax Settlement Agreement also provided that the cost of the settlement will be collected from the Suffolk County ratepayers through a surcharge on their rates (the "Suffolk Surcharge").

In April 2000 the Town of Islip and others commenced an action seeking a judgement declaring illegal certain provisions of the Shoreham Property Tax Settlement Agreement. That action has now been concluded and the validity of the Shoreham Property Tax Settlement Agreement has been upheld. The Authority expects to collect the Suffolk Surcharge beginning June 1, 2003.

Suffolk County commenced litigation in September 2002 challenging certain calculations made by the Authority under the Shoreham Property Tax Settlement Agreement. The Authority does not expect that the outcome of such litigation will adversely affect the Authority.

## **CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY**

### **General**

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

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

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

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

### **Energy Policy Act of 1992**

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

## Certain FERC Initiatives

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

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

The rates that LIPA charges for transmission service under its OATT, including the calculation of any stranded cost charge, are not subject to direct regulation by FERC under Part II of the FPA. FERC has reviewed the rates under LIPA's OATT and found that the OATT represents an acceptable reciprocity tariff subject to the condition that LIPA adopt a code of conduct and maintain an OASIS. A prospective customer seeking service under the OATT may challenge the rate or stranded cost charge quoted by LIPA to the customer by filing an application to the FERC for an order requiring LIPA to provide transmission service under Sections 211 and 212 of the FPA. FERC has discretion to entertain such an application, but it has noted that when FERC has approved an OATT for comparability purposes for a nonjurisdictional utility the applicant requesting a Section 211 order has the burden to show why service to the applicant under the same terms as available under the OATT is not sufficient and why a Section 211 order should be granted.

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

In the Spring of 1997, FERC issued its orders on rehearing of Order Nos. 888 and 889. In these supplemental orders FERC upheld the bulk of its rulings in Order Nos. 888 and 889, while making changes to certain aspects of those rules to implement its open-access policies. Public utilities were required to submit revised tariffs to FERC during the summer of 1997 to reflect FERC's orders on rehearing. In November 1997 and again in 1998, FERC issued further orders on rehearing affirming, with certain clarifications, its previous orders.

Neither the Authority nor LIPA is directly subject to the new rules. However, the Authority and LIPA are subject to the reciprocity provision in Order No. 888, described above. Moreover, the Authority has voluntarily filed an OATT that substantially conforms to the provisions of Order No. 888, as modified

on rehearing, which FERC had made a condition to FERC's approval of the transfer to the Authority of LILCO's transmission assets. On September 22, 1998 FERC approved LIPA's OATT finding that it is consistent with the compatibility requirements of Order No. 888 as modified on rehearing for an acceptable reciprocity transmission tariff on the condition that LIPA adopt a code of conduct and maintain an OASIS. LIPA's OASIS is in place. LIPA has filed its code of conduct with FERC.

Under Part II of the FPA, "public utilities" are subject to regulation by FERC. A "public utility" includes any person or entity that owns, controls, or operates facilities used for the transmission of electric energy in interstate commerce or for the sale of electric energy at wholesale in interstate commerce. However, under Part II of the FPA a "public utility" does not include a state or any political subdivision of a state, or any agency, authority, or instrumentality of any one or more of the foregoing. As a corporate municipal instrumentality and political subdivision of the State, the Authority, and, indirectly, LIPA, are largely exempt from FERC regulation as "public utilities" under Part II of the FPA. Notwithstanding this exemption, the Authority and LIPA are subject to the authority of FERC to order interconnection of its facilities pursuant to Section 210 of the FPA, and the authority of FERC to order "transmitting utilities" to provide transmission services in accordance with sections 211 and 212 of the FPA as amended by the Energy Policy Act.

## Competition

In New York and many other states, there have been legislative and regulatory actions to promote competition in the supply of power by requiring, among other things, the separation of power supply services and costs from electric transmission and distribution services and costs. Federal regulation of transmission assets and services has been the focus of increasing action and attention as transmission resources are viewed as the vehicle for delivery of competitively priced generation to wholesale and retail customers. In general, transmission and distribution resources are viewed as an inherently monopoly function that must remain regulated.

The Authority has taken several actions to promote an orderly transition to greater competition in power supply and retail customer choice in the power supply markets in the Service Area. Retail choice (sometimes called customer choice, retail wheeling, or retail open access) refers to a process by which retail customers choose among competitive suppliers for electric capacity, energy, and ancillary services. The delivery of capacity and energy is provided by the owner and operator of the local transmission and distribution system. Key issues that have surfaced in the movement to retail choice include the level of rate reductions accompanying the restructuring of individual utilities, recovery of stranded investments, and the timetable and methods for implementation of customer choice.

The Authority adopted a retail choice program (called "Long Island Choice") which is intended to offer electric customers the opportunity to choose an electric energy supplier other than LIPA. Currently, only three competitive suppliers offer supply to commercial electricity customers pursuant to Long Island Choice, and one of these suppliers has announced it will withdraw from the commercial and industrial market effective April 1, 2003. As of January 2003, three suppliers were selling electricity to 104 commercial and industrial customers in the Service Area. The sole alternative supplier for residential customers, KeySpan, has withdrawn from the residential market effective January 1, 2003, stating that it could not provide sufficient savings to make the effort worthwhile for consumers or the company. Approximately 15,000 residential customers served by KeySpan will be transferred to LIPA as service contracts terminate.

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

## **Proposed Federal Deregulation Legislation**

During several past sessions of the United States Congress, numerous bills were introduced (i) to restructure the electric utility industry, including providing choice of power suppliers at the retail level for customers of investor-owned and, under certain circumstances, consumer-owned utilities, including utilities owned by municipalities and other political subdivisions (certain of such bills included provisions relating to stranded cost recovery) and (ii) impacting the federal tax exemption of interest on bonds issued, and to be issued, to finance or refinance facilities owned by municipalities and political subdivisions used in the wholesale and retail power supply business (in certain cases, preserving such exemption and, in other cases, negatively impacting such exemption). All of these bills expired without being enacted.

The Bush Administration has proposed similar measures. Electricity restructuring legislation was introduced in the last Congress without approval and has been reintroduced in the current Congress. Further, the Authority is unable to predict whether any initiatives will be enacted into law and the extent to which any such electric utility restructuring legislation (i) would provide retail customers of investor-owned electric utilities, and possibly customers of consumer-owned utilities, including utilities owned by municipalities and other political subdivisions, with some form of ability to choose their supplier of electricity by a date certain, (ii) might (or might not) provide for some form of stranded cost recovery, (iii) may, under certain circumstances, adversely affect the tax exemption of interest on bonds previously issued for such purposes or require payment by utilities owned by municipalities and other political subdivisions of federal income tax on a portion of their utility income, and (iv) may contain provisions, among others, relating to direct federal regulation of transmission and wholesale power rates charged by municipal utilities, customer protection, transmission reliability and access, environmental matters, and the development and/or utilization of certain renewable energy resources.

The Authority is not able to predict the final form of any such legislation which might be enacted into law, nor what effect any such new law (if enacted) will have on the Authority or on the exclusion from federal gross income of interest on indebtedness of the Authority.

## **New York State Electric Utility Industry Regulation**

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

*NYISO and Regional Transmission Organizations.* For a description of the NYISO and information regarding FERC initiatives regarding Regional Transmission Organizations, see "The System-New York Independent System Operator" in this Part 2.

## **Environmental**

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



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

## **Nuclear Plant Matters**

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

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

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

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

Constellation currently ships low-level radioactive waste ("LLRW") generated at NMP2 to a disposal facility in Barnwell, South Carolina. During the period July 1, 1994 to June 30, 1995, the legislature of South Carolina denied access to the facility to out-of-region low-level radioactive waste generators, including those in the State. The Authority cannot predict whether the Barnwell facility will be closed again at some future date to out-of-region low-level radioactive waste generators.

NMP2's contract with the Barnwell facility extends through June 15, 2003 and includes a one-year option to renew. An extension of this contract to August 31, 2006 is being negotiated and is expected to be signed by June 15, 2003. Through the remaining contract term, Constellation intends to continue to use LLRW volume reduction and waste minimization techniques and to dispose of as much waste as possible at the Barnwell site. In the event disposal at the Barnwell facility is unavailable for

contractual or political reasons, Constellation is actively evaluating viable alternative waste disposal facilities. As a contingency, Constellation is developing plans for LLRW disposal involving the long-term storage of LLRW in the NMP2 facilities. At current generation rates, Constellation reports that NMP2 has storage capacity for spent fuel that is adequate until 2012. There is currently no LLRW in long-term storage at NMP2.

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

Constellation procures public liability and property insurance for NMP2, and LIPA will reimburse Constellation for its 18% share of those costs. The Price-Anderson Amendments Act mandates that nuclear power plants secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of \$300 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 103 presently licensed nuclear reactors in the United States to a retrospective assessment of up to \$88.1 million for each nuclear incident, payable at a rate not to exceed \$10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of \$15.9 million, per incident, through assessments of \$1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor.

Constellation has also procured \$500 million primary nuclear property insurance with the Nuclear Insurance Pools and approximately \$2.3 billion of additional protection (including decontamination costs) in excess of the primary layer through Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately \$2.7 million per loss.

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

## **ENVIRONMENTAL MATTERS**

### **General**

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

to the business and operations to be conducted by KeySpan Parties after the LIPA/LILCO Merger (the "Transferred Business").

The Authority and LIPA are subject to a number of federal, State and local environmental laws and regulations governing the installation, operation and maintenance of electric transmission and distribution systems. For example, various waste management regulations and siting laws will be pertinent.

### **Environmental Liabilities**

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

KeySpan Parties are responsible for all environmental liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those formerly operated by LILCO or any of its predecessors, whether or not such MGP Sites relate to the Transferred Business or the Retained Business; all environmental liabilities traceable to the Transferred Business; and certain scheduled environmental liabilities. Certain environmental liabilities that are traceable to GENCO, including liabilities arising from asbestos litigation, may be recovered from LIPA by KeySpan Parties as part of the capacity charge under the PSA. The Authority has established reserves for environmental liabilities which it believes, based on information currently available to it, are adequate.

LIPA Parties are responsible for all environmental liabilities traceable to the Retained Business (including environmental liabilities discovered in the future which arise from events or circumstances occurring prior to the LIPA/LILCO Merger) and certain scheduled environmental liabilities. Notwithstanding the parties' contractual allocation of environmental liabilities, under certain circumstances LIPA could be liable for environmental costs related to Transferred Assets as the prior owner if a KeySpan Party fails to satisfy such liability.

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

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

For a description of specific actual and potential environmental liabilities of the LIPA Parties and the KeySpan Parties, see "Environmental" in Note 14 to the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001, attached hereto as Appendix B.

### **REGULATION**

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

## New York State

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

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

On July 16, 1997, the PACB adopted a resolution (the "PACB Merger Resolution") which approved the execution and delivery of all agreements required for the consummation of the LIPA/LILCO Merger. The PACB made its approval subject to certain conditions (the "PACB Conditions"), which were accepted by the Authority by a resolution of the Trustees adopted unanimously on August 21, 1997. Two of those conditions relate to the establishment of rates, and are described herein under the caption "Rates and Charges—Authority to Set Electric Rates." The PACB Conditions, and the actions taken by the Authority to date and the Authority's plans to comply with such conditions, are described in the Independent Consultant's Report under the heading "Estimated Operating Results-Compliance with PACB Conditions." Included among the PACB Conditions is a prohibition against LIPA purchasing the GENCO Generating Facilities at a price greater than book value.

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

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

of the PSC or any other State regulatory body. See, however, "Rates and Charges-Authority to Set Electric Rates" in this Part 2.

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

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

## **Federal**

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

*Federal Energy Regulatory Commission.* Under Part II of the FPA, FERC regulates the rates, terms and conditions of (i) the sale for resale of electric power by "public utilities"; and (ii) the provision of transmission service in interstate commerce by public utilities. Neither the Authority nor LIPA is a "public utility" under the FPA. Although the rates, terms and conditions under which the Authority provides transmission service are not currently subject to general FERC jurisdiction, FERC may order the Authority to provide transmission service to individual customers meeting the requirements of Sections 211 and 212 of the FPA on rates, terms and conditions comparable to those of the Authority for the Authority's own use of its system.

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

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

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

## **Other Jurisdictions**

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

## **CORPORATE INCOME TAX RULINGS**

The Authority, together with LILCO and KeySpan, obtained a private letter ruling from the Internal Revenue Service ("IRS") containing two rulings on certain federal corporate income tax matters in connection with the LIPA/LILCO Merger.

One of those rulings holds that the public utility income of LILCO after it was acquired by the Authority and became LIPA will be excluded from LIPA's gross income for federal income tax purposes, i.e., that such income will be exempt from federal income taxation. This ruling is based on LIPA continuing to limit its activities to those of a public electric utility.

The other ruling holds that LILCO would not recognize any taxable gain under certain sections of the Code, either as a result of the acquisition of its stock by the Authority or as a result of LIPA's public utility income becoming exempt from federal income tax. The ruling expresses no opinion as to the tax treatment of future actual or constructive dispositions of assets by LIPA (including the application of the depreciation recapture rules of the Code) which could result in taxable gains or losses by LIPA.

The rulings are based in part on the conclusion of the IRS that LIPA will not become an "integral part" of the Authority as a result of the transaction or at any time thereafter. That conclusion in turn was based on a number of representations by the Authority with respect to the absence of any financial or other support for LIPA from the Authority and other agencies of the State. The ruling from the IRS provides expressly that, if "the facts and circumstances in the future are other than as contemplated" by the representations in the ruling, the Authority and LIPA "should seek an appropriate supplemental ruling" from the IRS with respect to the presence or absence of state support for LIPA and the effect of such state support on the status of LIPA and the original rulings.

The rulings described above are generally binding on the IRS, subject to a change in law, and are based upon the representations described above and the other facts presented to the IRS by LILCO and the Authority. The Authority is not aware of any facts or circumstances which would cause such representations or the facts as presented to be untrue or incomplete in any material respect. If the rulings were revoked, LIPA could be subject to significant federal income tax liability unless LIPA were otherwise exempt from federal taxation under applicable provisions of the Code. The Authority has covenanted that it shall not, nor shall it permit LIPA to, do or omit to do any act that would result in the revocation of the rulings and a resultant material federal income tax liability.

## **LITIGATION**

### **The Offered Securities**

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

### **Shoreham Litigation**

See "Shoreham Property Tax Settlement" in this Part 2.

## **Other Litigation**

LIPA is also involved in numerous actions arising from the ordinary conduct of its business both prior to and subsequent to the LIPA/LILCO Merger including environmental claims brought by governments and individual plaintiffs alleging that LIPA is responsible for all or a portion of the clean-up costs or personal injuries or damages as a result of the alleged use, release or deposit of hazardous substances. While LIPA cannot presently predict the costs of such pending claims, or additional similar claims which may arise in the future, LIPA believes that such litigation, in the aggregate, will not have a material adverse effect on the business or the affairs of the Authority or LIPA. See the Authority's Consolidated Financial Statements for the years ended December 31, 2002 and 2001, note 14 and "Environmental Matters-Environmental Liabilities" in this Part 2.

## **Potential Litigation**

The transactions described in this Official Statement, including the contemplated financing, have been the subject of criticism by various elected officials and other individuals and organizations which have publicly stated that additional litigation may be initiated challenging one or more aspects of the transactions described in this Official Statement.

## **AGREEMENT OF NEW YORK STATE**

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

## **CONTINUING DISCLOSURE UNDERTAKINGS FOR THE OFFERED SECURITIES**

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

## **ADDITIONAL INFORMATION**

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

## **LEGALITY FOR INVESTMENT**

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

## **FINANCIAL ADVISOR**

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

## **INDEPENDENT CONSULTANT**

Navigant Consulting, Inc. is the Authority's Independent Consultant. The Independent Consultant has prepared its Report, dated March 25, 2003, which is attached to this Part 2 as Appendix A. **THE REPORT OF THE INDEPENDENT CONSULTANT SHOULD BE READ IN ITS ENTIRETY.**



## **Appendix A**

### **Independent Consultant's Report**

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**Long Island Power Authority**

**Independent Consultant's Report  
In Connection with the  
Plan of Finance for 2003**

**March 25, 2003**

**Navigant Consulting, Inc.**

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March 25, 2003

Long Island Power Authority  
Board of Trustees  
333 Earle Ovington Boulevard  
Suite 403  
Uniondale, New York 11553

Chairman and Members of the Board of Trustees:

Navigant Consulting, Inc. ("NCI") has been retained by the Long Island Power Authority (the "Authority") in connection with the Authority's plan of finance for 2003. NCI submits this report (the "Independent Consultant's Report" or "Report") stating its findings, assumptions, and conclusions.

In the preparation of the Independent Consultant's Report, NCI conducted an evaluation of engineering, economic, planning, operations, regulatory, and related matters supporting an estimate of the annual operating results of the Authority for the period January 1, 2003 through December 31, 2008. For purposes of this assignment, NCI has made investigations and analyses, including discussions with staff and representatives of the Authority and KeySpan Corporation d/b/a KeySpan Energy, among others, and examinations of reports and projections prepared by consultant's and advisors to the Authority, which NCI deemed necessary and appropriate to reach its conclusions. The Independent Consultant's Report attached hereto should be read in its entirety.

Respectfully submitted,

Patrick S. Hurley  
Managing Director

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**LONG ISLAND POWER AUTHORITY**  
**INDEPENDENT CONSULTANT'S REPORT**  
**IN CONNECTION WITH THE**  
**PLAN OF FINANCE FOR 2003**

**TABLE OF CONTENTS**

<b>INTRODUCTION .....</b>	<b>1</b>
<b>MANAGEMENT AND OPERATION OF THE SYSTEM.....</b>	<b>2</b>
Authority Management and Organization.....	2
Management Services Agreement.....	2
Energy Management Agreement.....	3
<b>REGIONAL ECONOMY .....</b>	<b>3</b>
<b>POWER AND ENERGY REQUIREMENTS.....</b>	<b>4</b>
Long Island Choice Program.....	4
<b>SYSTEM POWER SUPPLY RESOURCES .....</b>	<b>4</b>
New York Independent System Operator .....	5
Existing Capacity and Energy Resources .....	5
Transmission Interconnection Facilities.....	8
Future Resource Additions.....	9
Fuel Supply.....	11
Environmental Regulations .....	11
<b>TRANSMISSION AND DISTRIBUTION SYSTEM.....</b>	<b>12</b>
Transmission Facilities.....	12
Distribution Facilities.....	12
Condition of Facilities .....	12
Reliability .....	13
Capital Expenditures.....	13
<b>RATES AND CHARGES.....</b>	<b>14</b>
Base Rates .....	14
Regional Comparison.....	15
<b>ESTIMATED OPERATING RESULTS .....</b>	<b>16</b>
Fuel Price Sensitivity Analysis .....	18
Compliance with PACB Conditions.....	19
<b>ASSUMPTIONS .....</b>	<b>20</b>
<b>CONCLUSIONS .....</b>	<b>22</b>

**LIST OF EXHIBITS**

1	Estimated Operating Results - Statement of Operations .....	24
2	Estimated Operating Results - Debt Service Coverage Calculations .....	26
3	Estimated Operating Results - Funds Available for Capital Expenditures and Other Purposes .....	29
4	Historical Loads and Resources .....	32

5	Estimated Capacity Requirements and Resources .....	33
6	Estimated Energy Requirements and Resources .....	34
7	Capital Expenditures.....	35
8	GENCO Generating Facilities Summary Description.....	36
9	Historical GENCO Generation .....	37
10	Summary of Power Supply Agreements .....	38
11	Energy Output of Power Supply Agreements.....	39

## LIST OF TABLES

1	Service Area Transmission Interconnections.....	8
2	Comparison of Average Unit Revenues .....	16
3	Results of Fuel Price Sensitivity Analysis .....	18



## INTRODUCTION

Presented herein is the Independent Consultant's Report (the "Report") of Navigant Consulting, Inc. ("NCI") resulting from NCI's analysis and investigations in connection with the issuance of bonds in 2003 by the Long Island Power Authority (the "Authority").

The Authority is a corporate municipal instrumentality and political subdivision of the State of New York authorized under the Long Island Power Authority Act (the "Act"). The Authority became the retail supplier of electric service in most of Nassau and Suffolk Counties and the Rockaway Peninsula of Queens County (the "Service Area") on May 28, 1998 by acquiring the Long Island Lighting Company ("LILCO") as a wholly owned subsidiary of the Authority through a merger (the "LIPA/LILCO Merger"). Since the LIPA/LILCO Merger, LILCO has done business under the name LIPA ("LIPA"). Before the LIPA/LILCO Merger, LILCO was a publicly traded, shareholder-owned corporation that, since the early 1900's, was the sole supplier of retail electric and gas service in the Service Area. LIPA (LILCO) no longer provides gas service in the Service Area. For the period prior to the LIPA/LILCO Merger, LILCO is referred to herein as "LILCO" and, for the subsequent period, is referred to herein as "LIPA."

The Authority, through LIPA, owns, among others, the following assets: (i) an electric transmission and distribution system (the "T& D System"), including assets, facilities, equipment, and contractual arrangements used to provide the transmission and distribution of electrical capacity and energy to electric customers within the Service Area; (ii) an undivided 18 percent ownership interest in the Nine Mile Point 2 Nuclear Power Station ("NMP2") located in upstate New York; and (iii) certain other intangible assets resulting from the LIPA/LILCO Merger. These assets, together with all other assets of the Authority and LIPA used in the furnishing of electric service, are referred to as the "System."

NCI is a nationally recognized firm of management consultants, engineers, economists, and regulatory specialists headquartered in Chicago, Illinois, with offices throughout the United States and abroad, including Long Island, New York that provides in-depth expertise on the power market in the northeastern United States. NCI's Energy and Water Practice provides services to energy firms and public agencies, including, but not limited to, electric and gas utilities, power producers, fuel suppliers, and power marketers. Typical services include power marketing analysis, transmission and distribution system planning, generation facilities evaluation, rate and pricing studies, environmental assessments, conservation and demand-side management ("DSM") program development and evaluation, strategic planning, marketing studies, and related services.

NCI has been retained by the Authority to evaluate the engineering, economic, planning, operations, regulatory, and related matters supporting the preparation of an estimate of annual operating results for the Authority (the "Estimated Operating Results") for the January 1, 2003 through December 31, 2008 period (the "Study Period"). This Report evaluates the adequacy of estimated revenues from electric power sales to fund the Authority's annual revenue requirements and meet the requirements of the Rate Covenant set forth in the Authority's Electric System General Revenue Bond Resolution (the "General Bond Resolution").

In addition to the services provided in connection with this Report, NCI serves as the Authority's Consulting Engineer and Rate Consultant, as defined in the General Bond Resolution. NCI also provides day-to-day assistance to the Authority on various issues, including operations, management, and expansion of its facilities, power supply resource development, rates and charges, environmental compliance, financial forecasting, and budget review and development, among other areas.

For purposes of the development of the Authority's Estimated Operating Results and the preparation of this Report, NCI has made investigations and analyses, including, but not limited

to, discussions with staff and representatives of and/or review of reports or information prepared by the Authority, LIPA, and KeySpan Corporation d/b/a KeySpan Energy ("KeySpan"), and examinations of reports and projections prepared by consultants and advisors to the Authority and LIPA, which NCI deemed necessary and appropriate to reach its conclusions. NCI's investigations and analyses were conducted with particular emphasis on consideration of those items of major potential economic, financial, and operational impact on the future operations of the Authority in its role as supplier of electric capacity and energy to its customers. This Report summarizes NCI's findings and presents certain technical and economic information concerning the Authority and LIPA. This Report should be read in its entirety for information on the Authority and LIPA.

This Report refers to certain agreements between the Authority and KeySpan related to the management and operation of the System and the provision of power supply services to meet the needs of LIPA's customers, including the Management Services Agreement (the "MSA"), the Energy Management Agreement (the "EMA"), the Power Supply Agreement (the "PSA"), and the Generation Purchase Right Agreement (the "GPRA"), among others (together, the "Agreements"). Copies of the Agreements may be obtained by contacting the Authority at (516)-222-7700 or by visiting the Authority's web site at [www.lipower.org](http://www.lipower.org).

## **MANAGEMENT AND OPERATION OF THE SYSTEM**

The Authority manages the operations, performance, and costs of the System with a senior management team comprised of engineering, legal, financial, accounting, and management professionals. The organization and performance of this senior management team is described below. This section also includes a discussion of the responsibilities of KeySpan under the terms of certain key outsourcing agreements.

### **AUTHORITY MANAGEMENT AND ORGANIZATION**

The Authority manages the performance and cost of electric service within the Service Area with a qualified senior management team and an organizational structure intended to maintain a small staff of Authority employees. The Authority staff is responsible for certain on-going functions, including, but not limited to: (i) certain system planning activities; (ii) certain power marketing efforts; (iii) DSM program definition; and (iv) financial activities. The Authority uses a combination of (i) a core group of senior managers; (ii) internal professional and administrative support staff; and (iii) outsourced services by specialists to meet the wide variety of skills and experience required to guide the management of the electric utility.

The day-to-day operation of the System, including LIPA's ownership interest in NMP2, is outsourced principally to KeySpan through the MSA and the EMA, in large part using personnel previously performing these functions for LILCO.

### **MANAGEMENT SERVICES AGREEMENT**

Through the MSA, LIPA relies on a subsidiary of KeySpan (the "Manager") to operate and maintain the T&D System in accordance with all applicable laws, good utility practices, and the policies and procedures established by the Authority. The Manager's responsibilities under the MSA include, but are not limited to: (i) the day-to-day operation and maintenance of the T&D system, including emergency repairs, customer service, billings, and meter readings; (ii) routine facility additions and improvements, including customer connections, procurement of goods and services from third parties, and inventory management; (iii) preparing and monitoring budgets, developing load and energy forecasts, and the acquisition, maintenance and use of power resource models and plans; and (iv) maintaining an operation and maintenance manual for the T&D system. The term of the MSA was extended to December 31, 2008 by agreement between the Authority and KeySpan, dated March 29, 2002.

In exchange for services rendered under the MSA, the Manager is entitled to receive an annual service fee as compensation. The service fee is paid on a monthly basis and is calculated based on five components, consisting of: (i) a fixed direct fee; (ii) a third party cost reimbursement component; (iii) a variable payment; (iv) a cost incentive fee; and (v) a non-cost performance component. In addition to the service fee, the Manager is reimbursed for all approved third-party costs and is paid or reimbursed for certain capital and unforeseeable costs.

#### **ENERGY MANAGEMENT AGREEMENT**

The EMA provides for a subsidiary of KeySpan (the "Energy Manager") to (i) procure and manage fuel supplies for LIPA to fuel electric generating facilities; (ii) perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs, and (iii) make off-system sales of energy, capacity, and ancillary services from generating facilities and other power supplies either owned or under contract to LIPA. LIPA is entitled to two-thirds of the profit from any off-system sales arranged by the Energy Manager. The EMA also provides for a continuation of the gas transportation rates in effect at the time of the LIPA/LILCO Merger through November 28, 2009, for gas transported on LIPA's behalf over the KeySpan gas distribution system to certain electric generating facilities. The EMA extends through May 28, 2013 for fuel supply procurement and management services and through May 28, 2006 for other services provided by the Energy Manager.

The Energy Manager is compensated for fuel management services through the payment by LIPA of: (i) a monthly fuel management fee; (ii) the cost of fuel purchased on LIPA's behalf; and (iii) a fuel purchase performance incentive/disincentive payment. Additionally, the Energy Manager receives one-third of net revenues from off-system sales, plus an annual system power supply management fee and a system power supply performance incentive/disincentive payment.

#### **REGIONAL ECONOMY**

Once considered a "bedroom community" of New York City, Long Island has evolved into a significant regional economy that benefits from its proximity to Manhattan, but also generates its own income, employment, and regional output. Future economic gains on Long Island are likely to be based, in part, on the effective utilization of the region's current assets, such as:

- Highly skilled labor force;
- Close proximity to New York City;
- Diverse institutions of higher education;
- Location advantages for European markets;
- Strong, diversified technology base;
- Core research institutions, such as Brookhaven National Laboratory, Long Island High Tech Incubator at Stony Brook, Cold Spring Harbor Laboratory, and medical research centers, such as North Shore Hospital; and
- Suburban life style.

The Long Island economy benefits from low unemployment (approximately 3.9 percent in 2002), high average personal income, and a strong service-based economy. During 2001, 5,686 new residential dwelling permits were issued in Nassau and Suffolk Counties. Although lower than the 6,438 permits issued during 2000, this figure is well above the average of 4,839 permits issued during the 1990 through 1999 period. During the fourth quarter of 2002, office vacancy

levels, stood at approximately 14 percent, compared to a high of nearly 16 percent in 1995 and a low of approximately 7 percent in 2000. During 2000, Nassau County had the third highest per capita income in New York State, while Suffolk County ranked sixth statewide.

## **POWER AND ENERGY REQUIREMENTS**

Electricity usage patterns and seasonal weather conditions in the Service Area result in maximum electrical demand during the summer months and relatively low load factors on an annual basis. Exhibit 4 sets forth the historical annual peak demands and energy requirements experienced for the Service Area for the 1998 through 2002 period.

The Manager has prepared an estimate of LIPA's annual peak demand and energy requirements within the service area for the Study Period. This estimate takes into account load reductions associated with economic development power provided to certain entities within the Service Area by the New York Power Authority ("NYPA"), conservation savings resulting from load reduction programs sponsored by LIPA and cogeneration production by end-users within the Service Area. Also taken into account are end-use demand and energy requirements served by third-party power suppliers through LIPA's Long Island Choice program.

Exhibits 5 and 6 provide a summary of LIPA's estimated demand and energy requirements for the Study Period. During this period, annual peak demands and energy requirements, before adjustment for various demand side programs, are estimated to increase at annual compound rates of growth of approximately 1.6 percent. The estimated demand and energy requirements shown in Exhibits 5 and 6 take into account the effects of LIPA's Long Island Choice program, as described below.

### **LONG ISLAND CHOICE PROGRAM**

The Authority's retail choice program (called "Long Island Choice") is intended to offer electric customers the opportunity to choose an electric energy supplier other than LIPA. Currently, only three competitive suppliers offer supply to electricity customers pursuant to Long Island Choice. The sole alternative supplier for residential customers, KeySpan, has announced it will withdraw from the residential market effective April 1, 2003, stating it cannot provide sufficient savings to make the effort worthwhile for consumers or the company. Approximately 15,000 residential customers served by KeySpan will be transferred to LIPA as service contracts terminate. KeySpan has announced it will also withdraw from the commercial and industrial market effective April 1, 2003, leaving Select Energy, a subsidiary of Connecticut-based Northeast Utilities, and ConEdison Solutions as the only alternative suppliers to commercial and industrial customers in the Service Area. These suppliers provide service to approximately 100 commercial and industrial customers, the loads of which accounted for less than one percent of LIPA's peak electric demand during 2002.

## **SYSTEM POWER SUPPLY RESOURCES**

LIPA obtains the capacity and energy resources needed to meet the electric requirements of its customers from a combination of its own power supply resources, resources under contract to it, and short-term market transactions. Capacity and energy from power supply resources located outside of the Service Area are delivered to the T&D System through a series of transmission interconnections with other electric systems in the region.

To provide for LIPA's rapid System load growth, LIPA has taken actions to increase its power supply, including contracting for the development of approximately 395 MW of new generation capacity that began operation on Long Island in 2002. LIPA has also entered into agreements for the development of approximately 200 MW of additional new generation capacity planned to be developed on Long Island in 2003 and 2004. In aggregate, these new facilities are

intended to boost LIPA's on-island supply to approximately 4,947 MW by summer 2003 and 4,981 MW by summer 2004. LIPA is expected to meet its load requirements using these resources combined with capacity from other sources, including NMP2, power purchases from NYPA and other projects, and capacity market purchases.

The New York Independent System Operator (the "NYISO") reliability rules, in part, require LIPA to supply at least 95 percent of its projected peak load from on-island resources (the "On-Island Requirement"). Based on LIPA's current projections of its loads and resources, LIPA's existing resources, including new generating plants under contract to be added in 2003 and 2004, are projected to be sufficient to meet or exceed this minimum requirement through 2005. After 2005, LIPA could meet the On-Island Requirement in several ways. Renewal of certain on-island power purchase contracts scheduled to terminate in 2004 and 2005 would enable LIPA to meet this requirement through 2008 without the addition of new on-island resources. Additionally, capacity purchases delivered to LIPA through a proposed new interconnection to Connecticut (described below under "TRANSMISSION INTERCONNECTION FACILITIES-Cross Sound Cable"), could supply LIPA with up to 330 MW of firm capacity from New England as early as the summer of 2004. Pursuant to NYISO rules, such capacity would be treated as on-island capacity for purposes of the NYISO's reliability rules. LIPA could also contract for capacity from new generating units proposed to be constructed on Long Island.

Presented below is a description of the power supply resources and transmission interconnections relied on by LIPA to supply the electric needs of its customers. See Exhibit 5 of this Report for more details concerning LIPA's projected loads and resources.

#### **NEW YORK INDEPENDENT SYSTEM OPERATOR**

The NYISO controls the New York State electric power grid pursuant to tariffs and market rules approved by the Federal Energy Regulatory Commission ("FERC"). Overall, the NYISO is intended to facilitate competition in the wholesale market for electric capacity and energy and to reflect the economic cost of transmission congestion. The NYISO has responsibility for the operation of certain of the transmission lines of the New York State electric utilities and for scheduling the use of these lines by parties wishing to use the facilities. Under normal circumstances, the NYISO does not operate or schedule transmission facilities owned by LIPA. LIPA participates in the NYISO under provisions designed to protect the Authority's tax-exempt status and retain control over its revenue stream. Each transmission owner participant in NYISO retains ownership and responsibility for maintenance of its respective transmission facilities and is responsible for billing and collecting for the use of these facilities.

In addition to its transmission-related responsibilities, the NYISO provides power pooling and power coordination functions. Operational features of the NYISO include (i) the establishment of a day-ahead and real-time bid-based spot energy market; (ii) the implementation of congestion pricing for transmission services; (iii) the creation of transmission congestion contracts; and (iv) markets for certain ancillary services.

#### **EXISTING CAPACITY AND ENERGY RESOURCES**

LIPA is expected to rely on existing power supply resources, including facilities owned by KeySpan, LIPA's share of NMP2, and recent and planned purchases of capacity and energy from new facilities constructed on Long Island to meet the bulk of its capacity and energy requirements during the Study Period. Exhibit 4 of this Report sets forth LIPA's historical loads and resources for the 1998 through 2002 period. LIPA's estimated loads and resources for the Study Period are shown in Exhibits 5 and 6. This information reflects the results of resource planning assessments conducted for purposes of this Report and is not intended to represent resource specific power supply expansion plans adopted by LIPA. The principal resources

reflected in Exhibits 5 and 6 and projected to be available to LIPA during the Study Period are described below.

### **Nine Mile Point Two Nuclear Station**

LIPA owns an undivided 18 percent interest (approximately 205 MW capacity delivered to Long Island) in NMP2. NMP2 is one of two boiling-water reactor nuclear units at the Nine Mile Point nuclear power station ("Nine Mile Point") located on the south shore of Lake Ontario near the Township of Scriba, New York. NMP2 began commercial operation in April 1988 under a Nuclear Regulatory Commission ("NRC") license that expires in 2026. LIPA is considering a proposal by Constellation to make an application to the NRC to extend the operating license of NMP2 beyond its current term. NCI cannot predict what the outcome of the filing will be if submitted to the NRC.

Until November 6, 2001, NMP2 was operated by Niagara Mohawk Power Corporation ("NMPC") and owned by NMPC and four cotenants, including LIPA. Constellation Nuclear LLC ("Constellation"), a division of Constellation Energy Group (NYSE:CEG), purchased 100 percent of the Nine Mile Point 1 Nuclear Power Station from NMPC and 82 percent of NMP2 from the cotenants, other than LIPA, on November 7, 2001. Constellation operates NMP2 under the terms of an amended and restated operating agreement with LIPA.

The operating agreement between LIPA and Constellation provides for a management committee comprised of one representative from each cotenant. Additionally, LIPA employs an on-site representative to provide additional support to protect LIPA's interests. The annual NMP2 business plan and the operating and capital budgets are developed by Constellation and submitted to LIPA for review and approval. LIPA receives output from NMP2 and is responsible for operating and capital costs in proportion to its ownership interest. Exhibit 7 sets forth the estimated capital expenditures for the facility through the Study Period.

### **KeySpan—Power Supply Agreement**

LIPA entered into the Power Supply Agreement (the "PSA") with KeySpan whereby a subsidiary of KeySpan ("GENCO") supplies LIPA with all of the capacity of the electric generation facilities on Long Island formerly owned by LILCO and now owned by KeySpan. The PSA terminates on May 28, 2013, and may be renewed by LIPA on terms comparable to the original PSA. The GENCO facilities consist of 53 fossil fuel generating units at 13 sites on Long Island with a total nameplate capacity of 3,961 MW. These steam, combustion turbine, and internal combustion generating units operate using oil, natural gas, or both. Exhibit 8 provides a summary description of the GENCO facilities. Historical generation levels for the GENCO facilities for the 1998 through 2002 period are shown in Exhibit 9.

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

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

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

The Generation Purchase Right Agreement ("GPRA"), between LIPA and KeySpan, provides LIPA with the one-time right to acquire all the equity interests in GENCO at fair market value. By amendment to the GPRA dated March 29, 2002, this right is exercisable by notice from LIPA to KeySpan at any time between November 28, 2004 and May 28, 2005. Should the Authority acquire the GENCO generating units pursuant to the terms of the GPRA, the PSA would be terminated.

In February 2001, and again in the June through September 2001 period, NCI conducted field observations of major GENCO facilities to assess their general condition. These observations consisted of plant walk-throughs, discussions with plant staff, and a limited review of operating and maintenance records. These reviews were undertaken to observe the general condition of the generating facilities, to provide familiarity with the units in order to put the capital budget and operation and maintenance budgets in context, and to provide information in connection with LIPA's consideration of its rights pursuant to the GPRA. As a whole, the facilities that NCI observed were found to be in adequate operating condition considering their age and operating history.

Under the terms of the PSA, LIPA is responsible for all costs related to any legal or regulatory proceedings concerning compliance with applicable environmental laws and regulations. Certain GENCO plants have asbestos present. The asbestos is primarily located in plant siding, piping, ductwork, and retired coal handling structures. NCI cannot predict the possible occurrence of costs associated with asbestos or other potential environmental matters.

#### **Other Power Supply Agreements**

In addition to the generation subject to the PSA with GENCO described above, LIPA currently purchases approximately 980 MW of capacity from generation facilities on Long Island and elsewhere under various power purchase agreements. These generating facilities and key terms of the associated power purchase agreements are summarized in Exhibit 10. Exhibit 11 summarizes the energy LIPA's purchases under these agreements.

#### **Short-Term Capacity Purchases**

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

#### **Market Energy Purchases**

In addition to energy purchased under the terms of the agreements described above, LIPA routinely purchases energy in the NYISO's day-ahead and real-time markets. These purchases are generally made when the price of energy from these sources is below the incremental cost of generation from LIPA's contracted resources. During 2002, approximately five percent of the Service Area's energy requirements were obtained through such energy purchases.

## TRANSMISSION INTERCONNECTION FACILITIES

The geographic location of the Service Area restricts the number of transmission interconnections between LIPA's T&D System and other systems in the region. Currently, five major transmission lines connect the T&D System with the Consolidated Edison Company of New York, Inc. ("Con Edison") and NYPA systems to the west and with Connecticut Light and Power ("CL&P") to the north. These interconnections are summarized in Table 1. One additional interconnection, the Cross Sound Cable (the "CSC"), will provide a second connection to southern Connecticut when it becomes fully operational (see "Cross Sound Cable" below).

**TABLE 1**  
**SERVICE AREA TRANSMISSION INTERCONNECTIONS**

<b>Name</b>	<b>Off System Terminal Locations</b>	<b>Interconnecting Utility<sup>1,2</sup></b>	<b>Voltage Level<sup>3</sup></b>
Dunwoodie to Shore Road.....	Westchester County, NY	Con Edison	345 kV
East Garden City to Sprainbrook ....	Westchester County, NY	NYPA	345 kV
Northport to Norwalk Harbor.....	Norwalk, CT	CL&P <sup>4</sup>	138 kV
Jamaica to Lake Success .....	Queens, NY	Con Edison	138 kV
Jamaica to Valley Stream.....	Queens, NY	Con Edison	138 kV

<sup>1</sup> These utilities own the portion of the interconnections not owned by LIPA, except for the interconnection with NYPA, which is entirely owned by NYPA.

<sup>2</sup> CL&P = Connecticut Light and Power.

<sup>3</sup> Kilovolt or "kV."

<sup>4</sup> CL&P is the wholly owned operating subsidiary of Northeast Utilities.

The Con Edison cable extending approximately 18 miles from Dunwoodie to Shore Road (the "Y-50 Cable") was placed in operation in August 1978 and is jointly owned by LIPA and Con Edison. This is a major transmission interconnection that has failed on a number of occasions. Most recently, in December 2000 and again in April 2001, the Y-50 Cable failed on the Long Island land portion. Between January and May 2002, the Long Island land portion of the Y-50 Cable was replaced. In May 2002, the submarine portion of the Y-50 Cable between Davids Island and Pea Island failed. Preliminary analysis indicates that the submarine section experienced mechanical failure, although the exact cause of the failure has not been determined. The Y-50 Cable was restored to service in June 2002 and is currently operating at full capacity.

The East Garden City to Sprainbrook interconnection (the "Y-49 Cable"), installed in 1991, is another major transmission interconnection. The Y-49 Cable is comprised of submarine and land-based portions totaling approximately 23 miles. This line is owned entirely by NYPA; however, most of the capacity of the Y-49 Cable is used by LIPA under the terms of a contract with NYPA. The Y-49 Cable has generally performed well with only a few instances of outages due to terminal equipment failures. On February 27, 2003, one of the submarine cables comprising the Y-49 Cable was damaged by a barge anchor. Repair of the damaged cable is not anticipated to be complete until after the summer of 2003. Nevertheless, the Y-49 Cable was put back in full service on March 8, 2003, using a spare submarine cable that was part of the original installation.

The cable from Northport to Norwalk Harbor (the "NUSCO Cable"), installed in 1969, extends approximately twelve miles under the Long Island Sound from the Northport generating station in Suffolk County, New York to Norwalk Harbor, Connecticut. LIPA owns that portion of the line from Northport to the New York-Connecticut state boundary. The NUSCO Cable is not ordinarily relied upon by LIPA to transfer power in either direction due to transmission constraints in Connecticut and Long Island during normal operations. Anchors from barges and ships operating in Long Island Sound have repeatedly damaged the NUSCO Cable. The most



recent event occurred on November 16, 2002, when a barge anchor damaged the NUSCO Cable. Repairs are underway and expected by LIPA to be completed by July 2003.

The NYISO periodically establishes minimum "on-Island" capacity requirements for the Long Island control area (identified as Zone K by the NYISO). The minimum requirements consider the capacity and reliability of the interconnections, among other factors.

The Authority has received proposals for the addition of new off-island transmission interconnections, including interconnections to New Jersey, and is considering these proposals along with its options for potential new power supplies, both in the Service Area and elsewhere. Please see "OTHER POWER SUPPLY ISSUES—Future Resource Additions" in this section for additional information on this subject.

### **Cross Sound Cable**

Cross-Sound Cable Company, LLC (the "CSC Company") has constructed an interconnection between New Haven, Connecticut and Shoreham, Long Island. The CSC Company (a Connecticut entity) is owned by TransEnergie U.S. Ltd., a subsidiary of Hydro Quebec, (74 percent), a United Illuminating Company subsidiary (25 percent); and Hydro Quebec (one percent). The CSC is a high-voltage, direct current buried submarine cable designed to provide the highly controllable transfer of up to 330 MW in either direction. LIPA has agreed to purchase up to 330 MW of the transmission capacity of the CSC for a 20-year period.

Following cable laying and burial in May 2002, the CSC Company determined that several sections of the CSC within the Long Island Sound were not buried to the depth required by its permits. The U.S. Army Corps of Engineers has determined that there would be no undue short-term environmental harm or navigational interference with the operation of the CSC in its present location until full burial depth can be achieved. The Connecticut Department of Environmental Protection ("DEP") has taken the position that operation of the CSC at less than the installed depth authorized by the DEP permit would require a modification of the permit. The CSC Company has requested a permit modification to allow operation pending burial to the full depth, but the DEP holds that a moratorium imposed by the State of Connecticut prevents it from modifying the permit. For purposes of this Report, NCI has assumed the CSC will be placed in commercial operation by May 2004. However, NCI can provide no assurance that all required approvals will be received by the CSC Company or that the CSC will be placed in commercial operation during the Study Period.

Until such time the CSC becomes commercially operable, LIPA will not incur costs associated with its agreement to purchase the capacity of the interconnection. If and when the facility begins commercial operation, LIPA is expected to utilize the interconnection to acquire capacity and energy when economical to do so. For purposes of this Report, NCI has assumed that LIPA would purchase lower cost energy in the New England market to be delivered via the CSC beginning in May 2004, but NCI has not assumed that LIPA would utilize the CSC for the delivery of purchased capacity.

### **FUTURE RESOURCE ADDITIONS**

LIPA plans to meet growth in its future capacity and energy requirements through a combination of new power supply resources. The Authority has entered into, or is currently negotiating, power purchase agreements associated with new generation facilities in the Service Area. LIPA is also considering options for the purchase of capacity and energy from proposed developments on Long Island as well as the acquisition and delivery of capacity and energy from off island. These new resources are described below.

The Authority has entered into a 15-year power purchase agreement with Jamaica Bay Peaking Facility, LLC, a subsidiary of FPL Energy, LLC ("FPL Energy"), to purchase the output from a new electrical generating facility to be constructed at a site in Far Rockaway, Queens. The proposed facility, to be called the Jamaica Bay Energy Center, would consist of one simple-cycle 54-MW Pratt & Whitney FT-8 Swift-Pac comprising two combustion turbines with a single generator. Due to limitations in the natural gas supply to the area, the turbine will initially operate on No. 2 fuel oil, but could use natural gas when adequate supply becomes available. The anticipated in-service date for this project is June 2003.

The Village of Greenport negotiated with developer Global Common Greenport, LLC to locate a 54-MW Pratt & Whitney Swift-Pac, simple cycle, low emission turbine generator within the village. The new unit will provide power to be sold to LIPA under the terms of a power purchase agreement that the Authority has negotiated with Global Common. The new facility is scheduled to be in service by the summer of 2003. The plant will be operated with No. 2 fuel oil.

Stony Brook University negotiated with Calpine Corporation to add 79.9 MW of capacity in a new facility adjacent to Calpine's existing cogeneration facility located on campus. LIPA will purchase any additional power not used by the campus under a separate agreement with Calpine. The first phase of the project will be completion of a 45 MW General Electric LM 6000, simple cycle, low emission turbine generator scheduled for the summer of 2003. The second phase will convert the facility to combined cycle operation, which is planned to add 34.9 MW of additional capacity by the summer of 2004.

In addition to the new power supply agreements described above, LIPA has entered into agreements to purchase approximately 10 MW from a new generating unit proposed to be constructed in the Village of Freeport for operation beginning in 2004. LIPA is also considering offers for the sale of capacity, energy, and ancillary services from major generation developments proposed for Long Island. One facility is a 250 MW gas-fired, combined-cycle generation plant proposed by KeySpan Energy Development LLC, a division of KeySpan, to be constructed in the Town of Huntington and operational in 2005 or later. Another is a 488 MW gas-fired, combined cycle plant proposed to be constructed in the Town of Brookhaven, by a unit of American National Power, a subsidiary of International Power plc, to be operational as early as 2006. A third development is proposed by Kings Park Energy, LLC, an affiliate of PPL Global, a subsidiary of PPL Corporation (NYSE:PPL), has proposed to build a 300 MW electric generating facility in the Town of Smithtown. The proposed facility would be comprised of six simple-cycle gas turbines (General Electric LM 6000) using natural gas as the main fuel. Low-sulfur distillate oil may be used as a backup fuel. Originally intended to be a merchant generation development, the company has decided to seek a buyer for the Kings Park project and not proceed with development because it lacks a contract for sale of power from the facility. In today's generation development environment, it is unlikely that any of these projects will be developed without agreements for the sale of all, or a significant portion, of their output to LIPA or others.

LIPA has issued a request for proposals for the development of an offshore wind park consisting of between 25 to 50 offshore wind turbines that would be capable of producing 100-140 MW in total. The proposed wind park may be operational by 2007 off the southern shore of Long Island.

In addition to new on-island generation, LIPA is considering its options for the purchase of generation capacity in New England for importation using the CSC. Under NYISO rules capacity imports over the CSC would be treated as "on-island" generation due to the highly controllable design of the CSC. LIPA is also considering the purchase of capacity of proposed new submarine transmission interconnections to New Jersey. New interconnections would not provide generation capacity absent associated generation capacity purchases, but such lines would provide for access by LIPA to more diverse power markets, and either reduce the need for

on-island capacity or provide capacity considered to be technically equivalent to on-island capacity.

#### **FUEL SUPPLY**

Under the terms of the PSA, LIPA is responsible for fuel used for operation of the GENCO facilities. The Energy Manager, as LIPA's agent, procures fuel needed for GENCO operation pursuant to the EMA. Oil and natural gas fuels are purchased through the spot market or term contracts based on market prices at, or near, the time of delivery. Oil fuels are delivered via ship, barge, or truck, depending on the particular generation site while natural gas is delivered by interstate pipeline and through KeySpan's gas distribution system for transport to the GENCO facilities. Numerous pipelines and trans-Canada pipelines connect the New York City market to gas supply regions. KeySpan is a party to the New York Facilities Agreement that provides for the use of the joint systems of area gas utilities to receive gas from their joint interstate pipelines.

Under separate agreement, KeySpan also procures fuel for certain other generation facilities under contract to LIPA as indicated in Exhibit 10, Summary of Power Supply Agreements.

Some generation facilities that LIPA is responsible for fuel supply are able to burn either natural gas or oil, allowing for the optimization of total fuel costs depending on current fuel prices and other factors. The particular fuel used for generation will depend on generation plant fuel capability, fuel supply and transportation availability, and relative fuel cost. During 2002, LIPA incurred oil and natural gas costs totaling approximately \$495 million, inclusive of hedging gains and related costs.

In addition to influencing the cost of energy generation under contract by LIPA, oil and gas prices are also key drivers of regional electricity market prices.

LIPA's estimated costs for natural gas are based on proprietary fuel price forecasts developed by KeySpan for each type of fuel. To prepare the forecasts, KeySpan relies on financial market data for near-term pricing and Cambridge Energy Research Associates forecasts for long-term pricing. Transportation and local distribution costs are added to estimate the cost of natural gas delivered to the generating plants. KeySpan develops oil price forecasts in a similar manner. For additional information on the oil and natural gas price forecasts relied on for purposes of this Report, please see the section entitled "ESTIMATED OPERATING RESULTS."

#### **ENVIRONMENTAL REGULATIONS**

Federal, New York State, and local jurisdictions have imposed, or proposed, regulations governing emissions from power plants. Amendments to the federal Clean Air Act enacted in 1990 impose specific standards for emission of nitrogen oxides ("NOx") and sulfur dioxide ("SO2"). Phase III of the regulations (the most stringent) become effective May 1, 2003. GENCO can comply with these standards by burning natural gas for a portion of its generation to reduce emissions to required levels. Suffolk County, New York, enacted legislation effective March 1, 2002, that imposes certain limits on carbon dioxide ("CO2") emissions for generating plants located in Suffolk County. Analyses performed by KeySpan for LIPA indicates that this CO2 regulation will have no material impact on GENCO generating units located in Suffolk County. NCI cannot predict whether or when new regulations will be enacted, or what the impact may be; however, it is possible that future regulations may have a material impact on the operation of affected generating facilities.

## **TRANSMISSION AND DISTRIBUTION SYSTEM**

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

### **TRANSMISSION FACILITIES**

LIPA's transmission facilities provide for the delivery of capacity and energy from the transmission interconnections and on-Island generating stations to LIPA's electric distribution system. As of December 31, 2002, the transmission system consists of approximately 1,282 miles of overhead and underground lines with voltage levels ranging from 23 kV to 345 kV.

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

Thirty-six transmission substations are in service and utilized on the T&D System. The combined capability of these substations is approximately 7,181 million volt-amperes ("MVA"). The transmission system includes transformation equipment at 17 generating sites that is used to step up the generation voltage to transmission voltage levels. With the exception of certain facilities at the GENCO generating facilities (e.g., auxiliary and starting transformers), transformation equipment at these sites is owned by LIPA.

### **DISTRIBUTION FACILITIES**

The distribution system is comprised of 13 kV and 4 kV facilities and is comprised of a combination of overhead and underground equipment. There are currently 141 substations throughout the Service Area that step the voltage down from transmission to distribution levels. These distribution substations have a combined transformation capability of approximately 6,709 MVA. As of December 31, 2002, the distribution system also includes 58,611 cable miles of overhead and underground line and 205,685 line transformers with a total capacity of approximately 18,839 MVA. Approximately 43.5 percent of the poles on which LIPA's distribution facilities have been installed are owned by Verizon Communications and used by LIPA pursuant to a joint-use agreement.

### **CONDITION OF FACILITIES**

During February 2001, NCI conducted limited on-site observations of principal and representative facilities comprising the T&D System. These observations consisted of visual examinations of facilities that NCI deemed adequate to allow it to assess the general condition of the facilities. In addition to field observations, NCI reviewed historical operation and maintenance records for the T&D System to assess past performance levels and examined written maintenance procedures to evaluate the adequacy of existing maintenance practices. NCI also reviewed the proposed 2001 T&D System capital expenditure levels approved by the Authority to assess the relationship to historical expenditure levels. Based on the observations and assessments conducted by NCI and the measured reliability of the T&D System as discussed below, the T&D System is considered by NCI to be in good condition.

## RELIABILITY

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

The MSA establishes incentive measures for the Manager to maintain frequency and duration of outages for the T&D system below prescribed levels. Statistics for the 1997 through 2001 period (the latest for which comparative data are available) indicate that LIPA's system-wide frequency and duration of outages were much better than average for similar New York State utilities. LIPA experienced higher levels of outages in 2002 compared with 2001 due to an increased number of weather-related events.

Based on preliminary data provided by the State of New York, the average period between interruptions for a customer served by LIPA during 2002 was approximately 12.1 months. For those LIPA customers affected by an interruption during 2002, the average length of interruption was approximately 69.1 minutes. These statistics compare to an average time between interruption of 15.4 months and an average interruption of 63.6 minutes for a LIPA customer during 2001. As mentioned above, the increase in frequency and duration of interruptions experienced during 2002 was the result of unseasonable weather on Long Island and is not believed to be a reflection of deterioration in overall T&D System reliability.

Over the five-year period 1997 through 2001, LIPA's customers experienced an average of 15.6 months between interruptions and average interruption times of 68.4 minutes. For all New York State utilities (other than Con Edison), the average time between interruptions during this five-year period was 13.3 months and the average duration of an interruption was 100.8 minutes.

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

## CAPITAL EXPENDITURES

During the 1998 through 2002 period, an average of approximately \$170 million per year is estimated to have been spent on additions and improvements to the T&D System. Amounts expended for T&D System additions and improvements during 2002 approximated \$235 million. These expenditures included moneys for reliability enhancements, capability expansion, new customer connections, facility replacements, and public works projects. For 2003, the Authority has approved a capital budget of approximately \$238 million for the T&D System. This capital expenditure program includes funds for reliability enhancements, capability expansion, new customer connections, facility replacements, and public works projects, as well as direct interconnection costs for new resource additions. Total budgeted capital expenditures for 2003 approximate \$245 million, inclusive of expenditures for NMP2 and internal LIPA needs.

Exhibit 7 provides a summary of the Authority's historical T&D System capital expenditures for the 1998 through 2002 period, LIPA's budgeted numbers for 2003 and 2004, and NCI's estimate of T&D System capital expenditures for the 2005 through 2008 period. The Authority anticipates that future T&D System capital expenditures may continue at levels greater than the average expenditure levels experienced during the 1998 through 2002 period. This increase reflects the need for capacity additions and transmission improvements to meet increased customer demands and significant transmission system upgrades to accommodate anticipated new transmission interconnections and generation facilities. As the T&D System loads increase, the transmission system will need to be enhanced to provide for continued reliable delivery of capacity and energy throughout the Service Area.

T&D System capital expenditures will continue to be subject to the Authority's annual approval process under the terms of the MSA. In 2001, LIPA initiated a new capital planning process and capital expenditure review process. The capital planning process is essential to ensure sound capital investment decisions and, when fully implemented by the Manager, will allow LIPA to identify, rank, fund, and manage capital investments. The process involves three phases: (i) *selection*, in which capital projects are screened, ranked, and selected; (ii) *control*, whereby an ongoing monitoring process manages selected capital projects to ensure that each investment continues to be required and is completed on schedule and within budget; and (iii) *evaluation*, wherein projects are reviewed upon completion to determine if the capital investment realized its expected mission and business performance goals, and provide feedback to continually improve the capital planning and execution process.

## **RATES AND CHARGES**

LIPA's retail electric rates are established by the Authority's Board of Trustees (the "Board") and are intended to provide sufficient revenues to satisfy LIPA's annual revenue requirements, including debt service coverage requirements and other obligations established by the General Bond Resolution. With the exception of the recovery of certain variations in LIPA's fuel and purchased power costs, LIPA's retail rate levels have not changed from the rates adopted by the Board at the time of the LIPA/LILCO Merger.

### **BASE RATES**

LIPA's retail electric rates generally reflect traditional rate designs and include fixed customer charges for all customer classes, seasonal energy rates for all customer classes except lighting, and seasonally differentiated demand charges for non-residential customer classes (greater than seven kW). The summer months are June through September, inclusive. Economic development and load retention incentives are provided to a small number of commercial customers. Miscellaneous service charges, pole attachment charges, and rental rates are also assessed on a monthly basis.

LIPA's base retail rates also include riders for variations in fuel and purchased power costs, Shoreham Nuclear Power Station ("Shoreham") property taxes, and payments in-lieu of taxes ("PILOTs"), as described below.

### **Fuel and Purchased Power Cost Adjustment Clause**

LIPA's tariff for electric service includes a fuel and purchased power cost adjustment ("FPPCA") mechanism that automatically adjusts LIPA's bills to customers to reflect changes from the costs of fuel and purchased power that are embedded in LIPA's base rates. Under the FPPCA provisions in effect until March 7, 2003, the FPPCA adjustment was set annually and with a one-year (or more) lag in recovery of costs incurred by LIPA. Because of this lag, changes (increases and decreases) in LIPA's fuel and purchased power costs experienced during a year were not reflected in customers' bills until a following 12-month period.

During 2000, 2001, and 2002, the Authority incurred costs for fuel and purchased power that exceeded the base allowance in the FPPCA by approximately \$329 million, \$207 million, and \$254 million, respectively. In each case, the Authority's Board approved waivers to the FPPCA limiting recovery of excess fuel and purchased power costs to approximately \$126 million for 2000, \$124.5 million for 2001, and \$129 million for 2002, with the recovery of these amounts occurring during a subsequent 12-month period. Actual fuel and purchased power costs in excess of these amounts were charged to expense in the year incurred.

On February 27, 2003, the Board approved a revised FPPCA mechanism (effective March 7, 2003) designed to recover, beginning in 2004, excess fuel costs in the year in which they are incurred, up to an amount necessary to achieve the financial target of \$20 million in revenues in excess of expenses. In order to transition to this current year cost recovery, the Board approved recovery of \$75 million of estimated excess 2003 costs over a 10-month period commencing in March 2003. This amount is in addition to the \$129 million of excess 2002 costs that will be recovered during 2003. The Board also approved deferral of \$70 million of excess 2003 costs for collection over a 12-month period beginning in January 2004. An additional amount of excess 2003 costs of approximately \$247 million will be deferred for collection over a 10-year period beginning in 2004.

Under the new cost recovery procedure approved by the Board, beginning 2004, LIPA will establish the FPPCA adjustment effective January 1 of each year at a level to recover estimated costs, plus the annual amount of amortization of the 2003 deferral, plus or minus any over-recoveries or under-recoveries from the prior year. During each calendar year, LIPA plans to closely monitor and, if necessary, modify the FPPCA adjustment to achieve the financial target of \$20 million in revenues in excess of expenses.

#### **Shoreham Property Tax Settlement Rider**

The Authority and certain taxing jurisdictions in Suffolk County have reached an agreement settling various matters related to previous property tax assessments on Shoreham (the "Shoreham Settlement"). The Shoreham Settlement results in a rate differential between non-Suffolk County customers (Nassau County and Rockaway Peninsula) and customers in Suffolk County. Currently, this differential is attributable to smaller Shoreham credits provided to Suffolk County customers in comparison to the credits provided to other customers. Beginning in June 2003, the differential will be entirely attributable to a Shoreham surcharge on Suffolk County customers. LIPA's rates include a rider that implements the Shoreham property tax settlement.

#### **PILOT Payment Recovery Rider**

LIPA's rates include a revenue tax factor to collect gross receipts taxes to be paid by LIPA in the form of PILOTs. Gross receipts taxes vary within the Service Area according to taxing jurisdiction. This rider is designed to recover the applicable gross receipts tax from each customer. The PILOT payments recovery rider also accommodates a Metropolitan Transportation Authority Temporary Surcharge that LIPA pays as a PILOT.

#### **REGIONAL COMPARISON**

Table 2 provides a comparison of average revenues per kilowatt-hour ("kWh") for 2002 (the latest year available), by revenue classification, for the major electric utilities in New York State, including LIPA. Prior to the LIPA/LILCO Merger, LILCO's rates were the highest in each revenue classification for all the major utilities in the state. Table 2 illustrates that the rate reduction adopted by the Authority in 1998 has improved the level of rates paid by electric consumers relative to the retail rates of other New York utilities.

**TABLE 2**  
**COMPARISON OF AVERAGE UNIT REVENUES**  
**(Cents per kWh)<sup>1</sup>**

	Revenue Classification		
	Residential	Commercial	Industrial
Consolidated Edison Company of New York	18.47	15.59	13.16
New York State Electric & Gas Corporation	13.75	11.57	6.84
Long Island Power Authority	13.66	11.18	NA <sup>2</sup>
Orange & Rockland Corporation	13.54	11.00	8.41
Niagara Mohawk Power Corporation	12.06	10.29	5.05
Rochester Gas & Electric Corporation	11.17	9.82	6.74
Central Hudson Gas & Electric Corporation	11.49	8.63	5.96

<sup>1</sup> Reflects annual revenues per kWh for calendar year 2000, the latest year available. Source: Federal Energy Information Administration, Form 861, "Annual Electric Utility Report."

<sup>2</sup> The Service Area has little traditional industrial load. For LIPA, this rate classification has not been reported to FERC since 1998.

### ESTIMATED OPERATING RESULTS

The Authority's Estimated Operating Results are shown in Exhibits 1 through 3 of this Report. Estimated operating revenues shown in Exhibit 1 have been developed based on the demand and energy forecast discussed previously in this Report and reflect a continuation through the end of the Study Period of the retail rates adopted by the Board. The estimated operating revenues are based on the assumption that the Authority will recover a portion of estimated variations in fuel and purchased power costs, as described in the section entitled "RATES AND CHARGES – Application of the FPPCA" of this Report. Estimated annual operating revenues also take into account the effects of the Shoreham property tax settlement and miscellaneous operating revenues.

Estimated expenses shown in Exhibit 1 reflect annual operating expenses, PILOTs, annual depreciation and amortization expenses, and interest income and expenses. Estimated operating expenses have been developed based on the terms of the MSA, EMA, and other agreements for power supply and transmission services, as well as budgets adopted or approved by the Authority for 2003. Estimated PILOTs reflect a continuation of recent historical tax levels applicable to the System and incorporate annual escalation rates consistent with the Authority's historical experience. A general level of inflation of 2.5 percent has been assumed for non-fuel and purchased power costs. Earnings on invested funds were developed based on estimated cash fund balances and are treated as an offset to annual revenue requirements. Annual debt service payments were based on debt service schedules provided by the Authority's financial advisor. Promissory note receipts represent payments by KeySpan equal to the annual debt service payments on certain LILCO debt retained by LIPA.

Estimated fuel and purchased power expenses were developed based on power system simulation results provided by KeySpan. These results account for electric system capacity and energy requirements throughout the region, capacity available to meet these needs, and other relevant factors. In addition, NCI took into account specific assumptions regarding existing and planned power purchase agreements, market prices for generation capacity, and oil and natural gas price projections, among other factors. The projected oil and natural gas prices used for purposes of the operating forecast set forth in Exhibit 1 of this report are based, in part, on NYMEX strip prices for residual oil and natural gas as of February 27, 2003. Fuel prices (oil and natural gas) are extremely volatile, and there can be no assurance that the projected prices used for purposes of this Report will not be exceeded. (See "RATES AND CHARGES—BASE RATES—



Fuel and Purchased Power Cost Adjustment Clause” for a discussion of LIPA’s fuel and purchased power cost recovery mechanism.) LIPA has entered into hedging arrangements for natural gas and oil with the intention to stabilize a portion of its fuel costs.

As described previously, the Board approved a revision to the FPPCA on February 27, 2003. The Estimated Operating Results shown in Exhibit 1 reflect excess fuel and purchased power costs for 2003 of approximately \$553 million. Pursuant to the Board’s decision to phase in current year cost recovery of excess fuel and purchased power costs, approximately \$391 million of this amount is to be recovered in three parts: (i) \$75 million will be recovered in 2003, which begins the transition to recovery of costs in the current year; (ii) costs of \$70 million will be deferred and recovered from customers in 2004; and (iii) approximately \$247 million will be deferred and recovered in equal annual amounts over ten years commencing in 2004. The portion of the excess 2003 costs not recovered through this process will be expensed. Amounts to be collected during 2003 are in addition to the recovery of approximately \$151 million of excess 2001 and 2002 costs to be recovered during the year.

As shown in Exhibit 1, taking into consideration the withdrawal from the Rate Stabilization Fund during 2003 described below, the Authority’s annual revenues are expected to be sufficient throughout the Study Period to meet annual revenue requirements and provide funds available for other purposes. Exhibit 2 provides a reconciliation of Estimated Operating Results on a cash-equivalent basis and the calculation of estimated annual debt service coverage levels for the Study Period. The General Bond Resolution and Electric System General Subordinated Revenue Bond Resolution (the “General Subordinated Bond Resolution”) contain covenants that obligate LIPA to maintain rates and charges for electric service sufficient to meet annual revenue requirements and provide a debt service coverage ratio of 120 percent of debt service payments on senior lien debt, including certain other obligations identified in the General Bond Resolution (the “Rate Covenant”).

Exhibit 2 provides NCI’s estimate of the Rate Covenant calculation for the Study Period. For purposes of the Rate Covenant, the General Bond Resolution allows the Authority to take into account amounts withdrawn or expected to be withdrawn from the Authority’s Rate Stabilization Fund for purposes of determining the adequacy of operating revenues to meet the Rate Covenant. As shown in Exhibit 2, the Authority is expected to rely on a withdrawal from the Rate Stabilization Fund to satisfy the requirements of the Rate Covenant during 2003. The need for this withdrawal is the result of excess fuel and purchased power costs during 2003 and LIPA’s transition to current year cost recovery under the revised FPPCA. As described in the previous section of this Report, the changes in the FPPCA approved by the Board are designed to recover, beginning in 2004, excess fuel costs in the year in which they are incurred, up to an amount necessary to achieve the financial target of \$20 million in revenues in excess of expenses. As shown in Exhibit 2, once the changes to the FPPCA are fully implemented in 2004, additional withdrawals from the Rate Stabilization Fund to satisfy the Rate Covenant are not expected to be required during the Study Period.

Amounts withdrawn from the Rate Stabilization Fund during 2003 to meet the Rate Covenant are estimated to be repaid immediately from unrestricted cash reserves held by LIPA. As shown in Exhibit 3, LIPA is estimated to maintain minimum year-end cash balances throughout the Study Period ranging from approximately \$482 million to \$579 million, including \$250 million in the Rate Stabilization Fund.

The General Bond Resolution and General Subordinated Bond Resolution contain covenants that obligate LIPA to make PILOTs to State and local taxing jurisdictions. The priority of payments under the General Bond Resolution also specifies that PILOTs and certain other expenses are subordinate to debt service. Included in Exhibit 2 is NCI’s calculation of debt service coverage levels for the Study Period based on this priority of payments. During the Study

Period, annual debt service coverage levels on senior lien debt are estimated to range from 1.81 to 2.42 times annual debt service payments. Estimated debt service coverage levels on all debt obligations, including subordinate and unsecured debt, range from 1.57 to 2.15 annual debt service payments during the Study Period.

#### FUEL PRICE SENSITIVITY ANALYSIS

Fuel and purchased power costs represent LIPA's single largest operating expense, equivalent to more than 40 percent of LIPA's total annual revenue requirement. NCI has prepared an assessment of Estimated Operating Results based on specific changes in the fuel and purchased power expense levels assumed in this Report. For purposes of this sensitivity analysis, fuel and purchased power costs were assumed to increase by 10 percent, 7 percent, and 3 percent over the levels reflected in Exhibit 1 for 2003, 2004, and 2005, respectively. Beginning in 2006, fuel and purchased power expenses were assumed to return to the levels reflected in Exhibit 1. The results of this analysis are summarized in Table 3 and provide a measure of the impact such increases would have on debt service coverage levels, Rate Stabilization Fund amounts, and unrestricted cash balances.

**TABLE 3**  
**RESULTS OF FUEL PRICE SENSITIVITY ANALYSIS**

	Calendar Year		
	2003	2004	2005
Senior Lien Debt Service Coverage Levels			
Base Case <sup>1</sup> .....	1.81	2.42	2.28
Higher Fuel Price Case <sup>2</sup> .....	1.58	2.44	2.29
Withdrawals from Rate Stabilization Fund <sup>3</sup>			
Base Case (\$000) <sup>1,4</sup> .....	\$125,166	--	--
Higher Fuel Price Case (\$000) <sup>2,4</sup> .....	\$216,537	--	--
Rate Stabilization Fund Balance – Year-End <sup>5</sup>			
Base Case (\$000) <sup>1,4</sup> .....	\$250,000	\$250,000	\$250,000
Higher Fuel Price Case (\$000) <sup>2,4</sup> .....	\$250,000	\$250,000	\$250,000
Total Cash Balance – Year-End <sup>5,6</sup>			
Base Case (\$000) <sup>1</sup> .....	\$494,693	\$578,947	\$520,192
Higher Fuel Price Case (\$000) <sup>2</sup> .....	\$403,322	\$588,085	\$530,016

<sup>1</sup> Estimated Operating Results reflected in Exhibits 1 through 3 of this Report.

<sup>2</sup> Reflects increases of 10 percent, 7 percent, and 3 percent over the levels reflected in Exhibit 1 for 2003, 2004, and 2005, respectively in fuel and purchased power costs incorporated in the Base Case.

<sup>3</sup> Amounts withdrawn from the Rate Stabilization Fund to meet LIPA's Rate Covenant for the year indicated.

<sup>4</sup> During 2003, amounts are estimated to be withdrawn from the Rate Stabilization Fund to satisfy the requirements of the Rate Covenant of the General Bond Resolution. Amounts withdrawn from the Rate Stabilization Fund will flow to other available cash balances held by LIPA. LIPA has indicated that funds equal to the withdrawal will immediately be deposited into the Rate Stabilization Fund from such other available cash balances, resulting in no effective change in the Rate Stabilization Fund balance or other available cash balances.

<sup>5</sup> End-of-year balance for the year indicated.

<sup>6</sup> Includes amounts in the Rate Stabilization Fund.

As illustrated in Table 3, the increases in fuel and purchased power costs described above are estimated to increase LIPA's total expenditures for fuel and purchased power by approximately \$90 million during 2003, \$55 million during 2004, and \$21 million during 2005. These additional costs are estimated to result in an increase of approximately \$91 million in the

withdrawal from the Rate Stabilization Fund during 2003 to meet the requirements of the Rate Covenant. As described earlier, this withdrawal is estimated to be repaid immediately from unrestricted cash reserves and is not expected to result in a decrease in the year-end Rate Stabilization Fund balance. Additional withdrawals from the Rate Stabilization Fund are not expected to be necessary during the Study Period.

As shown in Table 3, total estimated cash balances during 2004 and 2005 are estimated to be higher under the increased fuel and purchased power cost scenario than under the base assumptions reflected in Exhibits 1 through 3. This increase is a result of the increase in the excess fuel and purchased power cost deferral established during 2003 and the subsequent recovery of that deferral beginning in 2004 for a 10-year period.

The results presented in Table 3 illustrate the expected effectiveness of the changes to the FPPCA adopted by the Board on February 27, 2003. With the exception of 2003, which is a transition year for implementation of such changes, all increases in fuel and purchased power costs assumed in this sensitivity analysis are recovered through the provisions of the revised FPPCA on a current year basis (as necessary to achieve a financial target of \$20 million in revenues in excess of expenses).

The analysis described above was performed solely for the purpose of assessing the sensitivity of LIPA's financial results to changes in fuel and purchased power costs and is not intended to reflect all possible scenarios, or those most likely to occur, that could impact LIPA's Estimated Operating Results during the Study Period. Additionally, the sensitivity analysis conducted by NCI is not intended to represent a worst-case assessment of factors that could influence LIPA's financial performance during the Study Period.

#### COMPLIANCE WITH PACB CONDITIONS

As a condition of approval of the LIPA/LILCO Merger, the New York Public Authorities Control Board ("PACB") established certain conditions to be met by LIPA and the Authority. Two of these conditions pertain to the rates charged by LIPA for retail electric service over the 1998 through 2008 period, as restated below.

1. *"LIPA will guarantee that, over a ten year period commencing on the date when LIPA begins providing electric service, average rates within the LIPA service territory will be reduced by no less than fourteen percent when measured against LILCO's base rates at the date of this resolution. The fourteen percent savings must not include the impact of the Shoreham tax settlement. The fourteen percent average rate reduction may be adjusted to reflect emergency conditions and extraordinary unforeseeable events including a precipitous (sic) rise in oil prices. As part of this guarantee, a contract between LIPA and NEWCO will provide that no less than two percent cost savings to LIPA's customers must result from the Amended and Restated Agreement and Plan of Exchange and Merger."*

2. *"LIPA will not implement an increase in average customer rates exceeding two and one half percent over a twelve month period, nor will LIPA extend or reestablish any portion of a temporary rate increase over two and one half percent, without approval of the Public Service Commission following a full evidentiary hearing."*

NCI calculates that, over a 10-year period commencing on May 29, 1998 (the date LIPA began providing electric service), LIPA can be expected to achieve average rate reductions of approximately 15.1 percent when measured against LILCO's base retail rates in effect July 16, 1997 (the date of the PACB resolution approving the Agreements). These reductions exclude the impacts of the Shoreham property tax settlement, pass-through adjustments, such as the FPPCA, and certain credits.

The Estimated Operating Results shown in Exhibit 1 reflect annual operating revenues that assume no increase in LIPA's existing base retail rates during the Study Period, excluding

pass-through adjustments, such as the Shoreham Settlement and the FPPCA. The revenues computed on this basis are estimated to be sufficient to meet all of LIPA's annual revenue requirements, including debt service payments on the bonds.

## **ASSUMPTIONS**

The results of the analyses performed in the preparation of this Report and the conclusions presented herein are predicated upon the general condition that the assumptions presented herein are reasonable and will continue, as stated, for the Study Period, without major modification or change. Although NCI believes the assumptions made are reasonable, NCI makes no representation or warranty that alternative or additional assumptions would necessarily be unreasonable or that the assumed conditions will, in fact, occur. In this connection, NCI's conclusions may be affected favorably or unfavorably by unforeseen future events, and therefore, to the extent conditions differ from those assumed herein, the results that will be achieved by the Authority and LIPA will vary from those forecast. NCI undertakes no obligation to update or revise any portion of this Report to reflect any events or circumstances after the date of this Report. In addition, NCI's studies, analyses, investigations, and projections have been based upon its understanding of certain documents and information provided to NCI by the Authority, LIPA, Keyspan, and the Authority's legal, financial, and accounting advisors. While NCI believes these sources to be reliable, except as otherwise noted herein, they have not been independently verified for either accuracy or validity, and no assurances are offered with respect thereto. To the best of NCI's knowledge, the data and summaries presented herein accurately reflect the information furnished to NCI by the Authority, LIPA, Keyspan, and the Authority's legal, financial, and accounting advisors. Further, NCI has assumed that all contracts and agreements that have been relied upon in the conduct of its investigations will be fully enforceable in accordance with their terms and conditions. NCI makes no representations or warranties, and provides no opinion, concerning the enforceability or legal interpretations of such contractual and legal requirements.

The assumptions on which this Report is based include, but are not limited to, the following:

1. The Authority will complete the plan of finance for 2003 and will issue bonds, which, together with debt already issued by the Authority, will require debt service payments as set forth in Exhibit 1.
2. KeySpan and its subsidiaries will carry out their obligations in accordance with the terms of the Agreements.
3. LIPA will fund repairs, renewals, and replacements to the T&D System, and the Manager will make such repairs, renewals, and replacements in accordance with prudent utility practices and the MSA, as may be required to continue the safe and reliable operation of the T&D System.
4. Power supply resources will be available at the times and in the amounts shown in Exhibits 5 and 6 to meet the electric capacity and energy requirements of LIPA's customers, with adequate reserves for reliability.
5. LIPA's capacity and energy requirements will increase as projected in Exhibits 5 and 6.
6. The Authority will retain staff, advisors, and consultants, as necessary, to carry out its responsibilities for financing, contract administration, planning, public relations, and other matters in connection with the ownership, operation, and maintenance of the System.

7. The Authority will approve reasonable capital expenditures by GENCO, and GENCO will make repairs, renewals, and replacements in accordance with prudent utility practice and the PSA, as may be required to continue the reliable operation of GENCO's generating facilities.
8. The Authority and Constellation Nuclear will provide operating and capital funds in a timely manner as needed to maintain the reliable, cost effective operation of NMP2 and to meet applicable regulations, including environmental and safety standards.
9. Natural gas transportation facilities to deliver gas to and within the Service Area will be maintained, improved, and expanded to enable operation of the on-island generating facilities as forecast by the Manager in its resource planning calculations and as provided in the PSA for the GENCO facilities, as well as for other power production facilities under contract to LIPA within the Service Area, for the Study Period.
10. The Authority will realize revenues and incur costs in connection with the System as set forth in Exhibits 1 through 3.
11. Recovery of fuel and purchased power costs in excess of the amount recovered through LIPA's base retail rates will be achieved in accordance with, and to the extent provided by, the FPPCA without waiver or variation.
12. LIPA's share of NMP2 decommissioning costs will increase from the estimated prepared on behalf of the NMP2 cotenants in 1996 at an average rate of no more than 3.0 percent per year and will be funded through annual deposits by LIPA of a least \$2.1 million and \$1.0 million for the contaminated and non-contaminated portions, respectively, of NMP2. Annual earnings on the decommissioning funds held by, or on-behalf of, LIPA will average 6.0 percent.
13. LIPA will maintain the Rate Stabilization Fund at the levels shown in Exhibit 3 of this Report.
14. The Rate Stabilization Fund will be used for the purposes and in the amounts shown in Exhibit 2 of this Report for the Study Period.
15. LIPA will realize earnings on its invested funds, including the decommissioning funds, equal to the interest rates provided by the Authority's financial advisor, as reflected in Exhibit 1.
16. The Authority will adopt electric rates that provide debt service coverage levels at least equal to the minimum requirements set forth in the General Bond Resolution.
17. There will be no changes in applicable federal, State, or local laws that will establish new limits that have a material impact on the operation and maintenance of the GENCO, NYPA Flynn, or other generating facilities located within the Service Area during the Study Period.
18. There will be no changes in regulations or policies, or adverse impact under current regulations or policies, of federal, State, or local agencies with jurisdiction over NMP2 that will cause new capital additions or operation and maintenance costs to exceed the estimated amounts of such costs reflected in Exhibits 1 through 3 of this Report.
19. Any legislation enacted by the federal government that provides for the restructuring of the electric utility industry will not preclude the use of tax-exempt debt by the Authority for the funding of capital improvements, or for other purposes contemplated during the

Study Period and will not preclude LIPA from owning or operating the System as contemplated in this Report.

This Report has been prepared solely for the Authority for the purposes set forth in the Report and the Report may not be used for any other purpose. In particular, this Report does not express any recommendation, opinion, or advice as to the wisdom, desirability, or prudence of the issuance, sale, or purchase of the Authority's bonds or as to the action any person should take in connection with the offer, issuance, purchase, or sale of the Authority's bonds. NCI and its employees are independent contractors providing professional services to the Authority and LIPA and are not officers, employees, or agents of the Authority or LIPA. NCI and its employees are not and shall not be considered to be fiduciaries of the Authority or LIPA, any purchaser or offeree of the Authority's bonds, or any other person named in this Report or the Authority's offering documents for its bonds. This Report and the Authority's offering documents for its bonds should be read in their entirety. A wide variety of information, including financial information, concerning the subject matter of this Report is publicly available from the Authority and other sources. These sources may include reports in the press attributed to NCI, its employees, or representatives. Any such information from any source that is inconsistent with the information set forth in this Report or the Authority's offering documents for its bonds should be disregarded.

## CONCLUSIONS

On the basis of the considerations, assumptions, studies, and analyses described in this Report, NCI presents the following conclusions. This Report should be read in its entirety before making any decision or judgment whether or not to purchase the Authority's bonds based on the conclusions presented herein.

1. The System, in combination with the common plant, the rights of LIPA under the Agreements, and the obligations of KeySpan and its affiliates, has provided and is expected to continue to provide LIPA with the facilities, labor, management, and related resources required to operate and maintain the T&D System in accordance with prudent utility practices and the requirements of the General Bond Resolution and the Subordinated Bond Resolution.
2. The T&D System is in good condition and, with maintenance and capital expenditures at levels reflected in Exhibit 1 and Exhibit 7 of this Report, can be operated throughout the Study Period at levels of reliability consistent with those experienced by the T&D System during the 1998 through 2002 period. With continued maintenance and capital expenditures in accordance with prudent utility practice, the T&D System can reasonably be expected to achieve levels of reliability beyond 2008 that are comparable to those experienced during the Study Period.
3. Existing and additional power supply resources will be available to reliably meet the electric capacity and energy requirements of the T&D System for the Study Period.
4. Based on FERC Form 1 filings, historical operations and maintenance reports, interviews with power plant staff, and NCI's observations of the GENCO generating unit sites and facilities, NCI is not aware of regulatory compliance or operational problems with the GENCO generating units which would result in operating costs or capital expenditures materially different from those reflected in Exhibit 1 of this Report or which would jeopardize the operation of the GENCO generating units for the remaining term of the PSA.
5. In accordance with the provisions of the EMA, the Energy Manager has been and will continue to be able to secure sufficient natural gas and fuel oil supplies, transportation,

and storage to deliver fuel to the GENCO generating units on behalf of LIPA as necessary to operate the GENCO plants at the rates of production, and at the times needed, to achieve the energy production assumed in the Estimated Operating Results in this Report.

6. The staff and management personnel employed by the Manager, GENCO, and the Energy Manager have, as a whole, extensive and varied experience operating and maintaining the LIPA Assets and the GENCO facilities, are highly qualified to perform the duties required of them by the Authority, and have been and are expected to continue to be able to fulfill their obligations under the MSA, PSA, and EMA with respect to the operation of the System.
7. Through a combination of its own staff, outsourced professional services, and the Board's guidance, the Authority has been and is expected to continue to be able to provide appropriate policy, financial, and management control over the Manager, GENCO, and the Energy Manager to operate and maintain the T&D System in accordance with prudent utility practices and to secure adequate power supply resources for LIPA's customers, all at expenditure levels consistent, on average, with those reflected in the Estimated Operating Results set forth in Exhibits 1 through 3.
8. Revenues from the sale of electricity and from other sources, together with withdrawals from the Rate Stabilization Fund shown in Exhibits 2 and 3, have been and are expected to continue to be sufficient to meet LIPA's annual revenue requirements, including debt service and debt service coverage requirements on the Authority's senior and subordinated bonds during the Study Period.
9. Absent emergency conditions and extraordinary unforeseeable events, the Authority is expected to achieve average rate reductions of no less than 14 percent over a ten-year period commencing on May 28, 1998 when measured against LILCO's base rates in effect July 16, 1997. These reductions exclude the impacts of pass-through adjustments such as those associated with the Shoreham Settlement and the FPPCA.
10. The Authority is not expected to implement an increase in average customer rates exceeding 2.5 percent over a 12-month period, within the Study Period, excluding the impacts of pass-through adjustments such as those associated with the Shoreham Settlement and the FPPCA.
11. The assumptions upon which the Estimated Operating Results shown in Exhibits 1 through 3 of this Report are based are reasonable for the purposes for which they have been relied on.

**EXHIBIT 1**  
**ESTIMATED OPERATING RESULTS**  
**STATEMENT OF OPERATIONS**  
**(\$000)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>Sales of Electricity (GWh)<sup>1</sup></b> .....	19,016	19,324	19,539	19,807	20,099	20,449
<b>Total Electric Revenues<sup>2</sup></b> .....	\$ 2,587,608	\$ 2,819,741	\$ 2,783,693	\$ 2,836,469	\$ 2,917,091	\$ 3,013,696
<b>Expenses:</b>						
Fuel and Purchased Power Costs <sup>3</sup> .....	\$ 1,124,093	\$ 1,285,700	\$ 1,210,832	\$ 1,222,536	\$ 1,254,402	\$ 1,303,126
Operations and Maintenance Expenses <sup>4</sup> .....	675,649	686,724	711,484	738,437	778,507	810,510
General and Administrative Expenses <sup>5</sup> .....	42,073	43,461	44,548	45,661	46,803	47,973
Operating Taxes <sup>6</sup> .....	214,178	216,730	216,913	227,637	238,521	250,168
Depreciation and Amortization <sup>7</sup> .....	233,018	264,126	271,121	278,021	284,546	291,821
<b>Total Expenses</b> .....	<u>\$ 2,289,011</u>	<u>\$ 2,496,741</u>	<u>\$ 2,454,899</u>	<u>\$ 2,512,292</u>	<u>\$ 2,602,778</u>	<u>\$ 2,703,598</u>
<b>Operating Income</b> .....	\$ 298,597	\$ 323,000	\$ 328,794	\$ 324,178	\$ 314,312	\$ 310,098
Other Income and Deductions, Net <sup>8</sup> .....	40,889	42,892	41,002	40,816	41,331	42,206
<b>Income from Continuing Operations</b>						
Before Interest Charges .....	\$ 339,487	\$ 365,892	\$ 369,796	\$ 364,994	\$ 355,644	\$ 352,304
LIPA Bond Interest Expense <sup>9</sup> .....	326,238	336,313	337,578	334,142	329,971	326,606
Other Interest and Fees <sup>10</sup> .....	18,612	17,655	20,293	18,927	13,748	13,773
<b>Total Interest Charges</b> .....	\$ 344,850	\$ 353,968	\$ 357,871	\$ 353,068	\$ 343,719	\$ 340,379
Promissory Note Receipts <sup>11</sup> .....	(25,363)	(8,075)	(8,075)	(8,075)	(8,075)	(8,075)
<b>Net Interest Charges</b> .....	<u>\$ 319,487</u>	<u>\$ 345,892</u>	<u>\$ 349,796</u>	<u>\$ 344,993</u>	<u>\$ 335,643</u>	<u>\$ 332,304</u>
<b>Excess (Deficiency) of Revenues</b>						
Over Expenses <sup>12</sup> .....	<u>\$ 20,000</u>	<u>\$ 20,000</u>	<u>\$ 20,000</u>	<u>\$ 20,000</u>	<u>\$ 20,000</u>	<u>\$ 20,000</u>

<sup>1</sup> Includes bundled electric sales, Long Island Choice, Power for Jobs, Other Sales to Public Authorities, and Street Lighting.

<sup>2</sup> Includes revenues from residential, commercial, and industrial bundled electric sales, Long Island Choice, Power for Jobs, Other Sales to Public Authorities, Street Lighting, Sales for Resale, and transmission of electricity for others. Also includes pole attachment fees, late payment charges, and other miscellaneous revenues. Electric revenues include offsets for the Shoreham Settlement credits and surcharges. The Shoreham Settlement credits cease May 2003 and the Shoreham Settlement surcharge commences June 1, 2003. Electric revenues also include the recovery of excess fuel and purchased power costs in accordance with the FPPCA.

<sup>3</sup> Includes LIPA's costs for fossil and nuclear fuel, costs of purchased capacity and energy (other than non-fuel PSA costs), wheeling charges, costs and settlements of fuel price hedges, and deferred excess fuel and purchased power costs.

<sup>4</sup> Includes costs in accordance with the MSA, PSA, NMP2 operation and maintenance expenses, Clean Energy Program costs, research and development, storm damage reserve, un-collectible accounts, customer service and economic development programs, product development, load research programs, power quality programs, postage-paid envelopes, and other miscellaneous expenses.

<sup>5</sup> Includes LIPA's general and administrative expenses, such as employee salaries and benefits, utilities, rent and legal, and consulting fees.

<sup>6</sup> Includes payments in lieu of property taxes to various taxing jurisdictions for NMP2, the T&D System, Shoreham, and merchant generating plants, as well as gross receipts taxes.

<sup>7</sup> Consists of amortization of an acquisition adjustment, depreciation of plant-in-service, payments to the NMP2 decommissioning fund, and the amortization of a fuel-related regulatory asset.



**EXHIBIT 1**  
**ESTIMATED OPERATING RESULTS**  
**STATEMENT OF OPERATIONS**  
**(CONTINUED)**  
**(\$000)**

**Footnotes (Continued):**

<sup>8</sup> Interest earned on balances in the Rate Stabilization Fund and cash fund. Includes annual carrying charge on the Shoreham Settlement regulatory asset, interest earned on the LIPA's nuclear decommissioning trust fund, earnings from the sale of emission credits, rental income and other interest income. Certain miscellaneous payments, including donations and lobbying costs, are included as reductions to the income items.

<sup>9</sup> Interest expense on bonds, subordinated debt, and other indebtedness (after net swap receipts and payments).

<sup>10</sup> Includes bank and letter of credit fees, debt administration costs, interest on customer deposits, amortization of costs associated with debt issuance and redemptions, and carrying charges on deferred credits. Also includes the estimated reduction in interest expense due to capitalized interest.

<sup>11</sup> Receipts from KeySpan for repayment of certain assumed debt held by LIPA.

<sup>12</sup> Consistent with the FPPCA, recovery of excess fuel and purchased power costs are set so that LIPA achieves \$20 million of revenues in excess of expenses for each calendar year. The fuel and purchased power cost recovery will not exceed the fuel and purchased power costs incurred by LIPA for any year.

Note: Amounts may not add due to rounding.

**EXHIBIT 2**  
**ESTIMATED OPERATING RESULTS**  
**DEBT SERVICE COVERAGE CALCULATIONS**  
**(\$000)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>CALCULATION OF CASH AVAILABLE FOR DEBT SERVICE</b>						
<b>Excess (Deficiency) of Revenues Over Expenses<sup>1</sup></b> .....	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000
<b>Plus:</b>						
Amortization of Deferred Shoreham Property Settlement Credits <sup>2</sup> .....	\$ 22,275	\$ 36,592	\$ 37,017	\$ 37,757	\$ 38,491	\$ 39,336
Deferred Fuel Cost Reconciliation <sup>3</sup> .....	151,196	70,000	-	-	-	-
NMP2 Amortized Fuel Expense <sup>4</sup> .....	7,171	6,793	7,459	6,081	6,642	6,272
Prepaid NMP2 Refueling Outage Costs <sup>5</sup> .....	3,569	(2,119)	-	-	-	-
PSA Property Taxes – Accrual Net of True-Up <sup>6</sup> .....	5,800	6,100	6,400	6,700	7,000	7,400
Pre-Paid Insurance Premiums <sup>7</sup> .....	(603)	(237)	-	-	-	-
Depreciation and Amortization <sup>8</sup> .....	233,018	264,126	271,121	278,021	284,546	291,821
Amortization of Deferred Shoreham Property Settlement Costs <sup>9</sup> .....	203	-	-	-	-	-
Interest Charges <sup>10</sup> .....	344,850	353,968	357,871	353,068	343,719	340,379
Proceeds from the Shoreham Property Tax Settlement Securities <sup>11</sup> .....	25,265	-	-	-	-	-
<b>Subtotal</b> .....	<b>\$ 812,744</b>	<b>\$ 755,223</b>	<b>\$ 699,868</b>	<b>\$ 701,628</b>	<b>\$ 700,398</b>	<b>\$ 705,209</b>
<b>Less:</b>						
Deferred Fuel Costs <sup>12</sup> .....	\$ 70,000	\$ -	\$ -	\$ -	\$ -	\$ -
Deferral to Establish Fuel Regulatory Asset <sup>13</sup> .....	247,422	-	-	-	-	-
Shoreham Settlement Costs <sup>14</sup> .....	25,265	-	-	-	-	-
NMP2 Cash Fuel Expense <sup>15</sup> .....	1,290	8,347	1,322	8,670	1,371	8,820
Prepaid Fuel Hedging Program Costs – Net of Amortization <sup>16</sup> .....	18,782	5,740	-	-	-	-
Funding for NMP2 Plant Decommissioning <sup>17</sup> .....	4,500	4,500	4,500	4,500	4,500	4,500
Carrying Charges on Deferred Shoreham Property Tax Settlement Costs <sup>18</sup> .....	25,183	26,003	26,855	27,751	28,690	29,682
Bank and Related Fees <sup>19</sup> .....	10,619	12,478	13,018	11,818	10,618	10,618
<b>Subtotal</b> .....	<b>\$ 403,061</b>	<b>\$ 57,068</b>	<b>\$ 45,695</b>	<b>\$ 52,739</b>	<b>\$ 45,179</b>	<b>\$ 53,620</b>
<b>Operating Cash Available for Debt Service and Coverage</b> .....	<b>\$ 409,682</b>	<b>\$ 698,155</b>	<b>\$ 654,174</b>	<b>\$ 648,889</b>	<b>\$ 655,219</b>	<b>\$ 651,589</b>

**EXHIBIT 2**  
**ESTIMATED OPERATING RESULTS**  
**DEBT SERVICE COVERAGE CALCULATIONS**  
**(CONTINUED)**  
**(\$000)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>RATE COVENANT TEST</b>						
Operating Cash Available for Debt Service and Coverage <sup>20</sup> .....	\$ 409,682	\$ 698,155	\$ 654,174	\$ 648,889	\$ 655,219	\$ 651,589
Less Debt Service:						
Senior Lien Debt Service <sup>21</sup> .....	395,563	423,830	430,822	461,514	466,134	473,832
20% Coverage on Senior Lien Debt Service <sup>22</sup> .....	79,113	84,766	86,164	92,303	93,227	94,766
Subordinate Debt Service <sup>23</sup> .....	34,809	45,649	46,406	46,416	46,416	46,427
Subsidiary Unsecured Debt Service <sup>24</sup> .....	25,363	8,075	8,075	8,075	8,075	8,075
<b>Subtotal</b> .....	<b>\$ 534,848</b>	<b>\$ 562,321</b>	<b>\$ 571,468</b>	<b>\$ 608,309</b>	<b>\$ 613,853</b>	<b>\$ 623,100</b>
<b>Revenue Excess (Deficiency)</b> .....	<b>\$ (125,166)</b>	<b>\$ 135,834</b>	<b>\$ 82,706</b>	<b>\$ 40,581</b>	<b>\$ 41,367</b>	<b>\$ 28,489</b>
Amounts from (to) Rate Stabilization Fund <sup>25</sup> .....	125,166	-	-	-	-	-
<b>Revenue Excess (Deficiency) After Rate Stabilization Fund</b> .....	<b>\$ -</b>	<b>\$ 135,834</b>	<b>\$ 82,706</b>	<b>\$ 40,581</b>	<b>\$ 41,367</b>	<b>\$ 28,489</b>
<b>DEBT SERVICE COVERAGE BASED ON PRIORITY OF PAYMENTS</b>						
Operating Cash Available for Debt Service and Coverage <sup>26</sup> .....	\$ 409,682	\$ 698,155	\$ 654,174	\$ 648,889	\$ 655,219	\$ 651,589
Plus:						
PILOTs <sup>27</sup> .....	214,178	216,730	216,913	227,637	238,521	250,168
Capital Leases <sup>28</sup> .....	93,370	111,000	110,000	108,000	107,000	106,000
<b>Total Cash Available for Debt Service and Coverage According to Priority of Payments</b> .....	<b>\$ 717,230</b>	<b>\$ 1,025,885</b>	<b>\$ 981,087</b>	<b>\$ 984,526</b>	<b>\$ 1,000,741</b>	<b>\$ 1,007,757</b>
Senior Lien Debt Service <sup>29</sup> .....	\$ 395,563	\$ 423,830	\$ 430,822	\$ 461,514	\$ 466,134	\$ 473,832
<b>Coverage on Senior Lien Debt Service</b> .....	<b>1.81</b>	<b>2.42</b>	<b>2.28</b>	<b>2.13</b>	<b>2.15</b>	<b>2.13</b>
Senior Lien and Subordinate Debt Service <sup>30</sup> .....	\$ 430,372	\$ 469,480	\$ 477,228	\$ 507,931	\$ 512,551	\$ 520,259
<b>Coverage on Senior Lien and Subordinate Debt Service</b> .....	<b>1.67</b>	<b>2.19</b>	<b>2.06</b>	<b>1.94</b>	<b>1.95</b>	<b>1.94</b>
Total Debt Service <sup>31</sup> .....	\$ 455,735	\$ 477,555	\$ 485,303	\$ 516,006	\$ 520,626	\$ 528,334
<b>Coverage on Total Debt Service</b> .....	<b>1.57</b>	<b>2.15</b>	<b>2.02</b>	<b>1.91</b>	<b>1.92</b>	<b>1.91</b>

**EXHIBIT 2**  
**ESTIMATED OPERATING RESULTS**  
**DEBT SERVICE COVERAGE CALCULATIONS**  
**(CONTINUED)**  
**(\$000)**

**Footnotes:**

- <sup>1</sup> From Exhibit 1.
- <sup>2</sup> Recovery of debt service related payments for bonds issued in connection with the Shoreham Settlement.
- <sup>3</sup> Recognition of deferred excess fuel and purchased power costs as an expense in the year during which the costs are recovered.
- <sup>4</sup> Amortization of capitalized nuclear fuel costs based on energy production by NMP2.
- <sup>5</sup> Amortization of capitalized nuclear refueling costs, net of cash outlays.
- <sup>6</sup> Accrual of estimated increases in property taxes that are subject to the following year's reconciliation of PSA costs.
- <sup>7</sup> Amortization of prepaid fuel expenses.
- <sup>8</sup> From Exhibit 1.
- <sup>9</sup> Write-off of Shoreham Settlement related costs expensed in 2003.
- <sup>10</sup> From Exhibit 1.
- <sup>11</sup> Portion of the proceeds of bonds attributable to Shoreham Settlement bill credits each year.
- <sup>12</sup> Fuel and purchased power costs incurred during 2003 to be charged to customers during 2004.
- <sup>13</sup> Deferral of excess fuel and purchased power costs during 2003 to achieve \$20 million of revenues in excess of expenses. This amount will be collected in equal increments over a ten-year period beginning in 2004.
- <sup>14</sup> Bill credits issued in accordance with the Shoreham property tax settlement.
- <sup>15</sup> Cash purchases for NMP2 nuclear fuel. Amounts are included in the capital expenditures.
- <sup>16</sup> Cash payments for fuel hedging costs for future periods.
- <sup>17</sup> Cash deposits to the NMP2 decommissioning fund.
- <sup>18</sup> Annual carrying charges recorded on the Shoreham property tax settlement regulatory asset.
- <sup>19</sup> Bank fees, letter of credit fees, and bond administration costs.
- <sup>20</sup> From Exhibit 2.
- <sup>21</sup> Debt service on bonds (net of swap receipts).
- <sup>22</sup> Twenty percent of total debt service on senior lien bonds (after net swap receipts and payments), in accordance with Section 701 of the General Bond Resolution.
- <sup>23</sup> Consists of variable rate debt and commercial paper. Letters of credit and remarketing fees are excluded
- <sup>24</sup> Debt service on unsecured indebtedness.
- <sup>25</sup> Withdrawals from the Rate Stabilization Fund to meet the Rate Covenant. The amount shown as a withdrawal represents the portion of the balance on hand in the Rate Stabilization Fund which the Authority may be required to withdraw from such fund to comply with the Rate Covenant contained in the General Bond Resolution. The amount, if any, actually withdrawn would depend upon actual expenses and revenues. Based upon current estimates, the Authority expects that sufficient funds will be available to either avoid such withdrawal or, if the withdrawal is necessary, to replenish the Rate Stabilization Fund by no later than the time shown above in the amount shown as a deposit.
- <sup>26</sup> From Exhibit 2.
- <sup>27</sup> Please refer to Exhibit 1, note 6.
- <sup>28</sup> Payments made under power supply agreements deemed to be capital leases.
- <sup>29</sup> Please refer to Exhibit 2, note 21.
- <sup>30</sup> Please refer to Exhibit 2, note 23. Includes both senior lien bonds (after net swap receipts and payments) and subordinated debt service
- <sup>31</sup> Please refer to Exhibit 2, note 24. Includes senior lien bonds (after net swap receipts and payments), subordinated debt service, and unsecured debt service.

Note: Amounts may not add due to rounding.

**EXHIBIT 3**  
**ESTIMATED OPERATING RESULTS**  
**FUNDS AVAILABLE FOR CAPITAL EXPENDITURES AND OTHER PURPOSES**  
**(\$000)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>FUNDS PROVIDED FROM:</b>						
Excess of Revenues Over Expenses <sup>1</sup> .....	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000	\$ 20,000
Plus:						
Amortization of Deferred Shoreham						
Property Tax Settlement Credits <sup>2</sup> .....	\$ 22,275	\$ 36,592	\$ 37,017	\$ 37,757	\$ 38,491	\$ 39,336
Deferred Fuel Cost Reconciliation <sup>3</sup> .....	151,196	70,000	-	-	-	-
NMP2 Amortized Fuel Expense <sup>4</sup> .....	7,171	6,793	7,459	6,081	6,642	6,272
Prepaid NMP2 Refueling Outage						
Costs <sup>5</sup> .....	3,569	(2,119)	-	-	-	-
PSA Property Taxes – Accrual Net of						
True-Up <sup>6</sup> .....	5,800	6,100	6,400	6,700	7,000	7,400
Pre-Paid Insurance Premiums - Net <sup>7</sup> .....	(603)	(237)	-	-	-	-
Depreciation and Amortization <sup>8</sup> .....	233,018	264,126	271,121	278,021	284,546	291,821
Amortization of Deferred Shoreham						
Property Tax Settlement Costs <sup>9</sup> .....	203	-	-	-	-	-
Debt Service Interest Expense <sup>10</sup> .....	344,850	353,968	357,871	353,068	343,719	340,379
Commercial Paper Draws <sup>11</sup> .....	-	-	-	-	-	-
Proceeds from Bonds and Notes <sup>12</sup> .....	200,000	89,260	30,307	56,743	90,514	139,930
<b>Total Sources of Funds</b> .....	<b>\$ 987,479</b>	<b>\$ 844,483</b>	<b>\$ 730,175</b>	<b>\$ 758,371</b>	<b>\$ 790,913</b>	<b>\$ 845,139</b>
<b>FUNDS USED FOR:</b>						
Deferred Fuel Costs <sup>13</sup> .....	\$ 70,000	\$ -	\$ -	\$ -	\$ -	\$ -
Deferral to Establish Fuel Regulatory						
Asset <sup>14</sup> .....	247,422	-	-	-	-	-
Shoreham Settlement Credits <sup>15</sup> .....	25,265	-	-	-	-	-
Prepaid Fuel Hedging Program Costs						
- Net <sup>16</sup> .....	18,782	5,740	-	-	-	-
Funding for NMP2						
Decommissioning <sup>17</sup> .....	4,500	4,500	4,500	4,500	4,500	4,500
Carrying Charges on Deferred						
Shoreham Property Tax Settlement						
Costs <sup>18</sup> .....	25,183	26,003	26,855	27,751	28,690	29,682
Bank and Related Fees <sup>19</sup> .....	10,619	12,478	13,018	11,818	10,618	10,618
Commercial Paper Take-Out <sup>20</sup> .....	-	-	-	-	-	-
Debt Service Payments <sup>21</sup> .....	455,735	477,555	485,303	516,006	520,626	528,334
Capital Expenditures <sup>22</sup> .....	245,279	233,953	259,254	226,935	232,068	275,895
Change in Cash Position Due to						
Operating, Financing, and Investing						
Activities <sup>23</sup> .....	(115,307)	84,254	(58,755)	(28,639)	(5,589)	(3,889)
<b>Total Uses of Funds</b> .....	<b>\$ 987,479</b>	<b>\$ 844,483</b>	<b>\$ 730,175</b>	<b>\$ 758,371</b>	<b>\$ 790,913</b>	<b>\$ 845,139</b>

**EXHIBIT 3**  
**ESTIMATED OPERATING RESULTS**  
**FUNDS AVAILABLE FOR CAPITAL EXPENDITURES AND OTHER PURPOSES**  
**(CONTINUED)**  
**(\$000)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>Funds Available for Working Capital and Other Purposes</b>						
Beginning Fund Balance <sup>24</sup> .....	\$ 360,000	\$ 244,693	\$ 328,947	\$ 270,192	\$ 241,554	\$ 235,965
Changes in Cash Position Due to Operating, Financing, and Investing Activities <sup>25</sup> .....	(115,307)	84,254	(58,755)	(28,639)	(5,589)	(3,889)
Amounts Withdrawn from Rate Stabilization Fund <sup>26</sup> .....	125,166	-	-	-	-	-
Amounts Deposited to Rate Stabilization Fund <sup>26</sup> .....	(125,166)	-	-	-	-	-
Ending Balance <sup>27</sup> .....	<u>\$ 244,693</u>	<u>\$ 328,947</u>	<u>\$ 270,192</u>	<u>\$ 241,554</u>	<u>\$ 235,965</u>	<u>\$ 232,075</u>
<b>Rate Stabilization Fund<sup>28</sup></b>						
Beginning Balance .....	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
Amounts Withdrawn from Rate Stabilization Fund <sup>26</sup> .....	(125,166)	-	-	-	-	-
Amounts Deposited to Rate Stabilization Fund <sup>26</sup> .....	125,166	-	-	-	-	-
Ending Balance .....	<u>\$ 250,000</u>	<u>\$ 250,000</u>	<u>\$ 250,000</u>	<u>\$ 250,000</u>	<u>\$ 250,000</u>	<u>\$ 250,000</u>
<b>Total Funds Available<sup>29</sup></b>						
Beginning Balance .....	\$ 610,000	\$ 494,693	\$ 578,947	\$ 520,192	\$ 491,554	\$ 485,965
Amounts To (From) Fund .....	(115,307)	84,254	(58,755)	(28,639)	(5,589)	(3,889)
Ending Balance .....	<u>\$ 494,693</u>	<u>\$ 578,947</u>	<u>\$ 520,192</u>	<u>\$ 491,554</u>	<u>\$ 485,965</u>	<u>\$ 482,075</u>
<b>Capital Expenditure Funds</b>						
Amounts Funded Internally <sup>30</sup> .....	\$ 45,279	\$ 144,693	\$ 228,947	\$ 170,192	\$ 141,554	\$ 135,965
Amounts Funded Externally <sup>31</sup> .....	200,000	89,260	30,307	56,743	90,514	139,930
Total Expenditures <sup>32</sup> .....	<u>\$ 245,279</u>	<u>\$ 233,953</u>	<u>\$ 259,254</u>	<u>\$ 226,935</u>	<u>\$ 232,068</u>	<u>\$ 275,895</u>

<sup>1</sup> From Exhibit 1.

<sup>2</sup> Please refer to Exhibit 2, note 2.

<sup>3</sup> Please refer to Exhibit 2, note 3.

<sup>4</sup> Please refer to Exhibit 2, note 4.

<sup>5</sup> Please refer to Exhibit 2, note 5.

<sup>6</sup> Please refer to Exhibit 2, note 6.

<sup>7</sup> Please refer to Exhibit 2, note 7.

<sup>8</sup> Please refer to Exhibit 2, note 8.

<sup>9</sup> Please refer to Exhibit 2, note 9.

<sup>10</sup> Please refer to Exhibit 2, note 10.

<sup>11</sup> Draws on LIPA's commercial paper line of credit.

<sup>12</sup> Proceeds from the issuance of bonds and notes.

<sup>13</sup> Please refer to Exhibit 2, note 12.

**EXHIBIT 3**  
**ESTIMATED OPERATING RESULTS**  
**FUNDS AVAILABLE FOR CAPITAL EXPENDITURES AND OTHER PURPOSES**  
**(CONTINUED)**  
**(\$000)**

**Footnotes (Continued):**

- <sup>14</sup> Please refer to Exhibit 2, note 13.
- <sup>15</sup> Please refer to Exhibit 2, note 14.
- <sup>16</sup> Please refer to Exhibit 2, note 16.
- <sup>17</sup> Please refer to Exhibit 2, note 17.
- <sup>18</sup> Please refer to Exhibit 2, note 18.
- <sup>19</sup> Please refer to Exhibit 2, note 19.
- <sup>20</sup> Repayment of all or a portion of the principal outstanding on commercial paper.
- <sup>21</sup> Debt service on senior lien bonds (after net swap receipts and payments), subordinated indebtedness, and unsecured debt.
- <sup>22</sup> Estimated capital expenditures associated with the T&D System, NMP2, and LIPA internal uses.
- <sup>23</sup> Increase or (decrease) in year-end cash position, excluding the Rate Stabilization Fund.
- <sup>24</sup> Cash balance of funds available for uses other than the Rate Stabilization Fund. It is LIPA's policy to maintain a balance in excess of \$100 million. Amounts in excess of \$100 million are used to fund the next year's capital expenditure program.
- <sup>25</sup> See note 23 above.
- <sup>26</sup> During 2003, amounts are estimated to be withdrawn from the Rate Stabilization Fund to satisfy the requirements of the Rate Covenant of the General Bond Resolution (please see Exhibit 2). Amounts withdrawn from the Rate Stabilization Fund will flow to other available cash balances held by LIPA. LIPA has indicated that funds equal to the withdrawal will immediately be deposited into the Rate Stabilization Fund from such other available cash balances, resulting in no effective change in the Rate Stabilization Fund balance or other available cash balances.
- <sup>27</sup> The ending balance after changes in cash position.
- <sup>28</sup> The target balance is \$250 million.
- <sup>29</sup> The total of the Funds Available for Capital Expenditures and Other Purposes and the Rate Stabilization Fund.
- <sup>30</sup> Internal funding of LIPA's capital expenditure program. Amounts available for Capital Expenditures and Other Purposes in excess of \$100 million are used to fund the next year's capital expenditure program.
- <sup>31</sup> The amount of bonds (before financing costs) issued to fund LIPA's capital expenditure program.
- <sup>32</sup> LIPA's total capital expenditures.

Note: Amounts may not add due to rounding.

# **EXHIBIT 4** **HISTORICAL LOADS AND RESOURCES**

	Calendar Year				
	1998	1999	2000	2001	2002
<b>Annual Peak Demand (Summer) (MW)<sup>1</sup></b>	4,208	4,622	4,252	4,781	4,929
<b>Capacity (MW)<sup>2</sup></b>					
Nuclear <sup>3</sup> .....	206	205	207	207	204
Purchased Capacity:					
GENCO					
Steam <sup>4</sup> .....	2,649	2,661	2,655	2,659	2,634
Other <sup>4</sup> .....	1,369	1,373	1,353	1,378	1,405
Other Purchased Capacity <sup>5</sup> .....	769	1,065	955	1,104	1,070
Total Purchased Capacity .....	4,787	5,099	4,963	5,141	5,109
Total Capacity .....	4,993	5,304	5,170	5,348	5,313
<b>Annual Reserve Margin:</b>					
MW <sup>6</sup> .....	785	682	918	567	384
Percent .....	18.7	14.8	21.6	11.9	7.8
<b>Energy (MWh)</b>					
Annual Energy Requirements:					
Retail Requirements .....	17,965,421	18,862,815	19,029,595	19,610,662	20,238,273
Sales for Resale .....	330,837	557,422	74,206	590,431	572,817
Total Energy Requirements <sup>7</sup> .....	18,296,258	19,420,237	19,103,803	20,201,093	20,811,090
Generating Resources:					
Nuclear <sup>3</sup> .....	1,306,231	1,571,117	1,400,044	1,598,132	1,519,573
Purchased Energy:					
GENCO					
Steam .....	10,057,429	11,622,120	10,866,087	11,794,254	11,785,320
Other .....	334,833	526,219	657,496	892,258	789,626
Other Purchased Energy <sup>5</sup> .....	6,597,765	5,700,781	6,180,174	5,916,449	6,716,571
Total Purchased Energy .....	16,990,027	17,849,120	17,703,757	18,602,961	19,291,517
Total Energy .....	18,296,258	19,420,237	19,103,803	20,201,093	20,811,090

<sup>1</sup> Includes firm sales for resale and Long Island Choice load.

<sup>2</sup> Summer rating.

<sup>3</sup> LIPA's 18 percent share of NMP2.

<sup>4</sup> 2002 values from KeySpan Energy, Electric Station Generating Capability, Exhibit No. 1, Issue No. 117, issued February 25, 2002.

<sup>5</sup> Includes on and off-island resources under contract at time of peak. Resources include capacity associated with independent power producers, Fitzpatrick, Gilboa, firm capacity purchases, and Power-for-Jobs, and power supply agreements, including FPL Energy Far Rockaway, Calpine Bethpage, KeySpan Glenwood Landing, KeySpan Port Jefferson, PPL Global Shoreham, and PPL Global Pilgrim.

<sup>6</sup> Equal to capacity less annual peak demand.

<sup>7</sup> Amounts shown for 1999 through 2002 include sales for resale, Power-for-Jobs, Long Island Choice, and the Grumman campus, which LIPA began serving in 2000.



**EXHIBIT 5**  
**ESTIMATED CAPACITY REQUIREMENTS AND RESOURCES**  
**(MW)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>System Demand</b>						
Peak Demand <sup>1</sup> .....	4,906	4,989	5,072	5,153	5,239	5,329
Less: Cogeneration and NYPA Loads <sup>1</sup> .....	82	85	86	87	88	89
Adjusted Peak Demand .....	4,824	4,904	4,986	5,066	5,151	5,240
Less: DSM <sup>2</sup> .....	151	107	114	123	134	148
Net LIPA Load <sup>3</sup> .....	4,673	4,797	4,872	4,943	5,017	5,092
Required Reserve Margin <sup>4</sup> .....	841	864	877	890	903	917
Total Capacity Requirements .....	5,514	5,661	5,749	5,833	5,920	6,009
<b>Resources</b>						
NMP2 .....	204	204	204	204	204	204
GENCO Capacity <sup>5</sup> .....	4,062	4,062	4,062	4,062	4,062	4,062
Non-Dispatchable IPPs .....	220	220	165	165	163	163
NYPA (Flynn) .....	135	135	135	135	135	135
NYPA (Pitzpatrick) <sup>6</sup> .....	160	-	-	-	-	-
NYPA (Gilboa) .....	50	50	50	50	50	50
NYPA (Power for Jobs) .....	25	13	1	-	-	-
2002 Resource Additions <sup>7</sup> .....	395	395	320	272	272	272
Future Firm Supply:						
2003/2004 Resource Additions <sup>8</sup> .....	152	197	197	197	197	197
Other Future Firm Supply <sup>9</sup> .....	111	385	615	748	837	926
Total Capability .....	5,514	5,661	5,749	5,833	5,920	6,009
Reserve Margin <sup>10</sup> .....	18%	18%	18%	18%	18%	18%

<sup>1</sup> Source: LIPA Mid-Year 2000 Base Forecast of Electricity Sale, Requirements, and Peak Loads: 2003-2022 (rev. January 24, 2003).

<sup>2</sup> LIPA DSM programs include conservation, direct load control, and peak load reduction.

<sup>3</sup> Includes Long Island Choice load.

<sup>4</sup> Equals 18 percent of Net LIPA Load as set by the New York State Reliability Council.

<sup>5</sup> Values based upon KeySpan Energy, Electric Station Generating Capability, Exhibit No. 1, Issue No. 119, issued December 20, 2002. See Exhibit 8 for details.

<sup>6</sup> The Fitzpatrick capacity contract terminates on December 31, 2003. Thereafter, LIPA expects to enter into a revised contract for the purchase of energy only through December 31, 2007.

<sup>7</sup> Includes FPL Energy Far Rockaway, Calpine Bethpage, KeySpan Glenwood Landing, KeySpan Port Jefferson, PPL Global Shoreham, and PPL Global Pilgrim. Ratings based upon LIPA Installed Capacity Forecast – Summer 2002 through 2015, issued December 30, 2002.

<sup>8</sup> Includes FPL Energy Jamaica Bay, Global Common Greenport, Calpine Stony Brook, and Incorporated Village of Freeport. Ratings based on values in power purchase agreements.

<sup>9</sup> Purchase of firm capacity, installed capacity, or other sources of supply.

<sup>10</sup> Calculation of reserve margin based on Net LIPA Load plus Long Island Choice load.

**EXHIBIT 6**  
**ESTIMATED ENERGY REQUIREMENTS AND RESOURCES**  
**(GWH)**

	Calendar Year					
	2003	2004	2005	2006	2007	2008
<b>Energy Requirements</b>						
System Energy Requirements <sup>1</sup> .....	21,065	21,453	21,719	22,043	22,402	22,831
Less: NYPA and Cogen Loads <sup>2,3</sup> .....	514	524	530	537	544	552
DSM <sup>4</sup> .....	89	138	168	197	236	281
Total Energy Requirements.....	20,462	20,791	21,021	21,309	21,622	21,998
<b>Resources<sup>5</sup></b>						
NMP2.....	1,701	1,580	1,701	1,589	1,701	1,594
GENCO.....	12,924	11,320	9,619	8,861	9,577	9,467
New Resource Additions <sup>6</sup> .....	606	496	406	376	438	397
Non-Dispatchable IPPs.....	2,733	2,522	2,384	2,402	2,446	2,362
NYPA (Flynn) <sup>7</sup> .....	-	-	-	-	-	-
NYPA (Fitzpatrick) <sup>8</sup> .....	1,504	1,247	1,245	1,245	1,245	-
NYPA (Gilboa) <sup>9</sup> .....	-	-	-	-	-	-
NYPA (Power for Jobs).....	254	236	-	-	-	-
Net Economy <sup>10</sup> .....	739	3,390	3,275	2,936	2,318	4,279
Other Future Firm Supply <sup>11</sup> .....	-	-	2,391	3,900	3,897	3,899
Total Resources.....	20,462	20,791	21,021	21,309	21,622	21,998

<sup>1</sup> Source: LIPA Base Forecast of Electricity Sale, Requirements, and Peak Loads: 2003-2022 (rev. January 24, 2003).

<sup>2</sup> Before the effect of customer cogeneration and loads served by NYPA.

<sup>3</sup> Customers in the Service Area receiving energy from NYPA under existing NYPA programs and customer cogeneration.

<sup>4</sup> Reductions for LIPA DSM programs resulting from measures implemented during the Study Period. Programs include conservation, direct load control, and peak load reduction.

<sup>5</sup> Assumes May 2004 in-service date for the Cross Sound Cable.

<sup>6</sup> Includes the 2002 Resource Additions (FPL Energy Far Rockaway, Calpine Bethpage, KeySpan Glenwood Landing, KeySpan Port Jefferson, PPL Global Shoreham, and PPL Global Pilgrim) and the 2003/2004 Resource Additions (FPL Energy Jamaica Bay, Global Common Greenport, Calpine Stony Brook, and Incorporated Village of Freeport).

<sup>7</sup> NYPA Flynn energy is included in Net Economy.

<sup>8</sup> The Fitzpatrick capacity contract terminates on December 31, 2003. Thereafter, LIPA expects to enter into a revised contract for the purchase of energy only through December 31, 2007.

<sup>9</sup> Net Gilboa pumping energy is included in Net Economy.

<sup>10</sup> Short-term purchases net of short-term sales. Includes net Gilboa pumping energy.

<sup>11</sup> Other purchase of energy from firm resources or other sources of supply.

Note: Amounts may not add due to rounding.

**EXHIBIT 7**  
**CAPITAL EXPENDITURES**  
**(\$ MILLIONS)**

	Historical					Estimated					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
T&D System <sup>1</sup> :											
System Enhancements.....	\$ 97	\$ 92	\$ 153	\$ 171	\$ 203	\$ 205	\$ 183	\$ 215	\$ 175	\$ 190	\$ 225
New Customers .....	20	20	20	26	29	30	30	32	32	32	32
Public Works.....	5	3	8	2	3	3	3	3	3	3	3
Total T&D System .....	\$ 122	\$ 115	\$ 181	\$ 199	\$ 235	\$ 238	\$ 216	\$ 250	\$ 210	\$ 225	\$ 260
NMP <sup>2</sup> .....	\$ 14	\$ 3	\$ 11	\$ 7	\$ 12	\$ 5	\$ 16	\$ 7	\$ 15	\$ 5	\$ 14
LIPA Internal <sup>3</sup> .....	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2
Total Capital Expenditures...	\$ 136	\$ 118	\$ 192	\$ 206	\$ 247	\$ 245	\$ 234	\$ 259	\$ 227	\$ 232	\$ 276

<sup>1</sup> Values for 1998 through 2002 obtained from LIPA. Values for 2001 and 2002 are subject to reconciliation through the MSA settlement process. Values for 2003 and 2004 reflect amounts included in LIPA's approved capital budgets. Values for 2005 through 2008 are estimated. Amounts prior to 2005 include direct interconnection costs.

<sup>2</sup> Reflects LIPA's 18 percent share of NMP2's nuclear fuel purchases and asset expenditures as derived from Constellation's NMP Nuclear Power Station 2003-2007 Business Plan, LIPA Version (November 22, 2002). Amounts exclude materials and supplies inventory purchases.

<sup>3</sup> Capital expenditures for information systems, furniture, and equipment. Amounts for 1998 through 2002 included in Total T&D System capital expenditures.

**EXHIBIT 8**  
**GENCO GENERATING FACILITIES**  
**SUMMARY DESCRIPTION**

Facility	Nameplate Rating (MW) <sup>1</sup>	Summer DMNC Rating (MW) <sup>2</sup>	Fuel	Year of Commercial Operation	County
Steam Turbine:					
E.F. Barrett 1,2.....	350	391	Gas, Oil	1956, 1963	Nassau
Far Rockaway 4 <sup>3</sup> .....	100	110	Gas, Oil	1953	Queens
Glenwood 4,5.....	200	233	Gas	1952, 1954	Nassau
Northport 1,2,4.....	1,125	1,157	Gas, Oil	1967-1977	Suffolk
Northport 3.....	375	372	Oil	1972	Suffolk
Port Jefferson 3,4.....	350	388	Gas, Oil	1958, 1960	Suffolk
Subtotal .....	2,500	2,651			
Combustion Turbine:					
E.F. Barrett 1-12 <sup>4</sup> .....	311	310	Gas, Oil	1970-1971	Nassau
Wading River <sup>4</sup> .....	242	245	Oil	1989	Suffolk
East Hampton 1.....	21	23	Oil	1970	Suffolk
Glenwood 1-3 <sup>4</sup> .....	126	112	Oil	1967-1972	Nassau
Holtsville 1-10 <sup>5</sup> .....	567	531	Oil	1974-1975	Suffolk
Northport G-1.....	16	15	Oil	1967	Suffolk
Port Jefferson GT.....	16	14	Oil	1966	Suffolk
Shoreham 1-2.....	72	65	Oil	1966, 1971	Suffolk
Southampton 1.....	12	9	Oil	1963	Suffolk
Southold 1.....	14	14	Oil	1964	Suffolk
West Babylon 4.....	52	49	Oil	1971	Suffolk
Subtotal .....	1,449	1,399			
Internal Combustion:					
East Hampton 2-4.....	6	6	Oil	1962	Suffolk
Montauk 2-4.....	6	6	Oil	1961	Suffolk
Subtotal .....	12	12			
Total.....	3,961	4,062			

<sup>1</sup> Source: LILCO's 1996 Annual Report to the NYPSC.

<sup>2</sup> DMNC values applicable for the 2003 summer capability period. Values based upon KeySpan Energy, Electric Station Generating Capability, Exhibit No. 1, Issue No. 119, issued December 20, 2002.

<sup>3</sup> Permitted for both oil and gas, but currently operational on gas only.

<sup>4</sup> Includes increase in DMNC values associated with power recovery activities.

<sup>5</sup> DMNC value reflects power recovery installation in 2000 that increased the units' DMNC by 53 MW.

**EXHIBIT 9**  
**HISTORICAL GENCO GENERATION<sup>1</sup>**  
**(GWH)**

	Calendar Year				
	1998	1999	2000	2001	2002
Steam Turbine:					
E.F. Barrett 1,2 .....	1,422.5	1,825.4	1,450.2	1,606.2	1,634.4
Far Rockaway 4 .....	359.2	398.2	379.8	295.5	404.2
Glenwood 4,5.....	495.9	679.6	692.3	797.1	804.0
Northport 1-4.....	5,895.2	7,093.6	6,557.0	7,374.1	7,297.4
Port Jefferson 3,4.....	1,884.6	1,625.4	1,786.8	1,721.4	1,645.3
Subtotal.....	10,057.4	11,622.2	10,866.1	11,794.3	11,785.3
Combustion Turbine <sup>2</sup> :					
E.F. Barrett 1-12 .....	75.7	81.4	76.2	125.7	155.8
Wading River .....	106.3	169.0	314.8	409.1	256.2
East Hampton 1 .....	11.5	12.8	14.4	16.1	16.4
Glenwood 1-3 .....	6.0	16.4	9.9	19.6	35.8
Holtsville 1-10.....	112.0	199.4	233.0	293.8	290.9
Northport G-1.....	0.3	0.8	0.6	0.6	1.4
Port Jefferson GT .....	0.2	0.6	(1.7)	1.9	1.2
Shoreham 1-2.....	1.2	17.6	(0.1)	11.1	12.1
Southampton 1 .....	6.2	7.4	1.7	2.9	2.0
Southhold 1 .....	3.8	6.4	0.9	2.9	4.9
West Babylon 4.....	4.1	6.2	1.2	1.9	5.9
Subtotal.....	327.3	518.0	650.9	885.6	782.6
Internal Combustion <sup>2</sup> :					
East Hampton 2-4 .....	4.1	4.2	3.6	4.1	3.9
Montauk 2-4 .....	2.9	4.0	3.0	2.4	3.2
Subtotal.....	7.0	8.2	6.6	6.5	7.1
Total .....	10,391.7	12,148.4	11,523.6	12,686.4	12,574.9

<sup>1</sup> Source: KeySpan.

<sup>2</sup> The output of some units is too small to show, but is included in the totals.

Note: Amounts may not add due to rounding.

**EXHIBIT 10**  
**SUMMARY OF POWER SUPPLY AGREEMENTS**  
**(EXCLUDING GENCO)**

Unit Name	Location	Owner	Summer Capacity (MW)	Contract Expiration	Year In-Service	Unit Type <sup>4</sup>	Primary Fuel Type <sup>5</sup>
NYPA Flynn.....	Holtsville	NYPA	134.9	2014	1994	CC	Natural Gas <sup>5</sup>
Hempstead Resource Recovery .....	Hempstead	American Refuel	67.7	2009	1989	ST	Refuse
Trigen NDEC Combined Cycle .....	Garden City	TriGen	46.3	2016	1991	CC	Natural Gas <sup>6</sup>
Gruman Combined Cycle <sup>1</sup> .....	Bethpage	Calpine	52.5	2004	1989	ST	Natural Gas
Huntington Resource Recovery .....	Huntington	Covanta	23.4	2012	1991	ST	Refuse
Babylon Resource Recovery .....	W. Babylon	Ogden	14.4	2008	1989	ST	Refuse
SUNY-Stony Brook Cogeneration <sup>2</sup> .....	Stony Brook	Calpine	N/A	2015	1995	Cogen.	Natural Gas
Islip Resource Recovery .....	Ronkonkoma	Islip R. R.	9.0	2010	1990	ST	Refuse
Oceanside Landfill.....	Oceanside	Zahren	1.0	2006	1991	IC	Methane
Yaphank Landfill.....	Yaphank	Zapco	3.6	2008	1983	IC	Methane
Bethpage Landfill (Oyster Bay) <sup>3</sup> .....	Old Bethpage	Old Bethpage	N/A	2010	1986	IC	Methane
Smithtown Landfill .....	Kings Park	Smithtown	N/A	2010	1985	IC	Methane
South Oaks Hospital.....	Amityville	South Oaks Hospital	N/A	2005	1990	IC	Natural Gas
PPL Global Shoreham .....	Shoreham	PPL Global	76.0	2017	2002	SC	Diesel <sup>7</sup>
KeySpan Glenwood.....	Glenwood	KeySpan	71.4	2027	2002	SC	Natural Gas <sup>6,7</sup>
KeySpan Port Jefferson.....	Port Jefferson	KeySpan	77.3	2027	2002	SC	Natural Gas <sup>6,7</sup>
FPLE Bayswater.....	Far Rockaway	FPL Energy	47.2	2020	2002	SC	Natural Gas <sup>7</sup>
PPL Global Edgewood .....	Pilgram	PPL Global	74.6	2005	2002	SC	Natural Gas <sup>7</sup>
Calpine Bethpage.....	Bethpage	Calpine	48.1	2005	2002	SC	Natural Gas <sup>7</sup>
NYPA Power-for-Jobs .....	N/A	NYPA	24.5	N/A	N/A	N/A	N/A
Fitzpatrick.....	Scriba	Entergy	160.0	2003 <sup>8</sup>	1975	ST	Nuclear
Gilboa .....	Gilboa	NYPA	50.0	2015	1973	PS	Water

<sup>1</sup> The energy purchased subsequent to 1999 includes energy to serve load at the Grumman campus, which LIPA began serving in January 2000.

<sup>2</sup> Registered as a generator with the NYISO on March 28, 2001; no further energy sales will be made to LIPA.

<sup>3</sup> Terminated parallel generation agreement on October 1, 2001.

<sup>4</sup> CC = Combined Cycle; ST = Steam; Cogen = Cogeneration; IC = Internal Combustion; SC = Simple Cycle; PS = Pumped Storage.

<sup>5</sup> Also burns No. 2 fuel oil.

<sup>6</sup> Also burns kerosene.

<sup>7</sup> LIPA is responsible for fuel procurement and has contracted with KeySpan for this service.

<sup>8</sup> LIPA is currently in contract negotiations.

**EXHIBIT 11**  
**ENERGY OUTPUT OF POWER SUPPLY AGREEMENTS<sup>1</sup>**  
**(GWH)**

Type of Resource	Calendar Year				
	1998	1999	2000	2001	2002
Independent Power Producers					
NYPA Flynn .....	1,199.9	1,019.5	1,207.5	1,206.3	1,250.2
Other <sup>2</sup> .....	1,810.5	1,821.3	1,648.9	1,639.0	1,811.3
Subtotal IPPs .....	3,010.3	2,840.8	2,856.4	2,845.3	3,061.5
NYPA Off-Island: Fitzpatrick & Gilboa .....	1,668.0	1,732.0	1,089.6	1,356.8	1,524.8
Off-Island Purchases <sup>3</sup> .....	1,919.5	899.2	1,831.7	766.0	1,080.2
Other Purchases <sup>4</sup> .....	-	228.7	402.5	948.3	1,050.0
Total Purchases .....	6,597.8	5,700.8	6,180.2	5,916.4	6,716.6

<sup>1</sup> Source: KeySpan.

<sup>2</sup> Various small contracts.

<sup>3</sup> Energy purchases made on the spot market, net of sales on the spot market, plus bi-lateral purchases.

<sup>4</sup> Reflects Power-For-Jobs and Long Island Choice programs.

Note: Amounts may not add due to rounding.

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## **Appendix B**

### **Consolidated Financial Statements of the Authority**

Consolidated Financial Statements of the Authority

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# **Long Island Power Authority and Subsidiaries**

**Consolidated Financial Statements  
December 31, 2002 and 2001**

# **Long Island Power Authority and Subsidiaries**

## **Index**

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<b>Section I.</b>	<b>Management's Discussion and Analysis of the Consolidated Results of Operations for the Year Ended December 31, 2002</b>	<b>1-11</b>
<b>Section II.</b>	<b>Long Island Power Authority Consolidated Financial Statements</b>	
	Report of Independent Accountants	12
	Statements of Financial Position	13
	Statements of Revenues, Expenses, and Changes in Accumulated Deficit	14
	Statements of Cash Flows	15
	Statements of Capitalization	16
	Notes to Consolidated Financial Statements	17-52

# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

---

### Overview

During 2002, LIPA made significant progress towards its goal of increasing the supply of electricity available to LIPA's nearly 1.1 million customers from both on- and off-island resources. At the same time, significant improvements were made to the transmission and distribution system, and much was accomplished to advance LIPA's energy conservation and efficiency efforts. A hot summer season created record demand for electricity, which started with an early April heat wave that set a new record for pre-summer demand. LIPA's load exceeded the 5,000 megawatts (MW) mark for the first time during the summer of 2002.

On Wednesday, July 3<sup>rd</sup>, a new Long Island Control Area (LICA) peak-hour demand record of 5,030 megawatts (MW) was established, which exceeded the previous summer's peak record of 4,906 MW by 124 MW. Twenty-six days later, on Monday, July 29<sup>th</sup>, the first day of a seven-day heat wave, a new LICA peak-hour demand record of 5,059 MWs was reached. The new record, which would eventually stand as the summer 2002 peak record, was 153 MWs in excess of the summer 2001 peak, an extraordinary year-to-year peak growth rate. A hot August resulted in demand exceeding 4,900 MW on several days.

The LICA includes three municipalities served by their own utilities, located within LIPA's service territory.

### Steps Taken to Satisfy Customer Needs

- During a heat wave in the summer of 2001, LIPA concluded that additional on-island generating facilities would be needed to satisfy Long Island's anticipated peak load for the summer of 2002, forecasted at that time to be approximately 400 – 500 MW above the 2001 peak level. Both the New York State Department of Public Service ("PSC") and New York Independent System Operator ("NYISO") concurred that there was a need for additional generating capacity within LIPA's service territory. As a result of these concerns, LIPA initiated its Powering Long Island 2002. Through this initiative, ten new power generating units, built by four different developers, were licensed, constructed and placed in service at six locations throughout LIPA's service territory. Combined, the units added more than 400 megawatts of new on-island capacity available to LIPA.
- LIPA also continued its program of strategic investment in its transmission and distribution system to help improve reliability and to upgrade capacity to serve growing customer load. Capital improvements to the system, which totaled approximately \$246 million, included such items as: capacity improvements; replacement and upgrade of equipment such as transformer banks, and circuit breakers; new substations; enhanced transmission lines; and upgraded command and control equipment. Also included in the \$246 million discussed above, is \$56 million of investment made to interconnect the ten new power generating facilities, referred to above, to the power grid.

# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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### Financial Discussion

#### Restatement

In November 2002, after numerous discussions between KeySpan Energy ("KeySpan") and Authority personnel, KeySpan confirmed that the financial information provided by KeySpan included misstatements of the Authority's electric system revenues in various periods, including 2002 and 2001. In response to this notification, the Authority retained independent accountants to conduct an investigation of the revenue error, and a separate accounting firm specializing in electric power matters, to perform a quality assurance review of KeySpan operations that service the Authority.

The revenue review concluded the following:

- In 2002, KeySpan **overstated** revenues of the Authority by approximately \$62.6 million;
- In 2001, KeySpan **overstated** revenues of the Authority by approximately \$11.6 million;
- In 2000, KeySpan **understated** revenues of the Authority by approximately \$5.9 million;
- In 1999, KeySpan **overstated** revenues of the Authority by approximately \$2.9 million;
- In 1998, KeySpan **understated** revenues of the Authority by approximately \$6.7 million.

The Authority's audited financial statements for 2002 reflect the revised revenue amounts. The Authority has restated 2001 results to reflect the corrected revenue figures, and has reduced the 2001 opening balance of the Accumulated deficit to capture the net revenue understatements related to 2000, 1999, and 1998, totaling approximately \$9.7 million.

#### Financing Plans

The Authority has approved a plan of finance that it expects to complete over the next several months that includes various borrowings. The plan of finance is expected to include the following components: (i) the Authority plans to remarket its \$27.3 million Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds scheduled to mature on April 1, 2010; (ii) the Authority plans to issue approximately \$625 million of uninsured, fixed rate, senior lien bonds (the "Series 2003A & B Bonds"). The Series 2003 A & B Bonds will be issued to refund certain series of the Electric System General Revenue Bonds Series 1998A, 1998B, and 2000A that are currently insured by Financial Security Assurance ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"); (iii) in connection with the expiration of certain letters of credit supporting the Authority's \$700 million Electric System Subordinated Revenue Bonds, Series 1 through 3, the Authority plans to remarket \$600 million of such Bonds as subordinate lien variable rate or auction rate bonds, and refund the remaining \$100 million with fixed rate senior lien bonds; the Authority plans to issue \$200 million of fixed rate senior lien bonds to fund certain capital expenditures; and (iv) the Authority plans to issue approximately \$600 million Refunding VR Bonds on or near June 1, 2003 to refund approximately \$587 million Electric System General Revenue Bonds Series 1998A (2029 maturity, 5.50%). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003, as more fully described in Note 5 to the Authority's Consolidated Financial Statements for the year ended December 31, 2002.

# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

### Liquidity

The Authority's cash, cash equivalents and investments totaled approximately \$610.3 million and \$688.4 million at December 31, 2002 and 2001, respectively. The decrease is primarily the result of funding capital expenditures with cash from operations, and higher payments related to fuel and purchased power costs. Cash generated from operations, combined with available cash balances from 2001 exceeded the Authority's operating, construction and refunding requirements for 2002, and as such, the Authority was able to complete the year without the issuance of any new debt. Furthermore, the Authority has been able to maintain a \$250 million balance in its Rate Stabilization Fund.

The Authority's Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 ("Notes") up to a maximum amount of \$300 million. As of December 31, 2002, the Authority had Notes outstanding totaling \$100 million, leaving \$200 million of undrawn liquidity available. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement, expiring on May 23, 2003. The Authority is currently negotiating a replacement LOC to become effective immediately upon the expiration of the existing agreement. It is expected that the replacement LOC will carry a three-year term.

### Capitalization

The Authority's capitalization, including current maturities of long-term debt, is as follows:

#### **Capitalization**

(in thousands)

	Balance at December 31, 2002	Balance at December 31, 2001
General Revenue Bonds	\$ 5,646,894	\$ 5,778,595
Subordinated Revenue Bonds	1,165,518	1,161,196
Commercial Paper Notes	100,000	100,000
NYSERDA Notes	332,425	332,425
Debentures	270,000	270,000
	<u>\$ 7,514,837</u>	<u>\$ 7,642,216</u>

Long term debt decreased as a result of the scheduled maturities of approximately \$140 million, partially offset by the accretion of the capital appreciation bonds totaling approximately \$29 million.

In February 2003, LIPA furnished notice for a March 2003 redemption of its \$270 million Long Island Lighting Company Debentures, 8.2% Series due 2023. Funding for this redemption, including interest to

## Long Island Power Authority and Subsidiaries

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

---

the date of redemption and call premium, totaling approximately \$281 million was provided by KeySpan in accordance with the terms of a promissory note to LIPA.

Also in February 2003, LIPA announced its intention to redeem in March 2003, approximately \$177 million of its NYSERDA financing notes. KeySpan also provided funding for this redemption in accordance with the terms of a promissory note to LIPA.

#### Investment Ratings

The Authority's securities are rated by Standard and Poor's Corporation (S&P), Moody's Investors Service (Moody's), and Fitch Investors Services, LP (Fitch).

#### Investment Ratings

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	Moody's	Standard & Poors	Fitch
Senior Lien Debt	Baa1	A-	A-

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

Over the past few years, domestic utilities and energy firms generally have come under increasing credit pressure. These pressures stem from a number of factors, including: high profile investigations of accounting irregularities related to a number of companies registered with the Securities and Exchange Commission; concerns over investments in domestic and international merchant power projects; potential overbuild of the domestic capacity markets; concern over departures from core regulated activities; great flux in the regulatory environment; and, a general slowdown of the U.S. and larger global economies. While these credit concerns have had far less of a direct impact on the public power sector, they have nonetheless added to ratings pressure because of, among other things, increased counterparty exposure risk, increased volatility of fuel costs, and the heightened concerns over liquidity.

In December 2002, S&P placed LIPA on CreditWatch negative, reflecting concerns that LIPA's financial performance could be impaired as a result of KeySpan's overstatement of LIPA's revenues for 2002. S&P stated that the "potential for an overstatement of revenues, combined with the lack of third-quarter financials, introduces risk that LIPA's net revenues could be materially reduced".

Other factors cited by S&P as putting pressure on LIPA's credit ratings were rising capital expenditures, concerns over LIPA's original fuel recovery mechanism (which has been amended, as more fully



# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

discussed below under the caption *Fuel and Purchased Power Costs—modification of the FPPCA mechanism*), and concerns over LIPA's longer term plans to meet capacity needs on Long Island.

The following is a summary of the Authority's financial information for 2002 and 2001:

### Summary Statement of Financial Position

(in thousands)

	December 31,	
	2002	2001
<b>Assets</b>		
Capital assets, net	\$ 3,041,699	\$ 2,299,389
Cash, cash equivalents and investments	610,326	688,369
Other current assets	319,294	263,933
Promissory notes receivable	605,247	605,289
Nonutility property and other investments	75,324	38,903
Deferred charges	110,053	76,657
Regulatory assets	693,082	572,382
Acquisition adjustment	3,417,981	3,530,662
<b>Total Assets</b>	<b>\$ 8,873,006</b>	<b>\$ 8,075,584</b>
<b>Capitalization</b>		
Long-term debt	\$ 7,267,657	\$ 7,502,131
Accumulated deficit	(11,253)	(31,365)
Total Capitalization	7,256,404	7,470,766
<b>Capital lease obligation</b>	599,871	-
<b>Current liabilities</b>	703,166	482,883
<b>Non-current liabilities</b>	313,565	121,935
<b>Total Capitalization and Liabilities</b>	<b>\$ 8,873,006</b>	<b>\$ 8,075,584</b>

# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

### Summary Statement Revenues, Expenses and Changes in Accumulated Deficit

(in thousands)

	Twelve Months Ended December 31,	
	2002	2001 Restated
<b>Electric Revenue</b>	\$ 2,459,210	\$ 2,356,351
<b>Expenses</b>		
Operations - fuel and purchased power	924,778	881,335
Operations and maintenance	767,217	719,853
General and administrative	49,780	36,746
Depreciation and amortization	220,654	212,283
Payments in lieu of taxes	218,156	219,579
Total Operating Expenses	2,180,585	2,069,796
Excess of operating revenues over expenses	278,625	286,555
Other income, net	52,204	72,049
Interest charges	310,717	338,056
Excess of revenues over expenses	20,112	20,548
Accumulated deficit - Beginning	(31,365)	(61,670)
Correction of an error in prior periods	-	9,757
Accumulated deficit - as restated	(31,365)	(51,913)
Accumulated deficit - Ending	\$ (11,253)	\$ (31,365)

### Excess of Revenues over Expenses

The excess of revenues over expenses for the year ended December 31, 2002, was approximately \$20 million compared with approximately \$21 million for the prior year.

### Revenue

Revenue increased by approximately \$103 million as compared to 2001. The increase is primarily attributable to: system load growth totaling approximately \$57 million; higher recoveries of previously deferred fuel and purchased power costs (described below) totaling approximately \$25 million; the effects of weather estimated to have positively impacted revenue by approximately \$23 million; and an increase

# Long Island Power Authority and Subsidiaries

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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of other revenue of approximately \$6 million. The revenue increase was partially offset by lower Shoreham credits of approximately \$8 million. The increase in other revenue was primarily the result of higher sales of ancillary services (ICAP) totaling approximately \$4 million, and higher revenue due to increased transmission services fees charged to others who use LIPA's transmission and distribution facilities.

### Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). The FPPCA mechanism was designed to allow LIPA to recover from or return to customers any fuel and purchased power costs that fall outside an established base fuel and purchased power cost tolerance band. The tolerance band was designed to increase in 1% increments annually until such time as the fuel and purchased power costs increased in excess of 5% cumulatively over the original base cost. The FPPCA as designed, would have recovered in subsequent years, all costs incurred in each such period in excess of LIPA's base cost of fuel and purchased power.

For the years ended December 31, 2002, and 2001, the Authority's Board of Trustees decided, however, to limit the recovery of fuel and purchased power costs in excess of those charged to customers in base rates (excess fuel costs) to 5.8% of revenue from base rates. Amounts that exceed the 5.8% are charged to fuel and purchased power expense in the current period, as the Authority will not seek future recovery from customers for those amounts.

For the years ended December 31, 2002, and 2001, excess fuel costs totaled approximately \$254 million and \$207 million, respectively. Of those amounts, approximately \$129 million and \$125 million were deferred at December 31, 2002 and 2001. Costs incurred beyond the 5.8% deferral during the years ended December 31, 2002 and 2001 totaling approximately \$125 million and \$82 million, respectively, were charged to fuel and purchased power expense. The fuel and purchased power cost variation from 2001 includes an increase of approximately \$25 million caused by the timing of the recovery of previously deferred fuel and purchased power costs. This variation is attributable to twelve months of recovery in the 2002 figures, compared with nine months and 24 days of recovery in the 2001 figures, as the recovery of the 2000 deferred fuel and purchased power costs began on March 7, 2001. The amortization to fuel and purchased power expense of amounts previously deferred, is equal to that which is included in revenue, and as a result, there is no impact on earnings.

In addition, fuel and purchased power expense for the year ended December 31, 2002, was reduced by an unrealized gain of approximately \$40 million necessary to comply with the provisions of Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires fuel-related derivatives to be re-valued each period to their estimated fair market value. The \$40 million mark-to-market unrealized gain resulted from the change in fuel related derivatives values at December 31, 2002 when compared to their values at December 31, 2001. However, the fuel derivative values at December 31, 2002 totaled approximately \$32 million. The unrealized gains/losses are included in Fuel and Purchased Power expense but because this valuation is unrealized, it is excluded from the FPPCA calculation.

## Long Island Power Authority and Subsidiaries

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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Eliminating the effects of the accounting mechanisms used to comply with the Authority's tariffs and SFAS No. 133, reveals that fuel and purchased power costs in 2002 increased by approximately \$65 million, or approximately 7%, when compared to the year ended December 31, 2001. Approximately \$24 million of the increase was a result of increased sales. The remaining increase was a result of the increased costs of fuel and purchased power.

#### Modification to the FPPCA mechanism

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

- With respect to 2002 deferred fuel costs, recovery will be over a ten-month period beginning March 2003.
- With respect to 2003 excess fuel costs: (i) \$75 million will be collected in 2003 between March and December; (ii) \$70 million will be deferred and collected in 2004; and (iii) an additional amount sufficient to generate an excess of revenue over expenses of \$20 million in 2003 will be deferred and collected in level annual amounts over a ten year period commencing in January 1, 2004.
- With respect to 2004 and subsequent years' excess fuel costs, collections of these amounts will be on a current year basis in amounts sufficient to generate excess revenue over expenses of \$20 million. For the years ending 2003 and beyond, excess fuel costs not deferred will be charged to expense as the Authority will not seek recovery of such amounts under this modification.

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

O&M increased approximately \$47 million for the year ended December 31, 2002 when compared to 2001. This increase is primarily attributable to the cost of renting temporary emergency stand-by generators totaling approximately \$42 million and costs associated with repairing a 345 kilovolt submarine cable running under the Long Island Sound connecting Long Island to Westchester County, New York (Y-50 cable), totaling approximately \$5 million. The emergency generators were necessary to ensure adequate supply and maintain reliable service during the summer of 2002. It should be noted that the Y-50 cable, once repaired, operated at 67% of its rated capacity through September, and was not returned to 100% until the beginning of October. The cable has performed without problems since being brought back to its 100% level.

Other increases included anticipated increases in the Management Services Agreement ("MSA") fee totaling approximately \$21 million. This increase is the result of escalation clauses within the agreement, and additional work requested by the Authority. Additionally, higher costs were incurred due to clean energy initiatives totaling approximately \$7 million (primarily as a result of the "Keep Cool Bounty

## Long Island Power Authority and Subsidiaries

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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Program"); costs associated with the development of new generating facilities totaling approximately \$6 million; increased preventative maintenance costs on substations not provided for in the agreed upon MSA annual fee, totaling approximately \$4 million; and increased Power Supply Agreement ("PSA") property taxes totaling approximately \$4 million.

These increased costs were offset by lower O&M costs being incurred under the MSA during 2002 compared with 2001 totaling approximately \$22 million. This decrease was the result of a greater percentage of the MSA effort being utilized to support capital improvements, thereby reducing available funds to perform maintenance work. The Authority does not expect that this decrease in O&M will have any long-term detrimental effect on service quality.

In addition, the increase was also offset by lower costs related to Nine Mile Point 2 ("NMP2") Plant totaling approximately \$4 million (in 2001 LIPA incurred a pension and benefit related curtailment loss due to the sale of the NMP2 by the other co-tenants); and decreased costs related to the amortization of deferred costs related to rebates issued to non-Suffolk customers totaling approximately \$14 million.

#### General and Administrative Expenses ("G&A")

The increase in G&A totaling approximately \$13 million is primarily attributable to increasing reserve levels for claims for injuries and damages. There was also a slight increase due to anticipated increased fees for consulting services associated with the development of new generating and transmission facilities on Long Island.

#### Depreciation and amortization

The increase in depreciation and amortization reflects the increase in capital expenditures in 2001 that are now being depreciated. It is anticipated that 2003 depreciation will be higher than 2002 as the Authority continues to replace and upgrade older transmission and distribution facilities to improve service quality.

#### Payments in Lieu of Taxes

Payments in lieu of taxes ("PILOTs") decreased approximately \$1 million. There was an approximate \$7 million decrease in PILOTs on the Shoreham Nuclear Power Station property as the Authority made its final related payment in January 2002. This decrease was offset by the recognition of new PILOTs primarily attributable to the new generating facilities that became operational in the summer of 2002.

#### Other Income

Other income decreased approximately \$20 million. This decrease was primarily a result of decreased investment income of approximately \$9 million as a result of lower returns realized on cash and investment balances due to the general decline in interest rates. In addition, there were lower carrying charges in 2002 related to the Regulatory Asset established upon settlement of the Shoreham litigation by approximately \$7 million due to a refinement in the method of calculating this carrying charge; and the absence of interest earned on ISO rebillings during 2002 totaling approximately \$7 million.

## Long Island Power Authority and Subsidiaries

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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#### Interest Charges and Credits

Despite higher levels of debt outstanding, interest charges related to debt in 2002 were lower compared to the similar period last year, as interest rates on variable rate obligations were less in 2002.

#### Allowance for borrowed funds used during construction

Allowance for borrowed funds used during construction increased approximately \$5 million. This is primarily the result of increased Construction Work in Process ("CWIP") balances during 2002, attributable in part to the interconnections necessitated by the Powering Long Island 2002 projects.

#### Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority, in 2002, formed an Executive Risk Management Committee to strengthen executive management oversight for the risk mitigation activities of the Authority. In addition, the Authority hired an external consultant specializing in risk management, energy markets and energy trading to enhance guidelines and protocols for energy trading activities.

Whenever the Authority enters into a transaction to mitigate risk, it becomes exposed in the event of non-performance by the counterparty. To limit its exposure to risk, the Authority will only enter into derivative transactions with counterparties that have a credit rating of "investment grade" or better.

*Fuel and purchased power transactions:* The Company uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, and/or electricity. These instruments are recorded at their market value and any unrealized gains and losses are recognized in current period results, as a component of fuel and purchased power. At December 31, 2002, the Authority recognized an unrealized gain on its fuel derivatives of approximately \$40 million. At December 31, 2001, the Authority recognized an unrealized loss on these instruments of approximately \$8 million.

*Swaption:* In October 2002, the Authority completed the sale of an option to UBS AG ("counterparty") to hedge the call feature of its approximately \$587 million Electric System General Revenue Bonds, Series 1998A, 5.50% maturing in 2029. In exchange for the option, the Authority received an upfront option premium of \$82 million plus administrative and other costs totaling approximately \$24.4 million. As a result, the Authority recorded the swaption value at \$106.4 million, and recorded a receivable and prepaid expense of approximately \$21.6 million and \$2.8 million, respectively.

On February 3, 2003, UBS AG exercised its option. As a result, the Authority will issue variable rate debt in late May 2003 sufficient to redeem the 1998A 5.50% Electric System General Revenue Bonds maturing in 2029. In addition, the \$82 million premium that the Authority received in October 2002 will be used to reduce interest expense over the life of the variable rate debt.

## Long Island Power Authority and Subsidiaries

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

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*Interest rate transactions:* The Authority is party to an interest rate swap agreement in connection with its \$116 million Electric System General Revenue Bonds Series 2001 L. Under this swap, the Authority has effectively converted the terms of the underlying debt obligation from fixed to variable. Under the terms of this agreement, the Authority pays a variable rate equivalent to the Bond Market Association ("BMA") Index (1.52% and 1.61% at December 31, 2002, and 2001, respectively) and receives fixed rate payments at 5.1875%. The term of the swap is equal to the maturity of the Series L Bonds, May 1, 2033. The Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized gain of approximately \$10.4 million. This gain has been deferred, and will be charged to expense when realized. See Note 15, Subsequent Events, of the Consolidated Financial Statements for an update of this interest rate derivative transaction.

The Authority is party to interest rate swap agreements in connection with its \$250 million Electric System Subordinated Revenue Bonds Series 7 Bonds. The Authority has two separate agreements having notional amounts of \$150 million and \$100 million, respectively. These agreements effectively convert the underlying debt obligation from floating to fixed (4.2%). The interest rate swap agreements are co-terminus with the Series 7 Bonds, with optional earlier termination at the Authority's discretion. In accordance with SFAS No. 133, the Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized loss of approximately \$24.1 million. This loss has been deferred, and will be charged to expense when realized.

#### Capitalized Lease Obligations

During the summer of 2002, LIPA entered into six Power Purchase Agreements ("PPA's") for ten 44.4 MW generating units. Four of the PPA's, incorporating seven of the units, qualify as capital leases under Financial Accounting Standards Board pronouncement No. 13, "Accounting for Leases" ("SFAS No. 13"). Included in both Utility Plant and Capital Lease Obligations is approximately \$600 million, representing the unamortized net present value of the minimum lease payments under the PPA's that qualified for capitalization.

During the first quarter of 2003, the Authority entered into three PPA's for approximately 150 MW of capacity to be available for the summer of 2003. Additionally, the Authority entered into agreements to purchase approximately 50 MW from new generating facilities proposed to be constructed on Long Island by the summer of 2004.

**Report of Independent Accountants**

To the Board of Trustees  
Of the Long Island Power Authority and Subsidiaries:

In our opinion, the accompanying consolidated statements of financial position and of capitalization and the related consolidated statements of revenues, expenses and changes in accumulated deficit and of cash flows present fairly, in all material respects, the financial position of the Long Island Power Authority and its subsidiaries (collectively, the "Company") at December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the accompanying consolidated financial statements, the Company has restated its financial statements as of and for the year ended December 31, 2001 related to electric system revenues.

The Management's Discussion and Analysis and the supplementary information on pages 1 through 11 is not a required part of the basic financial statements but supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*PricewaterhouseCoopers LLP*

March 24, 2003



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

	<b>December 31,</b>	
	<b>2002</b>	<b>(restated Note 3) 2001</b>
<b>Assets</b>		
<b>Utility Plant and Property and Equipment, net</b>	<b>\$ 3,041,699</b>	<b>\$ 2,299,389</b>
<b>Current Assets</b>		
Cash and cash equivalents	491,986	368,866
Investments	118,340	319,503
Accounts receivable (less allowance for doubtful accounts of \$19,485 and \$21,480, respectively)	236,856	195,436
Other accounts receivable	21,971	-
Fuel inventory	46,839	54,418
Material and supplies inventory	7,277	9,794
Interest receivable	1,409	1,049
Prepayments and other current assets	4,942	3,236
<b>Total Current Assets</b>	<b>929,620</b>	<b>952,302</b>
<b>Promissory Notes Receivable</b>		
KeySpan Energy	602,427	602,427
Niagara Mohawk Power Corporation	2,820	2,862
<b>Total Promissory Notes Receivable</b>	<b>605,247</b>	<b>605,289</b>
<b>Nonutility Property and Other Investments</b>	<b>75,324</b>	<b>38,903</b>
<b>Deferred Loss related to Non Fuel Derivatives</b>	<b>39,597</b>	<b>-</b>
<b>Deferred Charges</b>	<b>70,456</b>	<b>76,657</b>
<b>Regulatory Assets</b>		
Shoreham settlement	544,098	425,056
Fuel and purchased power costs recoverable	148,984	147,326
<b>Total Regulatory Assets</b>	<b>693,082</b>	<b>572,382</b>
<b>Acquisition Adjustment (net of accumulated amortization of \$677,530 and \$64,849, respectively)</b>	<b>3,417,981</b>	<b>3,530,662</b>
<b>Total Assets</b>	<b>\$ 8,873,006</b>	<b>\$ 8,075,584</b>
<b>Capitalization</b>		
Long-term debt	\$ 7,267,657	\$ 7,502,131
Accumulated deficit	(11,253)	(31,365)
<b>Total Capitalization</b>	<b>7,256,404</b>	<b>7,470,766</b>
<b>Capital Lease Obligation</b>	<b>599,871</b>	<b>-</b>
<b>Current Liabilities</b>		
Short-term debt	100,000	-
Current maturities of long-term debt	147,180	140,085
Accounts payable and accrued expenses	342,318	238,841
Accrued taxes	41,265	29,576
Accrued interest	47,745	49,511
Customer deposits	24,658	24,870
<b>Total Current Liabilities</b>	<b>703,166</b>	<b>482,883</b>
<b>Deferred Credits</b>	<b>131,037</b>	<b>98,467</b>
<b>Deferred Gain on Series 1998A Bonds</b>	<b>25,955</b>	<b>-</b>
<b>Swaption</b>	<b>132,366</b>	<b>-</b>
<b>Claims and Damages</b>	<b>24,207</b>	<b>23,468</b>
<b>Commitments and Contingencies</b>		
<b>Total Capitalization and Liabilities</b>	<b>\$ 8,873,006</b>	<b>\$ 8,075,584</b>

The accompanying notes are an integral part of these financial statements.

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

	Twelve Months Ended December 31, (restated Note 3)	
	2002	2001
<b>Electric Revenue</b>	\$ 2,459,210	\$ 2,356,351
<b>Expenses</b>		
Operations - fuel and purchased power	924,778	881,335
Operations and maintenance	767,217	719,853
General and administrative	49,780	36,746
Depreciation and amortization	220,654	212,283
Payments in lieu of taxes	218,156	219,579
Total Operating Expenses	2,180,585	2,069,796
<b>Excess of operating revenues over expenses</b>	278,625	286,555
<b>Other income, net</b>		
Investment income	14,860	23,638
Carrying charges on regulatory asset	29,290	36,192
Other	8,054	12,219
Total other income, net	52,204	72,049
<b>Excess of revenues over expenses before interest charges and (credits)</b>	330,829	358,604
<b>Interest charges and (credits)</b>		
Interest on long-term debt, net	295,911	316,592
Other interest	23,812	25,914
Allowance for borrowed funds used during construction	(9,006)	(4,450)
Total interest charges	310,717	338,056
<b>Excess of revenues over expenses</b>	20,112	20,548
<b>Accumulated deficit</b>		
Beginning balance as previously reported		(61,670)
Correction of prior periods		9,757
Beginning balance as adjusted	(31,365)	(51,913)
<b>Ending</b>	\$ (11,253)	\$ (31,365)

The accompanying notes are an integral part of these financial statements.

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

	Twelve Months Ended December 31, (restated Note 3)	
	2002	2001
<b>Cash Flows From Operating Activities</b>		
Received from customers for the system sales, net of refunds	\$ 2,400,193	\$ 2,336,871
Other operating revenues received	40,002	20,675
Paid to suppliers and employees:		
Operations and maintenance	(775,374)	(758,336)
Fuel and purchased power	(896,436)	(810,389)
Payments in lieu of taxes	(276,678)	(265,306)
Net cash provided by operating activities	<u>491,707</u>	<u>523,515</u>
<b>Investing Activities</b>		
Net purchases of investment securities	201,163	(42,429)
Earnings received on investments	14,532	21,591
Other	(3,603)	(3,850)
Net cash provided by (used in) investing activities	<u>212,092</u>	<u>(24,688)</u>
<b>Cash Flows from Capital and related Financing Activities</b>		
Capital and nuclear fuel expenditures	(246,636)	(201,283)
Insurance proceeds	1,209	-
Swaption proceeds	82,017	-
Proceeds from the issuance of bonds, net of issuance costs	27,487	1,916,862
Interest paid, net	(277,371)	(296,260)
Redemption of long-term debt	(167,385)	(1,647,130)
Net cash used in capital and related financing activities	<u>(580,679)</u>	<u>(227,811)</u>
Net increase in cash and cash equivalents	123,120	271,016
Cash and cash equivalents at beginning of period	368,866	97,850
Cash and cash equivalents at end of period	<u>\$ 491,986</u>	<u>\$ 368,866</u>
<b>Reconciliation to Net Cash Provided by Operating Activities</b>		
Excess of operating expenses over operating revenue as previously reported		\$ 298,398
Correction of prior period		11,843
Excess of operating revenues over operating expenses	\$ 278,625	<u>286,555</u>
<b>Adjustments to reconcile excess of operating revenues over operating expenses to net cash provided by operating activities</b>		
Depreciation and amortization	220,654	212,283
Nuclear fuel burned	5,228	5,340
Shoreham Credits	(78,287)	(64,880)
Provision for claims and damages	22,448	10,727
Change in the fair market value of fuel related derivatives	(39,519)	7,606
Other, net	3,784	(68)
<b>Changes in operating assets and liabilities</b>		
Accounts receivable, net	(41,420)	22,965
Fuel and Material and supplies inventory	10,096	(13,961)
Fuel and purchased power costs recovered related to prior periods	127,508	102,779
Excess fuel and purchased power costs deferred	(129,166)	(124,505)
Accounts payable and accrued expenses	111,756	78,674
Net cash provided by operating activities	<u>\$ 491,707</u>	<u>\$ 523,515</u>

The accompanying notes are an integral part of these financial statements.

# Long Island Power Authority and Subsidiaries

16

## Consolidated Statements of Capitalization December 31, 2002 (Thousands of Dollars)

				December 31, (restate Note 3)	
	Maturity	Interest Rate	Series	2002	2001
<b>Electric System General Revenue Bonds</b>					
Serial Bonds	Annually to 2016	4.250% to 6.000%	a 1998A	\$ 1,083,990	\$ 1,136,2
Term Bonds	December 1, 2018 to 2029	5.000% to 5.750%	a 1998A	1,850,575	1,850,5
Capital Appreciation Bonds	December 1, 2003 to 2028	4.400% to 5.300%	a 1998A	182,723	173,9
Serial Bonds	Annually to 2016	4.000% to 5.250%	a 1998B	1,018,875	1,106,7
Term Bonds	April 1, 2018	4.750%	a 1998B	57,145	57,1
Capital Appreciation Bonds	June 1, 2005 to 2029	5.000% to 5.950%	a 2000A	376,494	356,3
Serial Bonds	September 1, 2013 to 2021	4.600% to 5 3/8%	a 2001A	21,960	21,9
Term Bonds	September 1, 2025 to 2029	5.000% to 5 3/8%	a 2001A	278,040	278,0
Term Bonds	May 1, 2033	1.500%	b 2001B	75,000	75,0
Term Bonds	May 1, 2033	1.100%	b 2001C	25,000	25,0
Term Bonds	May 1, 2033	1.200%	b 2001D	50,000	50,0
Term Bonds	May 1, 2033	1.100%	b 2001E	50,000	50,0
Term Bonds	May 1, 2033	1.300%	b 2001F	50,000	50,0
Term Bonds	May 1, 2033	1.300%	b 2001G	50,000	50,0
Term Bonds	May 1, 2033	1.400%	b 2001H	50,000	50,0
Term Bonds	May 1, 2033	1.400%	b 2001I	50,000	50,0
Term Bonds	May 1, 2033	1.450%	b 2001J	50,000	50,0
Term Bonds	May 1, 2033	1.400%	b 2001K	50,000	50,0
Term Bonds	May 1, 2033	5.375%	a 2001L	116,000	116,0
Term Bonds	May 1, 2033	1.140%	b 2001M	50,000	50,0
Term Bonds	May 1, 2033	1.250%	b 2001N	50,000	50,0
Term Bonds	May 1, 2033	1.150%	b 2001O	50,000	50,0
Term Bonds	May 1, 2033	1.250%	b 2001P	50,000	50,0
<b>Electric System Subordinated Revenue Bonds</b>					
	May 1, 2033	1.75% to 1.95%	b Series 1	250,000	250,0
	May 1, 2033	1.55% to 1.70%	b Series 2	250,000	250,0
	May 1, 2033	1.50% to 1.70%	b Series 3	200,000	200,0
	April 1, 2025	1.49% to 1.55%	b Series 7	250,000	250,0
	April 1, 2009 to 2012	4.000% to 5.250%	a Series 8	216,720	216,8
Total General and Subordinated Revenue Bonds				6,852,522	6,963,8
<b>Commercial Paper Notes</b>					
	January 7 to March 31, 2003	1.050% to 1.600%	b CP-1	100,000	100,0
	March 15, 2023	8.200%	a	270,000	270,0
<b>Debentures</b>					
<b>NYSERDA Financing Notes</b>					
Pollution Control Revenue Bonds	March 1, 2016	5.150%	a 1985 A,B	108,020	108,0
Electric Facilities Revenue Bonds	September 1, 2019	7.150%	a 1989 A,B	35,030	35,0
	June 1, 2020	7.150%	a 1990 A	73,900	73,9
	December 1, 2020	7.150%	a 1991 A	26,560	26,5
	February 1, 2022	7.150%	a 1992 A,B	13,455	13,4
	August 1, 2022	6.900%	a 1992 C,D	28,060	28,0
	November 1, 2023	5.300%	a 1993 B	29,600	29,6
	October 1, 2024	5.300%	a 1994 A	2,600	2,6
	August 1, 2025	5.300%	a 1995 A	15,200	15,2
Total NYSERDA Financing Notes				332,425	332,4
Fair market value adjustment				(25,955)	(25,955)
Unamortized premium and deferred amortization				(14,155)	(24,C
<b>Total Long-term debt</b>				7,514,837	7,642,2
Less Current Maturities				247,180	140,C
Long-Term Debt				7,267,657	7,502,1
<b>Accumulated Deficit</b>				(11,253)	(31,2
<b>Total Capitalization</b>				\$ 7,256,404	\$ 7,470,7

a - Fixed rate

b - Variable rate (rate presented is at December 31, 2002)

The accompanying notes are an integral part of these financial statements.

**Notes to Consolidated Financial Statements**

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**Note 1. Basis of Presentation**

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

As used herein, the term "LILCO" refers to the Long Island Lighting Company, the publicly owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger, as described in Note 2, and the term "LIPA" refers to that company as it exists after the LIPA/LILCO Merger, as a wholly-owned electric utility subsidiary company of the Long Island Power Authority (the "Authority"), doing business as LIPA. LIPA has 1 share of \$1 par value common stock authorized, issued and outstanding, which is held by the Authority and is eliminated in consolidation.

The Authority and its subsidiaries are referred to collectively, as the "Company."

**Note 2. Merger/Change in Control/Nature of Operations****Merger/Change in Control**

On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO (the "Merger") pursuant to an Agreement and Plan of Merger dated as of June 26, 1997, by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy, "KeySpan"), and the Authority, (the "Merger Agreement").

Pursuant to the Merger Agreement, immediately prior to the Merger, all of the assets and liabilities of LILCO related to the conduct of its gas distribution business and its non-nuclear electric generation business, and all common assets used by LILCO in the operation and management of its electric transmission and distribution business and its gas distribution business and/or its non-nuclear electric generation business (the "Transferred Assets") were sold to KeySpan.

As a result of the Merger, the Authority became the holder of 1 share of LILCO's common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately \$1.048 billion. At December 31, 2002, approximately \$602.4 million of those notes remain outstanding. The interest rate and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed by LIPA in the Merger. KeySpan is required to make principal and interest payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA transfers those amounts to debt holders in accordance with the original debt repayment schedule.

The cash consideration required for the Merger was obtained by the Authority from the proceeds of the issuance and sale of its Electric System General Revenue Bonds, Series 1998A and Electric System Subordinated Revenue Bonds, Series 1 through Series 6. The proceeds from the sale of the bonds were transferred by the Authority to LIPA in exchange for a promissory note of approximately \$4.949 billion. As a result of the Merger, there was a change in control of LILCO, which effectively resulted in the creation of a new reporting entity, LIPA.

The assets and liabilities of LILCO acquired by LIPA consist of: (i) LILCO's electric transmission and distribution system; (ii) its net investment in Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2");

**Notes to Consolidated Financial Statements**

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(iii) certain regulatory assets and liabilities associated with its electric business, (iv) allocated accounts receivable and other assets and liabilities; and (v) substantially all of its long-term debt.

Because of the manner in which LIPA's rates and charges are established by the Authority's Board of Trustees, the original net book value of the transmission and distribution and nuclear generation assets acquired in the Merger were considered to be the fair value of the assets. The excess of the acquisition costs over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35-year period. The acquisition adjustment arose principally through the elimination of LILCO's regulatory assets and liabilities, totaling approximately \$6.3 billion, and net deferred federal income tax liability of approximately \$2.4 billion. The balance of the acquisition adjustment is approximately \$3.4 billion and \$3.5 billion at December 31, 2002 and 2001, respectively.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services for LIPA's transmission and distribution system through a management services agreement ("MSA"). Therefore, LIPA pays KeySpan directly for services and KeySpan, in turn, pays the salaries of its employees. LIPA has no paid employees. LIPA is charged a management fee by the Authority to oversee LIPA's operations. LIPA contracts for capacity from the fossil fired generating plants of KeySpan, formerly owned by LILCO, through a power supply agreement ("PSA"). Energy is purchased and sold and fuel is purchased by KeySpan on LIPA's behalf through an energy management agreement ("EMA") (collectively; the "Operating Agreements").

The electric transmission and distribution system is located in the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways ("Service Area"). For the year ended December 31, 2002, LIPA received approximately 51% of its revenues from residential sales, 47% from sales to commercial and industrial customers, and the balance from sales to public authorities and municipalities.

**Nature of operations**

LIPA, as owner of the transmission and distribution system and as party to the Operating Agreements, conducts the electric business in the Service Area. The Authority is responsible for administering, monitoring and managing the performance by all parties to the Operating Agreements.

The Authority and LIPA are also parties to an Administrative Services Agreement, which describes the terms and conditions under which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area.

As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above.

**Note 3. Restatement**

In late 2002, the Authority determined that certain revenue information being provided to it by KeySpan was in error. Revenue for the year ended 2001 was overstated by approximately \$11.6 million, and revenue for the years 2000, 1999 and 1998 was understated by a total of approximately \$9.7 million. As a result, electric revenue for 2001, in the accompanying financial statements, has been reduced by \$11.6 million. The Authority's tariffs include a fuel cost deferral mechanism based upon revenue; and

## Notes to Consolidated Financial Statements

accordingly, the amount of the deferral was also reduced. As a result, fuel and purchased power expense recognition increased approximately \$630,000. Additionally, as the Authority recognizes payments-in-lieu-of-taxes ("PILOTs") expense based in part on revenue recognition, the decrease in revenue caused a decrease of approximately \$300,000 in the applicable PILOT expense. Accumulated deficit at January 1, 2001 was reduced by approximately \$9.7 million to reflect the impact of 1998 through 2000 understated revenues. The financial information for 2001 included in the financial statements gives effect to the restatement.

A summary of the effects of the restatement on the Authority's consolidated financial statements for the year ended December 31, 2001 is as follows:

### Restatement summary

<i>(in thousands)</i>	Previously reported	Restated
Electric revenue	\$ 2,367,900	\$ 2,356,351
Total operating expenses	2,069,502	2,069,796
Excess of operating revenues over expenses	298,398	286,555
Excess of operating revenues over expenses before interest charges and (credits)	370,447	358,604
Excess of revenues over expenses	\$ 32,391	\$ 20,548

### Note 4. Summary of Significant Accounting Policies

#### General

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

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Authority and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

#### Accounting for the Effects of Rate Regulation

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

**Notes to Consolidated Financial Statements**

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future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

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

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

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

If the Company had been unable to continue to apply the provisions of SFAS No. 71, at December 31, 2002, the Company estimates that approximately \$693 million of regulatory assets would be considered for write-off, and the acquisition adjustment, totaling approximately \$3.4 billion would be considered for impairment.

**Utility Plant and Property and Equipment**

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

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

**Cash and Cash Equivalents and Investments**

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



**Notes to Consolidated Financial Statements**

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**Fuel Inventory**

Fuel inventory represents the value of low sulfur and internal combustion fuels that LIPA had on hand at each year-end in order to meet the demand requirements of these generating stations. Fuel inventory is valued using the weighted average cost method.

**Material and Supplies Inventory**

During the year ended December 31, 2001, Constellation Nuclear LLC purchased 82% of the Nine Mile Point 2 ("NMP2") plant (discussed in further detail in Note 8). Coincident with the sale, LIPA was, in accordance with the terms of existing co-tenant agreements with the selling parties, required to purchase its 18% ownership interests in the materials and supplies inventory supporting the operations of NMP2.

**Promissory Note Receivable—Niagara Mohawk Power Corporation**

In order to facilitate the sale of NMP2, LIPA sold to Niagara Mohawk Power Corporation certain transmission assets located at the site of NMP2 in exchange for a promissory note totaling approximately \$2.8 million at December 31, 2002 and 2001, payable on the fifth anniversary of the sale with interest accruing at 9.5% compounded annually.

**Deferred Charges**

Deferred charges represent primarily the unamortized balance of costs incurred to issue long-term debt. Such amounts are amortized to interest expense on a straight-line basis over the life of the debt issuance to which they are related.

**Shoreham Settlement**

In January 2000, the Authority reached an agreement with Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District) (collectively, the "Suffolk Taxing Jurisdictions") and Nassau County regarding the over assessment of the Shoreham Nuclear Power Station. Under the terms of the agreement, the Authority is required to issue \$457.5 million of rebates and credits to customers over a five-year period, which began May 29, 1998. In order to fund such rebates and credits, the Authority used a portion of the proceeds from the issuance in May 1998 of its Series 1998A Electric System General Revenue Bonds and issued approximately \$325 million of Electric System General Revenue Bonds, Series 2000A in May 2000. Beginning in June 2003, LIPA's Suffolk County customers' bills will include a surcharge (the "Suffolk Surcharge") to be collected over the succeeding approximate 25 year period to repay the Authority for debt service on the bonds issued by the Authority to fund the Settlement, as well as, to reimburse the Authority for investment earnings the Authority would have otherwise received on the funds advanced for the payment of credits to LIPA's customers.

As future rates will be established at a level sufficient to recover all such costs identified above, LIPA recorded a regulatory asset in accordance with SFAS No. 71. The balance of the Shoreham settlement regulatory asset at December 31, 2002 and 2001 was approximately \$544 million and \$425 million, respectively. The balance represents costs recorded from 1998 through 2002 including rebates and credits issued to customers, costs of administering the program and debt service costs on the Bonds identified above.

In addition to the items described above, other costs related to the Settlement were incurred, but as future rates will not be established at levels to recover such costs, they fail to meet the capitalization criteria of SFAS No. 71. These costs include \$25 million contributed to Nassau County to fund the Clean Energy

**Notes to Consolidated Financial Statements**

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initiative, as well as the \$50 per meter rebate issued to Non-Suffolk County customers, which totaled approximately \$25 million.

**Fuel and purchased power costs recoverable**

LIPA's tariff includes a fuel recovery mechanism – the Fuel and Purchased Power Cost Adjustment ("FPPCA") – whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA applies to all service classifications and was designed to ensure that LIPA would recover from or return to customers any fuel and purchased power costs that fall outside an established base fuel and purchased power costs tolerance band. The tolerance band was designed to increase in 1% increments annually until such time as fuel and purchased power costs increase in excess of five percent cumulatively over the original base fuel and purchased power cost, as they did for the year ended December 31, 2000. The FPPCA is designed to recover, from that year forward, all costs in excess of the original base cost.

In February 2001, the Authority announced that in 2000 the Authority's costs for fuel and purchased power exceeded the amount charged to customers through base rates (excess fuel costs) by approximately \$307 million. On March 1, 2001, the Trustees approved a waiver of the FPPCA that limited cost recovery to approximately \$125.6 million of the additional amount through a fuel and purchased power surcharge equaling approximately 5.8 percent of base revenue for the 12-month period beginning on March 7, 2001. At December 31, 2001, approximately \$22.8 million of that balance remained outstanding. That remaining balance was fully recovered through charges to customers' bills through March 6, 2002.

In February 2002, the Authority announced that in 2001 costs for fuel and purchased power exceeded base fuel costs by approximately \$206.6 million. On February 28, 2002, the Trustees approved a waiver of the FPPCA that would limit cost recovery to approximately \$124.5 million of the additional amount through a fuel and purchased power surcharge of approximately 5.8 percent of base revenue for the 12 month period beginning on March 7, 2002. As a result, the Authority has charged to expense, as of December 31, 2001, approximately \$82.1 million of the excess fuel and purchased power costs. At December 31, 2002, approximately \$19.2 remained outstanding, which was subsequently collected through charges to customer bills through March 6, 2003.

In February 2003, the Authority announced that in 2002 costs for fuel and purchased power exceeded base fuel costs by approximately \$253.8 million, of which approximately \$129.2 million was deferred for future recovery, and the remaining \$124.6 million was charged to fuel and purchased power expense. Also in February, the Trustees approved a modification to the FPPCA mechanism, more fully discussed below, which provides recovery of the \$129.2 million deferral over a 10-month period that began in March 2003.

*Modification to the FPPCA mechanism*

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

- With respect to 2003 excess fuel costs: (i) \$75 million will be collected in 2003 between March and December; (ii) \$70 million will be deferred and collected in 2004; and (iii) an additional amount sufficient to generate an excess of revenue over expenses of \$20 million

**Notes to Consolidated Financial Statements**

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in 2003 will be deferred and collected in level annual amounts over a ten year period commencing in January 1, 2004.

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

**Capitalized Lease Obligations**

During the summer of 2002, LIPA entered into six Purchase Power Agreements ("PPA's") for ten 44.4 MW generating units. Four of the PPA's, incorporating seven of the units, qualify as capital leases under SFAS No. 13, "Accounting for Leases". Included in both Utility Plant and Capital Lease Obligations is approximately \$600 million, representing the unamortized net present value of the minimum lease payments under the PPA's that qualified for capitalization.

As permitted under SFAS 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 discussed above, as allowed through the ratemaking process. The value of the asset and the obligation are reduced each month so that the balance sheet properly reflects the remaining value of the obligation at each month end.

**Acquisition Adjustment**

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

**Fair Values of Financial Instruments**

The Company's financial instruments approximate their fair market value at December 31, 2002 and 2001. The fair values of the Company's long-term debt are based on quoted market prices.

**Deferred Credits**

Deferred credits represent amounts received by the Authority, the final disposition of which remains undetermined. Accordingly, the Authority has deferred the recognition of income until such determination is reached. Certain of these amounts may be returned to customers, the NYISO, or KeySpan. It is the Authority's policy to accrue carrying charges to the benefit of the eventual payee on all such amounts deferred at the Authority's average cost of money.

**Claims and Damages**

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

**Notes to Consolidated Financial Statements**

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**Revenues**

Revenues are comprised of cycle billings rendered to customers, based on meter reads, and the accrual of electric revenues for services rendered to customers not billed at month-end.

**Depreciation**

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

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

**Payments-in-lieu-of-taxes**

The Company is required to make payments-in-lieu-of-taxes ("PILOTS") for all operating taxes previously paid by LILCO, including gross income, gross earnings, property, Metropolitan Transportation Authority and certain taxes related to fuels used in utility operations. PILOTS also include payments to municipalities and school districts in which the defunct Shoreham power plant is located. Shoreham related PILOTS paid in the first year following the Company's acquisition of Shoreham, which occurred on February 29, 1992, were equal to the taxes and assessments which would have been paid had Shoreham not been transferred to the Company. In each succeeding year through 2001, Shoreham related PILOTS have been reduced by ten percent of the first year's required payment.

In 2002, the Company made its final payment with respect to the Shoreham property and has satisfied all PILOT obligation payments related thereto.

**Allowance for Borrowed Funds Used During Construction**

The allowance for funds used during construction ("AFC") is the net cost of borrowed funds used for construction purposes. AFC is not an item of current cash income. AFC is computed monthly on a portion of construction work in progress.

**Income Taxes**

The Authority is a political subdivision of the State of New York and, therefore, the Authority and its subsidiaries are exempt from Federal, state and local income taxes.

**Derivative Instruments**

The Authority uses financial derivative instruments to manage the impact of interest rate, energy price and fuel cost changes on its customers, earnings and cash flows. Effective January 1, 2001, the Authority adopted SFAS No. 133—"Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" to the extent appropriate under Governmental Accounting Standards.

These standards require that an entity recognize the fair value of all derivative instruments as either assets or liabilities in the balance sheet with the offsetting gains or losses recognized in earnings. These standards permit the deferral of hedge gains and losses to Other Comprehensive Income, under specific hedge accounting provisions, until the hedged transaction is realized. However, the Authority is a governmental agency and, therefore, its financial statements are prepared in accordance with the provisions of the Governmental Accounting Standards Board, which do not provide for Other Comprehensive Income.

**Notes to Consolidated Financial Statements**

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Moreover, as the Authority is subject to the provisions of SFAS No. 71, all such gains and losses are deferred until realized. Accordingly, the Authority's balance sheet reflects the inclusion of deferred losses in deferred charges, and the deferred gains in deferred credits.

**Use of Estimates**

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

**Reclassifications**

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

**Recent Accounting Pronouncements***Accounting for Asset Retirement Obligations*

Effective January 1, 2003, the Authority adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 requires an entity to record the fair value of legal obligations associated with the retirement of long-lived assets as a capitalized asset and as an asset-retirement obligation. The recognition of the depreciation of such asset and the accretion of interest on such liability will be charged to expense over the life of the assets. The Authority is currently in the process of completing its analysis of SFAS No. 143 and has concluded, on a preliminary basis, that the impact on future earnings will not be significant.

*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*  
During 2002, the Authority adopted GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," (GASB 34) as amended by GASB No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus, and GASB No. 38, "Certain Financial Statement Note Disclosures." The Authority follows "business type" activity requirements of GASB 34.

*Accounting for the Impairment or Disposal of Long-Lived Assets*

In 2002, the Authority adopted the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." This statement requires that long-lived assets be measured at the lower of book value or fair value less cost to sell. Adoption of SFAS No. 144 did not have a material adverse effect on the Company's financial position, cash flows or results of operations.

**Note 5. Risk Management**

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority, in 2002, formed an Executive Risk Management Committee. This committee established guidelines, one of which was to limit the Authority's exposure to credit risk in the event of non-performance by a counterparty, the Authority only enters into derivative transactions with counterparties that have a credit rating of "investment grade" or better.

**Notes to Consolidated Financial Statements**

*Fuel and purchased power transactions:* The Company uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, or electricity. These instruments are recorded at their market value and any unrealized gains and losses are recognized in current period results, as a component of fuel and purchased power. At December 31, 2002, the Authority recognized an unrealized gain on its fuel derivatives of approximately \$40 million. At December 31, 2001, the Authority recognized an unrealized loss on these instruments of approximately \$8 million. Despite inclusion of these amounts in current period earnings, these unrealized gains and losses are not includable in the FPPCA calculation until realized.

**Fuel Derivative Transactions**

(dollars in thousands, except strike price)

Type of Contract		Duration	Volume Per month	Floor \$	Ceiling \$	Strike Price	Fair Value
<u>Oil Contracts</u>		<i>(volumes in barrels)</i>					
Options							
Put	Short	Dec 02 - Dec 03	50,000-100,000			\$16.50- \$17.70	\$ (797)
Put	Long	Jan 03 - Dec 03	50,000			\$ 18.00	313
Call	Long	Dec-02	50,000			\$ 19.50	362
Collar		Dec 02 - Dec 04	25,000 - 50,000	\$ 13.00	\$ 20.50		13,408
Swap		Dec 02 - Dec 03	200,000			\$ 16.45 - \$17.80	18,373
<u>Gas Transactions</u>		<i>(volumes in decatherms)</i>					
Put	Short	March-03	89,000 - 98,000			\$3.20 - \$3.50	358
Put	Long	March-03	300,000			Customized	(152)
Swap		April-03	95,000			\$ 5.26	203
Market value							\$ 32,068

*Swaption:* In October 2002, the Authority sold an option to UBS AG ("counterparty") to hedge the call feature of its 1998A 5.5% Electric System General Revenue Bonds maturing in 2029. In exchange for the option, the Authority received an upfront option premium totaling approximately \$82 million. In addition, various administrative fees totaling approximately \$2.8 million were paid by the counterparty and the counterparty agreed to pay closing costs of up to \$21.6 million associated with the variable rate debt that the Authority will issue on or near the effective date of the swap, June 1, 2003. As a result, the Authority recorded the swaption value approximately at \$106.4 million, and recorded a receivable and prepaid expenses of approximately \$21.6 million and \$2.8 million, respectively.

As it is the call feature that is being hedged originally (from the date of sale to the date of exercise), and as it would be the Authority's position to protect the value of that option, the transaction during this period of time is to be considered a Fair Value Hedge, under SFAS No. 133 and is marked-to-market, accordingly.

**Notes to Consolidated Financial Statements**

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At December 31, 2002, the Authority recorded an unrealized loss totaling approximately \$25.9 million on this leg of the swaption. Coincident with the loss recognition, the Authority marked-to-market the underlying security, which resulted in an unrealized gain of approximately \$25.9 million, thereby neutralizing the effect on earnings.

Under the provisions of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation ("SFAS No. 71"), all such gains and losses are deferred until realized. Accordingly, the Authority's balance sheet reflects the inclusion of deferred losses in deferred charges, and deferred gains in deferred credits.

On February 3, 2003, the UBS AG exercised its option and paid to the Authority the \$21.6 million of closing costs, referred to above. As a result, the Authority will issue variable rate debt in late May 2003 sufficient to redeem its approximately \$587 million, Series 1998A, 5.50% Electric System General Revenue Bonds maturing in 2029. Effective with the issuance of the variable rate debt, the Authority will have changed the interest charges on the underlying securities from floating to fixed, which will classify this leg of the swaption as a cash flow hedge under SFAS No. 133. The Authority will continue to mark-to-market the value of this leg of the swaption, and defer any gains or losses until realized. This deferral treatment under SFAS No. 71 effectively eliminates any derivative gains or losses from earnings until the debt matures.

*Interest rate transactions:* The Authority is party to an interest rate swap agreement in connection with its \$116 million Electric System General Revenue Bonds Series 2001 L. Under this swap, the Authority has effectively converted the terms of the underlying debt obligation from fixed to variable, and has been designated a fair value hedge in accordance with SFAS No. 133. Under the terms of this agreement, the Authority pays a variable rate equivalent to the Bond Market Association ("BMA") Index (1.52% and 1.61% at December 31, 2002, and 2001, respectively) and receives fixed rate payments at 5.1875%. The swap agreement contained an interest rate cap of 18% through May 25, 2002. After May 25, 2002 no interest rate cap exists. The agreement allows for the counter party to terminate the agreement each May 1 and November 1, commencing on May 1, 2011. The term of the swap is equal to the maturity of the Series L Bonds, May 1, 2033. In accordance with SFAS No. 133, the Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized gain of approximately \$10.4 million. However, as the Authority is subject to the provisions of SFAS No. 71, this gain has been deferred, and will be charged to expense when realized.

The Authority is party to interest rate swap agreements in connection with its \$250 million Electric System Subordinated Revenue Bonds Series 7 Bonds. The Authority has two separate agreements having notional amounts of \$150 million and \$100 million, respectively. These agreements effectively convert the underlying debt obligation from floating to fixed (4.2%). The interest rate swap agreements are co-terminus with the Series 7 Bonds, with optional earlier termination at the Authority's discretion. In accordance with SFAS No. 133, the Authority marked-to-market these transactions at December 31, 2002, and recorded an unrealized loss of approximately \$24.1 million. However, as the Authority is subject to the provisions of SFAS No. 71, this loss has been deferred, and will be charged to expense when realized.

**Note 6. Rate Matters**

Under current New York law, the Authority is empowered to set rates for electric service in the Service Area without the approval of the PSC or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the Merger by the New York State Public Authorities Control Board (the "PACB"), that it will not impose any permanent increase, nor extend or re-establish any portion

**Notes to Consolidated Financial Statements**

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of a temporary rate increase, in average customer rates over a 12 month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. Another of the PACB conditions requires that the Authority reduce average rates within LIPA's service area by no less than 14% over a ten year period commencing on the date when LIPA began providing electric service, when measured against LILCO's base rates in effect on July 16, 1997 (excluding the impact of the Shoreham tax settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events.).

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

LIPA's tariff includes the FPPCA to allow LIPA to adjust customers' bills to reflect significant changes in the cost of fuel and purchased power and related costs.

LIPA's rates are largely based on LILCO's pre-Merger rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, LIPA's tariff includes the FPPCA, a PILOTS recovery rider, and a rider providing for the recovery of costs associated with the Shoreham tax settlement (credits and rebates).

The Act requires LIPA to make PILOTS for certain New York State and local revenue taxes that would otherwise have been imposed on LILCO. The PILOTS recovery rider allows for LIPA's rate adjustments to accommodate the PILOTS.

For a discussion on the Shoreham tax settlement and Suffolk County matters see Note 14.



## Notes to Consolidated Financial Statements

## Note 7. Utility Plant and Property and Equipment

Net utility plant in service at December 31, 2002 and 2001, is as follows:

Asset classification (in thousands)	December 31,	
	2002	2001
Generation - nuclear	\$ 666,007	\$ 663,492
Transmission and distribution	1,961,080	1,705,112
Common	13,519	15,005
Construction work in progress	99,772	140,939
Nuclear fuel in process and in reactor	35,848	27,579
Office equipment, furniture & leasehold improvements	2,513	2,282
	2,778,739	2,554,409
Generation assets under capital lease	612,415	-
Less - Accumulated depreciation and amortization	349,455	255,020
Total Net Utility Plant	\$ 3,041,699	\$ 2,299,389

## Changes in Capital Assets

(in thousands)	December 31,	
	2002	2001
Gross utility plant, beginning balance	\$ 2,413,470	\$ 2,261,802
Add: Acquisitions	287,327	164,723
Less: Dispositions	21,830	13,055
Gross utility plant, ending balance	2,678,967	2,413,470
Add: Generation assets under capital lease	612,415	-
Less: Accumulated depreciation	349,455	255,020
Add: Construction work in progress	99,772	140,939
Net utility plant, ending balance	\$ 3,041,699	\$ 2,299,389

## Note 8. Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2")

LIPA has an undivided 18% interest in Nine Mile Point 2 Nuclear Power Station ("NMP2"), located in Scriba, New York which, until November 6, 2001, was operated by Niagara Mohawk Power Corporation ("NMPC"). On November 7, 2001, Constellation Nuclear LLC ("Constellation") purchased 100% of the Nine-Mile Point 1 Nuclear Power Station, and 82% of NMP2, with LIPA retaining its 18% interest in NMP2. Prior to the sale, the cotenants of NMP2 and their respective percentage ownership were as follows: LIPA (18%), NMPC (41%), New York State Electric & Gas Corporation (18%), Rochester Gas Electric Corporation (14%) and Central Hudson Gas & Electric Corporation (9%).

LIPA's share of the rated capability of NMP2 is approximately 205 megawatts ("MW"). LIPA's net utility plant investment, excluding nuclear fuel, was approximately \$591 million and \$613 million at December 31, 2002 and 2001, respectively. Generation from NMP2 and operating expenses incurred by

**Notes to Consolidated Financial Statements**

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NMP2 are shared by LIPA at its 18% ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

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

**Nuclear Plant Decommissioning**

LIPA is making provisions for decommissioning costs for NMP2 based on a site-specific study performed in 1995. LIPA's share of the total decommissioning costs for both the contaminated and non-contaminated portions is estimated to be approximately \$145 million in 1996 dollars. LIPA maintains a trust fund for its share of the decommissioning costs of the contaminated portion of NMP2, which at December 31, 2002, and 2001, had an approximate value of \$37.5 million, and \$33.1 million, respectively. LIPA established a separate decommissioning fund for its share of the non-contaminated portion of NMP2, which had a value at December 31, 2002, and 2001 totaling approximately \$5.8 million and \$4.6 million, respectively. Through continued deposits and investment returns being maintained within these trusts, the Company believes that the value of these trusts will, in 2026, be sufficient to meet the Company's decommissioning obligations.

**NMP2 Radioactive Waste**

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

**Nuclear Plant Insurance**

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

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

Losses resulting from non-certified acts of terrorism are covered as a common occurrence, meaning that if non-certified terrorist acts occur against one or more commercial nuclear power plants insured by the insurer's of NMP2, within a 12-month period, such acts would be treated as one event and the owners of

## Notes to Consolidated Financial Statements

the currently licensed nuclear power plants in the United States would share one full limit of liability (currently \$3.24 billion).

The Price-Anderson Amendments Act mandates that nuclear power generators secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of \$300 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this "secondary financial protection" subjects each of the 103 presently licensed nuclear reactors in the United States to a retrospective assessment of up to \$88.1 million for each nuclear incident, payable at a rate not to exceed \$10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of \$15.9 million, per incident, through assessments of up to \$1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor.

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

Nuclear worker claims reported on or after January 1, 1998 are covered by a new insurance policy with an annual industry aggregate limit of \$200 million for radiation injury claims against all those insured by this policy.

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

Constellation has also procured \$500 million of primary nuclear property insurance and approximately \$2.25 billion of additional protection (including decontamination costs) in excess of the primary layer through the Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately \$2.7 million per loss.

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

## Notes to Consolidated Financial Statements

## Note 9. Investments and Cash and Cash Equivalents

Funds of the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. The Authority's investments may also be required to conform to additional restrictions contained in financing documents. The Authority's guidelines and any additional restrictions as required by financing documents comply with the New York State Comptroller's investment guidelines for public authorities.

All investments of the Authority are held by designated custodians in the name of the Authority. Investments are reported at amortized cost, which approximates fair market value at December 31, 2002 and 2001. Investments with maturities when purchased of less than 90 days are classified as cash and cash equivalents. Certain cash and cash equivalents and investments have been designated by the Authority's Board of Trustees to be used for specific purposes such as rate stabilization, capital additions, debt repayment, the funding of credits in accordance with the Shoreham Settlement Agreement, and Clean Energy initiatives.

The bank balances were \$1.7 million and \$1.6 million at December 31, 2002 and 2001, respectively. Cash deposits at banks were collateralized for amounts above the Federal Deposit Insurance Corporation ("FDIC") limits with securities held by the custodian banks in the Authority's name. The Authority is required to maintain compensating balances of approximately \$1 million.

Investments and cash and cash equivalents of the Authority at December 31, 2002 and 2001 are detailed below:

Investments and cash and cash equivalents (in thousands)	December 31,	
	2002	2001
Commercial Paper	\$ 397,435	\$ 294,288
U.S. Government/Agencies	135,050	88,435
Money market mutual funds	31,803	196,850
Repurchase Agreement	24,310	102,473
Master Notes	13,277	5,952
Corporate Bonds	6,788	-
Demand deposits	1,663	371
<b>Total investments and cash and cash equivalents</b>	<b>\$ 610,326</b>	<b>\$ 688,369</b>

## Note 10. Debt

## The Authority

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

## Notes to Consolidated Financial Statements

The Bonds are secured by a Trust Estate as pledged under the Authority's Bond Resolution (the "Resolution"). The Trust Estate consists principally of the revenues generated by the operation of LIPA's transmission and distribution system and has been pledged by LIPA to the Authority.

### Electric System General Revenue Bonds

#### Series 2001A

During the year ended December 31, 2001, the Authority issued Series 2001A Electric System General Revenue Bonds totaling \$300 million. These Bonds were issued for various capital purposes and to pay costs of issuance. This Series is comprised of Serial Bonds with maturities beginning September 1, 2013 and continuing through 2021 and Term Bonds with maturities beginning September 1, 2025 and continuing through 2029. These Bonds pay interest at a fixed rate every March 1 and September 1.

#### *Optional Redemption*

These Bonds are subject to redemption prior to maturity, at the option of the Authority, on any date on and after September 1, 2011 in whole, or in part from time to time, and in any order of maturity selected by the Authority, at a redemption price of par plus accrued interest on such principal amount to the redemption date.

#### *Sinking Fund*

The Bonds that mature on September 1, 2025 (approximately \$75.6 million) and September 1, 2027 (approximately \$112 million) are also subject to redemption, in part, through mandatory sinking fund installments each September 1, 2022 through 2027 at 100% of the principal amount, plus accrued interest to the redemption date.

#### Series 2001 B through K

The Authority also issued Series 2001 B through K Electric System General Revenue Bonds totaling \$500 million during the year ended December 31, 2001. The proceeds of this issuance were used to refund \$500 million Electric System Subordinated Revenue Bonds, Series 5 and 6. Series 2001 B through K are comprised of Auction Rate Term Bonds with a maturity date of May 1, 2033. Each Series bears interest at an auction rate that the Auction Agent advises results from an auction conducted for each applicable auction period. The auction date and auction period for each Series as of December 31, 2002 is as follows:

Series	Auction Date	Auction Period	Interest payment Date
2001 B	Each Business day	Daily	First Business day of the succeeding month
2001 C	Each Tuesday	Seven day	Each Wednesday
2001 D	Each Tuesday	Seven day	Each Wednesday
2001 E	Each Thursday	Seven day	Each Friday
2001 F	Each fifth Monday	35 day	Each fifth Tuesday
2001 G	Each Wednesday	Seven day	Each Thursday
2001 H	Each fifth Wednesday	35 day	Each fifth Thursday
2001 I	Each fifth Tuesday	35 day	Each fifth Wednesday
2001 J	Each Thursday	Seven day	Each Friday
2001 K	Each Wednesday	Seven day	Each Thursday

#### *Optional Redemption*

Each Series of the Auction Rate Bonds are subject to optional redemption prior to maturity, by the Authority, in whole or in part, on any interest payment date immediately following an auction period, at a

**Notes to Consolidated Financial Statements**

redemption price equal to the principal amount plus accrued interest to the redemption date; provided, however, that in the event of a partial redemption of Auction Rate Bonds of a Series, the aggregate principal amount of Auction Rate Bonds of such Series which will remain outstanding shall be equal to or more than \$10 million unless otherwise consented to by the broker-dealer which acts as the Auction Agent for such Series.

*Sinking Fund*

These Bonds are subject to redemption, in part, beginning on December 1, 2030 through May 1, 2033 from mandatory sinking fund installments.

Series 2001 L through P

Also during the year ended December 31, 2001, the Authority issued Electric System General Revenue Bonds, Series L through P totaling \$316 million maturing on May 1, 2033. The proceeds of this issuance were used to refund \$300 million of the Authority's Electric System Subordinated General Revenue Bonds consisting of Series 4 and a portion of Series 3, and to pay certain costs of issuance related to Series B through P.

Series M through P bear interest at an auction rate that the Auction Agent advises results from an auction conducted for each applicable auction period. The auction date and auction period for each Series as of December 31, 2002 is as follows:

Series	Auction Date	Auction Period	Interest payment Date
2001 M	Each Monday	Seven day	Each Tuesday
2001 N	Each Friday	Seven day	Each Monday
2001 O	Each fifth Monday	35 day	Each fifth Tuesday
2001 P	Each Thursday	Seven day	Each Friday

Series 2001 L are Fixed Rate Term Bonds that pay interest semiannually each May 1 and November 1.

*Optional Redemption*

Series L Bonds are subject to redemption prior to maturity, at the option of the Authority on any date on and after May 1, 2011 in whole or in part from time to time, and in any order of maturity selected by the Authority, at a redemption price of par plus accrued interest. Each Series of the M through P Auction Rate Bonds shall be subject to optional redemption by the Authority on any interest payment date immediately following an auction period, at a redemption price equal to the principal amount, plus accrued interest to the redemption date; provided, however, that in the event of a partial redemption of Auction Rate Bonds of a Series, the aggregate principal amount of Auction Rate Bonds of such Series which will remain outstanding shall be equal to or more than \$10 million unless otherwise consented to by the broker-dealer which acts as the Auction Agent for such Series.

*Sinking Fund*

These Bonds are subject to redemption, in part, beginning on May 1, 2030 through May 1, 2033 from mandatory sinking fund installments.

## Notes to Consolidated Financial Statements

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### Commercial Paper Notes

The Authority's Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 ("Notes") up to a maximum amount of \$300 million. The aggregate principal amount of the Notes outstanding at any time may not exceed \$300 million. As of December 31, 2002 and 2001, the Authority had Notes outstanding totaling \$100 million. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement, expiring on May 23, 2003. The Authority is currently in negotiations with a syndicate of banks to ensure that a replacement LOC is in place coincident with the expiration of the current LOC. The Authority believes that it will be successful in these negotiations and that a new LOC facility will be in place for a three year period beginning May 24, 2003. The Notes do not have maturity dates of longer than 270 days from their date of issuance and as Notes mature, the Authority continually replaces them with additional Notes. No Note can be issued with a maturity date after the expiration date of the Letter of Credit, and as the LOC expires in less than one year from the date of the statement of Financial Position, these Notes are classified as current.

### Series 2000A

These Bonds were issued to fund certain rebates and credits in accordance with the Shoreham Settlement Agreement, as more fully discussed in Note 14. These Bonds are comprised of tax-exempt Capital Appreciation Bonds with maturities beginning in June 2005 and continuing each year through 2029 and are not subject to optional redemption, mandatory sinking fund redemptions or any other redemption prior to maturity. Several of these Series will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.

### Series 1998A

This Series is comprised of Current Interest and Capital Appreciation Bonds. The Current Interest Bonds include: (i) tax exempt Serial Bonds with maturities that began in December 1999 and continue each year through December 2016; and (ii) tax exempt Term Bonds with maturities beginning in December 2018 and a final maturity in December 2029. The Capital Appreciation Bonds are tax exempt bonds with maturities beginning in December 2003 continuing each year through December 2028. The Current Interest Bonds pay interest at a fixed rate every June 1 and December 1. During the year ended December 31, 2002, the Authority retired at maturity, with cash from operations, its \$18.6 million 5.25% and its \$33.7 million 4.30% Serial Bonds. During the year ended December 31, 2001, the Authority retired at maturity, with cash from operations, its \$28.9 million 4.25% and its \$20.9 million 5.25% Serial Bonds.

### Optional Redemption

The 5.0% Serial Bonds due on December 1, 2014 (\$39.4 million) and the Serial and Term Bonds maturing on or after December 1, 2015 (except the Term Bonds maturing on December 1, 2029), which total \$207 million and \$1.4 billion, respectively, are subject to redemption prior to maturity, at the option of the Authority, at a price of 101% of the principal amounts on any date beginning on June 1, 2008 through May 31, 2009, or at 100.5% beginning on June 1, 2009, through May 31, 2010, or at 100% beginning June 1, 2010, through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

The Term Bonds maturing on December 1, 2029, (\$587.2 million) are subject to redemption prior to maturity, at the option of LIPA, on any date on and after June 1, 2003, in whole, or in part from time to time, at a redemption price of 101% of the principal amounts, together with the interest accrued on such principal amount to the redemption date.

**Notes to Consolidated Financial Statements**

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The Serial Bonds maturing through December 1, 2013, (\$833.1 million) and the 5.25% Serial Bonds due on December 1, 2014, (\$56.7 million) are not subject to redemption prior to maturity. In addition, the Capital Appreciation Bonds and the Taxable Term Bonds are not subject to redemption prior to maturity.

*Sinking Fund*

Certain Term Bonds are subject to redemption, in part, beginning on December 1, 2017 through December 1, 2029 at 100% of the principal amounts, plus accrued interest at the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

Certain of these Bonds will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.

*Series 1998B*

This Series is comprised of Serial Bonds with maturities that began in April 2000 and continue each year through April 2016 and Term Bonds maturing in April 2018. These Bonds pay a fixed rate of interest every April 1 and October 1.

During the year ended December 31, 2002 the Authority retired at maturity, with cash from operations, its \$25.0 million, 4.0%, and its \$62.8 million 5.0% Current Interest bonds. During 2001, the Authority retired at maturity, with cash from operations, its \$44.9 million, 4.25%, and its \$25.0 million 4.0% Current Interest bonds.

*Optional Redemption*

Securities maturing on and after April 1, 2009 (\$483.5 million) are subject to redemption prior to maturity, at the option of the Authority, at a redemption price of 101% of the principal amount on any date beginning on April 1, 2008, through May 31, 2009, or at 100.5% beginning on April 1, 2009 through May 31, 2010, or at 100% beginning April 1, 2010, through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

*Sinking Fund*

The Term Bond that matures on April 1, 2018 is subject to redemption, in part, beginning on April 1, 2017 at 100% of the principal amount, plus accrued interest to the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

Certain of these Bonds will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.



## Notes to Consolidated Financial Statements

Electric System Subordinated Revenue BondsSeries 1 through 3

During the year ended December 31, 2001, the Authority remarketed or refinanced Series 1 through 6 as detailed below:

	Outstanding at December 31, 2000	Remarketed	Refinancing Transactions	(in thousands) Outstanding at December 31, 2001
Series 1	\$ 250,000	\$ (250,000)		\$ -
Series 2	250,000	(250,000)		-
Series 3	250,000	(200,000)	\$ (50,000)	-
Series 4	250,000		(250,000)	-
Series 5	250,000		\$ (250,000)	-
Series 6	250,000		(250,000)	-
<i>Issued: Electric System General Revenue Bonds</i>				
Series 1A		125,000		125,000
Series 1B		125,000		125,000
Series 2A		125,000		125,000
Series 2B		100,000		100,000
Series 2C		25,000		25,000
Series 3A		100,000		100,000
Series 3B		100,000		100,000
<i>Issued: Electric System General Revenue Bonds</i>				
Series 2001 L - P			316,000	316,000
Series 2001 B - K			500,000	500,000
	\$ 1,500,000	\$ -	\$ 16,000	\$ 1,516,000

\*The Authority used \$16 million to pay costs of issuance.

As a result of these transactions, the remaining outstanding Series consists of Series 1A through 3B. These Bonds are variable rate bonds payable from and secured by the Trust Estate subject to and subordinated to the Authority's Electric System General Revenue Bonds and are supported by letters of credit that expire on May 23, 2003. These Bonds are classified into various modes that determine the frequency that the interest rate is re-determined, the interest rate applied and the optional redemption features. Subseries 1A, 2A and 3A are currently Weekly Mode bonds, therefore, the applicable interest rate is re-determined on a weekly basis. Subseries 1B, 2B, 2C and 3B are currently Daily Mode, and as such, the interest rates are re-determined daily.

Provisions of the indenture allow for a change in interest rate modes, at the option of the Authority. In addition to the daily and weekly modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually), a Fixed mode, or a Commercial Paper Mode.

A debt refinancing charge of approximately \$6.2 million resulted from these refundings/refinancings. In accordance with the provisions of GASB No. 23, the refinancing charge associated with this transaction has been deferred and shown in the Statement of Financial Position as Deferred amortization within long term

## Notes to Consolidated Financial Statements

debt and is being amortized, on a straight line basis, over the life of the new debt or the old debt, whichever is shorter.

### Series 7

This Series is comprised of variable rate bonds in the Weekly Mode. Provisions of the indenture allow for a change of interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually) or a Fixed term mode.

Principal and interest on these Bonds are secured by a financial guaranty insurance policy and the Authority has executed a Standby Bond Purchase Agreement to provide funds for the purchase of Series 7 Bonds tendered but not remarketed. The standby agreement expires in November 2008.

### *Optional and Mandatory Redemption*

Series 7 Bonds are redeemable on their respective interest rate re-determination dates at the option of the Authority. These Bonds are redeemable at face value when they are in the Weekly, Daily or Commercial Paper mode. Term or Fixed rate mode bonds are redeemable at rates varying between 100% and 101% when the life of the mode is greater than four years. Term or Fixed Rate mode bonds are not redeemable if the life of the mode is less than four years.

Series 1A through 3B and Series 7 Bonds are also subject to mandatory redemptions from sinking funds such that they will be redeemed by their respective maturity dates. Sinking funds for Series 1A through 3B begin on December 1, 2030 and on Series 7 sinking funds begin April 1, 2019.

### Series 8 (Subseries A-H)

This Series is comprised of Current Interest Bonds issued as follows:

<b>This Series is Comprised of Subseries</b>	<b>Mandatory Purchase Date (April 1)</b>	<b>Maturity (April 1)</b>	<b>Principal Outstanding \$(000)</b>	<b>Interest Rate to Mandatory Purchase Date</b>
8A		2009	\$ 23,360	5.25%
8A		2009	2,500	4.13%
8B		2009	17,160	4.30%
8B		2009	10,000	5.25%
8C	2003	2010	27,300	4.00%
8D	2004	2010	27,300	4.50%
8E	2005	2011	27,300	4.50%
8F	2006	2011	27,300	5.00%
8G	2007	2012	27,300	5.00%
8H	2008	2012	27,200	5.00%

Immediately prior to the mandatory purchase date, the Authority will determine to either purchase the Subseries or have such Subseries remarketed. Remarketed securities would then become due at the maturity date or such earlier date as determined by the remarketing. Additionally, the original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing if the Authority chooses to

**Notes to Consolidated Financial Statements**

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remarket. Principal, interest and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy.

During the year ended December 31, 2002, and 2001, the Authority remarketed its Subseries 8B Bonds and Subseries 8A Bonds, respectively. Subseries 8A and 8B bonds are in the Fixed Rate Mode, and pay interest on April 1 and October 1 of each year through its maturity date.

The Authority intends to remarket its Subseries 8C Bonds on the mandatory purchase date of April 1, 2003 and accordingly, such Bonds are not classified as current maturities of long-term debt.

No Subseries of Series 8 is subject to optional redemption or mandatory sinking fund redemption prior to its mandatory purchase date.

**LIPA**

The LILCO debt assumed by LIPA as part of the Merger, consisted of \$1.186 billion of General and Refunding Bonds, ("G&R Bonds"), that were defeased by LIPA immediately upon the closing of the Merger, debentures totaling \$2.27 billion, and tax exempt debt totaling approximately \$915.7 million. As part of the Merger, KeySpan and LIPA executed Promissory Notes whereby KeySpan was obligated to LIPA for approximately \$1.048 billion of the assumed debt (the "Promissory Notes"). KeySpan is required to pay LIPA principal and interest on the Promissory Notes 30 days in advance of the date amounts are due to bondholders. The balance of the Promissory Notes between KeySpan and LIPA totaled \$602.4 million at December 31, 2002 and 2001.

The tax exempt debt assumed by LIPA were notes issued on behalf of LILCO by the New York State Research and Development Authority ("NYSERDA") to secure tax-exempt Industrial Development Revenue Bonds, Pollution Control Revenue Bonds ("PCRBs"), and Electric Facilities Revenue Bonds ("EFRBs") issued by NYSERDA.

***Bond Defeasance/Refundings***

A portion of the proceeds of the Authority's Electric System General Revenue Bonds and Subordinated Bonds (which include fixed and variable rate debt) were used in 1998 to refund all the G&R Bonds, certain Debentures and certain NYSERDA notes issued by LILCO that were assumed by LIPA as a result of the Merger. The purpose of these refundings was to achieve debt service savings.

***General and Refunding Bonds***

On May 29, 1998, LIPA refunded all the G&R Bonds totaling \$1.186 billion by depositing \$1.190 billion in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on these obligations were sufficient to pay the principal and interest on the G&R Bonds, which were defeased on June 29, 1998. At December 31, 2002, and 2001, approximately \$1.130 billion of the G&R Bonds, outstanding are considered defeased.

The Authority will realize gross debt service savings from this refunding of approximately \$588 million over the original life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$576 million.

***Debentures***

In March 2000, LIPA deposited approximately \$58 million that it generated from operations, in an irrevocable escrow deposit account to be invested in direct obligations of the United States of America.

## Notes to Consolidated Financial Statements

The Company has received certification from an independent verification agent that the maturing principal of and interest on these obligations will be sufficient to pay the principal and interest on the following debentures that LIPA assumed as part of the Merger, which includes the fair market value adjustment on the date of purchase (reflected at the Company's carrying value).

<i>(in thousands)</i>		
Maturity	Interest Rate	Carrying Value
7/15/2001	6.250%	\$ 8,460
3/15/2003	7.050%	5,890
3/01/2004	7.000%	2,999
6/01/2005	7.125%	14,307
11/01/2022	9.000%	26,532

As a result of this defeasance, LIPA realized a gain on the early extinguishment of debt totaling approximately \$1.7 million.

In February 2003, the Authority called for redemption in March, its \$270 million Long Island Lighting Company Debentures, 8.2% Series due 2023. Funding for this redemption, including interest to the date of redemption and call premium, totaling approximately \$281 million was provided by KeySpan in accordance with the terms of a promissory note with LIPA.

### *NYSERDA Notes*

During 1998, the Authority deposited \$379 million in an irrevocable escrow deposit account to be invested in direct obligations of the United States of America. The maturing principal of, and interest on, such securities will be sufficient to pay the principal, interest and applicable call premium on the following issues of NYSERDA Notes: approximately \$11.9 million Series 1985A, approximately \$50 million Series 1989A, approximately \$15 million Series 1989B, approximately \$26 million Series 1990A, approximately \$73 million Series 1991A, \$50 million Series 1992A, approximately \$36.5 million Series 1992B, \$50 million Series 1992C and approximately \$22 million Series 1992D, (collectively, the "Refunded NYSERDA Notes"). At December 31, 2001, the above-mentioned outstanding Refunded NYSERDA Notes are considered defeased.

As a result of this refunding and the deposit with the Escrow Agent, the Refunded NYSERDA Notes are deemed to have been paid, and they cease to be a liability of LIPA. Accordingly, the Refunded NYSERDA Notes (and the related deposit with the Escrow Agent) are excluded from the Statement of Financial Position. The Authority will realize gross debt service savings from this refunding of approximately \$287 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$66 million.

### *Deferred Amortization*

A debt refinancing charge of \$61.9 million resulted from the refundings that the Authority has undertaken between May 28, 1998 and December 31, 2000, primarily because of the difference between the amounts paid for refundings, including amounts deposited with the Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, approximately \$61.9 million was deferred and shown in the Statement of Financial Position as Deferred amortization within long term debt and is being amortized, on a straight line method, over the shorter of

**Notes to Consolidated Financial Statements**

the life of the new debt or the old debt. The unamortized balance at December 31, 2002 and 2001 totaled \$21.0 million and \$28.1 million, respectively.

In February 2003, the Authority announced its intention to redeem in March 2003, the following NYSERDA financing notes:

**NYSERDA notes**

*(in thousands)*

Series	Principal	Rate	Maturity Date	Call Premium
EFRBs Series 1989 B	\$ 35,030	7.15%	9/1/2019	\$ 701
EFRBs Series 1990 A	73,900	7.15%	6/1/2020	1,478
EFRBs Series 1991 A	26,560	7.15%	12/1/2020	531
EFRBs Series 1992 B	13,455	7.15%	2/1/2022	269
EFRBs Series 1992 D	28,060	6.90%	8/1/2022	561
<b>Total</b>	<b>\$ 177,005</b>			<b>\$ 3,540</b>

KeySpan also provided funding for this redemption in accordance with the terms of a promissory note with LIPA.

*Debt Maturity Schedule***Debt Service**

*(in thousands)*

Years ended December 31,	Principal	Interest	Total
2003	\$ 147,180	\$ 294,091	\$ 441,271
2004	163,120	298,751	461,871
2005	171,515	292,147	463,662
2006	208,915	284,693	493,608
2007	218,535	276,149	494,684
2008-2012	1,268,150	1,233,471	2,501,621
2013-2017	975,895	1,007,971	1,983,866
2018-2022	1,222,105	794,049	2,016,154
2023-2027	1,319,770	544,450	1,864,220
2028-2032	1,960,610	167,094	2,127,704
2033-2037	409,980	3,099	413,079
Total Principal and interest	8,065,775	5,195,966	13,261,741
Less: unaccreted interest on CABs	550,938		550,938
	<b>\$ 7,514,837</b>	<b>\$ 5,195,966</b>	<b>\$ 12,710,803</b>

Notes to Consolidated Financial Statements

*Fair Values of Long-Term Debt*

The fair values of the Company's long-term debt at December 31, 2002 and 2001 were as follows:

Fair Value (in thousands)	December 31,	
	2002	2001
Electric System General Revenue Bonds, Series 1998 A	\$ 3,281,925	\$ 3,165,086
Electric System General Revenue Bonds, Series 1998 B	1,155,662	1,192,204
Electric System General Revenue Bonds, Series 2000 A	428,211	375,538
Electric System General Revenue Bonds, Series 2001 A	297,011	281,347
Electric System General Revenue Bonds, Series 2001 B through K	500,000	500,000
Electric System General Revenue Bonds, Series 2001 L through P	312,544	311,360
Electric System Subordinated Revenue Bonds, Series 1-3 & 1-6	700,000	700,000
Electric System Subordinated Revenue Bonds, Series 7	250,000	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	236,593	225,502
Electric System Commercial Paper Notes, CP-1	100,000	100,000
Debentures	283,160	279,261
NYSERDA Notes	333,183	338,412
<b>Total</b>	<b>\$ 7,878,289</b>	<b>\$ 7,718,710</b>

**Changes in Long-term Debt**

(in thousands)	December 31,	
	2002	2001
Long-term debt, beginning balance	\$ 7,502,130	\$ 7,218,890
Fair market value adjustment	(25,955)	-
Changes in deferred amortization	9,866	(18,673)
Increases	56,096	1,969,299
Decreases	(127,300)	(1,527,300)
	7,414,837	7,642,216
Due within one year	147,180	140,085
Long-term debt, ending balance	\$ 7,267,657	\$ 7,502,131

**Changes in Short-term debt**

(in thousands)	December 31,	
	2002	2001
Short-term debt, beginning balance	\$ -	\$ -
Increases	100,000	-
Decreases	-	-
Short-term debt, ending balance	\$ 100,000	\$ -

**Notes to Consolidated Financial Statements****Note 11. Changes in Other long-term liabilities**

(in thousands)	December 31,	
	2002	2001
Deferred Credits, beginning balance	\$ 98,467	\$ 60,955
Increases	48,337	41,612
Decreases	(15,767)	(4,100)
Deferred Credits, ending balance	\$ 131,037	\$ 98,467
Claims and damages, beginning balance	\$ 23,468	\$ 23,072
Increases	23,012	10,696
Decreases	(22,273)	(10,300)
Deferred Credits, ending balance	\$ 24,207	\$ 23,468

**Note 12. Retirement Plans**

The Authority participates in the New York State Employees' Retirement System (the "System"), which is a cost-sharing, multi-employer, and public employee retirement system. The plan benefits are provided under the provisions of the New York State Retirement and Social Security Law that are guaranteed by the State Constitution and may be amended only by the State Legislation. For full time employees, membership in and annual contributions to the System are required by the New York State Retirement and Social Security Law. The System offers plans and benefits related to years of service and final average salary, and, effective July 17, 1998; all benefits generally vest after five years of accredited service.

Members of the System with less than "10 years of service or 10 years of membership" contribute 3 percent of their gross salaries and the Authority pays the balance of the annual contributions for these employees. Effective October 1, 2000, members of the System with at least 10 years of service or membership no longer contribute 3 percent of their gross salaries. The Authority pays the entire amount of the annual contributions of these employees.

Under this plan, the Authority's required contributions and payments made to the System were approximately \$131,000, \$114,000 and \$82,000 for the years ended December 31, 2002, 2001, and 2000, respectively. Contributions are made in accordance with funding requirements determined by the actuary of the System using the aggregate cost method.

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

**Notes to Consolidated Financial Statements**

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**Note 13. Commitments****Existing Purchased Power and Transmission Agreements**

As a result of the Merger, LIPA has assumed contracts with numerous Independent Power Producers (“IPPs”) and the New York Power Authority (“NYPA”) for electric generating capacity. Under the terms of the agreement with NYPA, which will expire in May 2014, LIPA may purchase up to 100% of the electric energy produced at the NYPA facility located within LIPA’s service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed non-energy payments associated with operating and maintaining the plant.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs if they fail to deliver energy. For purposes of the table below, LIPA has assumed full performance by the IPPs, as no event has occurred to suggest anything less than full performance by these parties.

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

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



## Notes to Consolidated Financial Statements

The following table represents LIPA's commitments under existing purchased power and transmission contracts:

**Purchased power and transmission contracts assumed from LILCO**

<i>(in thousands)</i>	NYPA Holtsville			Firm Transmission	IPPs*	Total Business*
	Debt Service	Other Fixed Charges	Energy*			
<b>For the years ended</b>						
2003	\$ 22,050	\$ 14,096	\$ 16,592	\$ 23,355	\$ 154,800	\$ 230,893
2004	22,146	14,015	15,231	23,355	136,000	210,747
2005	22,246	14,581	14,492	23,355	119,900	194,574
2006	22,351	14,899	12,936	23,355	121,700	195,241
2007	22,462	15,226	12,498	23,355	124,700	198,241
2008 through 2012	110,057	81,306	73,935	116,775	457,100	839,173
2013 through 2017	16,627	22,836	20,503	116,775	172,700	349,441
2018 through 2022	-	-	-	116,775	-	116,775
2023 through 2027	-	-	-	116,775	-	116,775
2028 through 2032	-	-	-	116,775	-	116,775
<b>Total</b>	<b>237,939</b>	<b>176,959</b>	<b>166,187</b>	<b>700,650</b>	<b>1,286,900</b>	<b>2,568,635</b>
Less: Imputed interest	66,079	52,890	43,975	379,172	349,700	891,816
	<b>\$ 171,860</b>	<b>\$ 124,069</b>	<b>\$ 122,212</b>	<b>\$ 321,478</b>	<b>\$ 937,200</b>	<b>\$ 1,676,819</b>

\* Assumes full performance by NYPA and the IPPs.

**Additional Power Supplies***Purchase Power Agreements*

In order to meet the anticipated needs and demands of the service area for the summer of 2002, the Authority, through its subsidiary LIPA, entered into agreements with four private companies to construct and operate ten generating units at six sites throughout the service area. LIPA has entered into power purchase agreements ("PPA") with each of the companies for 100% of the capacity, and energy if needed, for the term of each PPA. The PPAs vary in duration from three to 25 years.

In accordance with accounting principles generally accepted in the United States of America, the PPAs are considered leases, and as such, will be accounted for in accordance with the provisions of SFAS No. 13, "Accounting for Leases." Four of the leases, covering seven of the ten generating units, will be accounted for as capitalized lease obligations, whereas the remaining two leases, covering the other three generating units, will be accounted for as operating leases.

## Notes to Consolidated Financial Statements

The following table represents LIPA's minimum lease payments for the PPAs:

### 2002 Purchase Power Agreements

<i>(in thousands)</i>	Capital	Operating
Minimum lease/rental payments		
2003	\$ 61,252	\$ 28,320
2004	60,026	28,258
2005	58,671	19,086
2006	47,401	-
2007	56,208	-
2008 through 2012	264,733	-
2013 through 2017	242,115	-
2018 through 2022	124,260	-
2023 through 2027	61,838	-
Total	\$ 976,504	\$ 75,664
Less: Imputed interest	376,633	
<b>Net present value</b>	<b>\$ 599,871</b>	<b>\$ 75,664</b>

### Submarine Cable

LIPA, in 2002, entered into a capital lease for a submarine cable running between Connecticut and Long Island whereby LIPA will be entitled to up to 330 megawatts of firm transmission capacity. The owner of the cable has determined that several sections of the cable were not buried to depths required by its permits. The Authority is under no obligation to remit payment to the owner of the cable until such time as the cable becomes operable.

The owner of the cable is, however, seeking recovery of certain costs, which the Authority is disputing. This dispute is currently before the Federal Energy Regulatory Commission. The Authority is unable to determine the outcome of these proceedings, and any amounts that may be owed to the owner of the cable cannot be determined at this time.

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

## Notes to Consolidated Financial Statements

**Office lease**

In December 1996, the Authority entered into a non-cancelable office lease agreement for the period January 1, 1997 through January 31, 2003. In January 2001, the lease was amended to include additional premises. As a result of the amendments, the lease expiration date was changed to January 31, 2011. The future minimum payments under the lease are as follows:

*(in thousands)*

Year ended December 31,	2003	\$	1,199
	2004		1,243
	2005		1,290
	2006		1,338
	2007		1,388
	2008 - 2011		4,613
Total			11,071
Imputed Interest			627
Net Present Value		\$	10,444

Rental expense for the office lease amounted to approximately \$1.2 million and \$1 million for the period ended December 31, 2002 and 2001, respectively.

**Note 14. Legal Proceedings****Shoreham Tax Matters**

Through November 1992, Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District)(collectively, the "Suffolk Taxing Jurisdictions"), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments on the Shoreham plant, claiming the plant was overassessed.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding \$868 million, including interest as of the date of the judgment. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain of the Suffolk Taxing Jurisdictions sought leave from the Appellate Division to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

**Notes to Consolidated Financial Statements**

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On January 11, 2000, the Authority, LIPA, and the Suffolk Taxing Jurisdictions entered into a Shoreham Settlement Agreement. Pursuant to the Shoreham Settlement Agreement, an amended judgment was filed, reducing the amount of the judgment and the Authority's PILOT claims to the greater of (i) \$620 million, plus interest, less the principal of the Shoreham Tax Settlement Bonds paid with the surcharge or (ii) the amount required to fully satisfy the Authority's remaining debt service and related obligations in connection with the Shoreham Tax Settlement Bonds. The amended judgment is enforceable by the Authority or LIPA in the event, among others, that any portion of the Shoreham Settlement Agreement is declared invalid or unenforceable.

In April 2000, an Article 78 proceeding was filed by the Town of Islip, its Supervisor and the Supervisors of three other townships, against the Authority, LIPA, the Suffolk Taxing Jurisdictions and the County of Nassau. The lawsuit sought a judgment declaring illegal those provisions of the Shoreham Settlement Agreement providing for the repayment of certain tax certiorari judgments by imposition of a surcharge on electric rates. On August 18, 2000, the Authority submitted its papers in opposition to the petition. A hearing was held on October 5, 2000 in the Supreme Court, State of New York, Suffolk County. Supplemental memoranda of law were submitted on October 19, 2000. In a decision dated December 5, 2000, the Court held that to the extent the Shoreham Settlement Agreement imposes a surcharge on electric rates on Suffolk County ratepayers; the Settlement Agreement violates the Suffolk County Tax Act. The Suffolk County Tax Act provides that Suffolk County shall pay the full amount of a tax judgment against Suffolk County and the other affected municipalities and shall recover from such other affected municipalities their share of the judgment. By Opinion and Order dated October 7, 2002, the Appellate Division, Second Department, unanimously reversed the Judgment of Supreme Court and dismissed the petition. The Appellate Division determined that the Shoreham Settlement Agreement was lawful. Petitioners filed motions in the Court of Appeals seeking permission to appeal to the Court of Appeals. On January 16, 2003, the Court of Appeals denied the petitioners' motion. This case is now concluded.

**Environmental**

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

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

**Notes to Consolidated Financial Statements**

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

**Environmental Matters Retained by LIPA**

*Long Island Sound Transmission Cables.* The Connecticut Department of Environmental Protection ("DEP") and the New York State Department of Environmental Conservation ("DEC") separately have issued Administrative Consent Orders ("ACOs") in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound that LIPA owns jointly with the Connecticut Light and Power Company ("CL&P"). The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

In November 2002, a work boat, owned and operated by a third party, dragged its anchor, causing extensive damage to four of the seven cables of the 138-kilovolt facility and the release of a minimal amount of dielectric cable fluid into the Long Island Sound. Temporary clamps and leak abaters were promptly placed on the impacted cables and stopped the leaks. Permanent repairs are expected to be undertaken in the spring of 2003. The preliminary estimate of the cost to bring these cables back to full service is approximately \$18 million. LIPA intends to seek recovery from third parties for costs incurred by LIPA as a result of this incident. The timing and amount of recovery, if any, cannot yet be determined. LIPA and CL&P maintain property damage insurance coverage for the cable system that LIPA believes will cover most of the repair costs. In any event, response and repair costs not covered by insurance or reimbursed by third parties will be shared equally by LIPA and CL&P. Additionally, LIPA has received notice from the NYISO that due to the cable outage certain credits may not be taken, the amount of which has not yet been finally determined, but could be considerable. LIPA will seek recovery of any such losses from the parties responsible for this incident.

*Simazine.* Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA has conducted studies and monitoring activities in connection with this herbicide and is currently working cooperatively with the DEC and others in this matter. The liability, if any, resulting from the use of this herbicide cannot yet be determined. However, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

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

*Metal Bank.* In December 1997, the EPA issued its Record of Decision ("ROD"), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is \$17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 Potential Responsible Parties ("PRPs"), including LIPA, for the remedial design and for remedial action at the site. LIPA cannot predict with reasonable certainty the actual cost of the selected remedy, who will implement

**Notes to Consolidated Financial Statements**

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the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability equal to its estimated cost representing its estimated share of the additional cost to remediate this site. The liability phase of the case was tried in the fall of 2002, which resulted in a finding of liability against Metal Bank in January 2003. At a March, 2003 conference before the federal judge, the court ordered that the second stage trial (determination of the final remedy) be held on November 1, 2003.

*PCB Treatment Inc.* LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing Polychlorinated Biphenyls ("PCBs"). According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and investigated environmental conditions at these properties. The work required under this consent order has been completed, and the PRPs, including LIPA, recently signed a second consent order that obligates them to clean up and restore the two contaminated properties. LIPA has been determined to be responsible for less than 1% of the materials that were shipped to this site. Although LIPA is currently unable to determine its precise liability for costs to remediate these sites, LIPA does not believe that this liability will have a material adverse effect on its financial position, cash flows or results of operations.

*Mattiace Petrochemical Site.* This site in Glen Cove operated as a bulked and drummed solvent retailer from the 1960s until 1987, and as a drum reconditioning facility from 1974 through June 1983. In 1988, EPA began remediating the heavily contaminated soil found at the site. LIPA was identified as a PRP by the EPA for LILCO's distribution of empty drums that may have contained solvent residues for reconditioning at the site and for the purchase of solvents during the 1980s. EPA is seeking to settle this matter with approximately 80 targeted PRPs for approximately \$50,000 in discounted past remediation costs and \$15 million in anticipated present value future remediation costs. LIPA's share of these costs is estimated at 3.6% based upon present allocations. A Joint Defense Group consisting of approximately 20 identified PRPs has been formed, of which LIPA is a member. Pursuant to active negotiations with EPA, the Joint Defense Group and others, have entered into a judicial consent decree settlement, which is expected to be filed in federal court this spring. LIPA's portion of the settlement was approximately \$466,000.

Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA

*Asharoken.* In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company). Although the Village's negligence claims were dismissed, the causes of action sounding in nuisance remain at issue. Specifically, the Village seeks injunctive relief based upon allegations that the design and construction of the Northport Power Plant upset the littoral drift of sand in the area, thereby causing beach erosion. The case was tried before a judge without a jury. The trial was completed in December 2002. The parties are scheduled to file post-trial briefs on March 31, 2003. Liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

In a related matter, 132 residents of the Village commenced an action in March 2002 seeking monetary damages and injunctive relief arising out of the same facts and circumstances as the pending 1996 action.

**Notes to Consolidated Financial Statements**

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The 2002 action has been discontinued without prejudice to renew depending on the outcome of the trial of the 1996 action.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility Other Superfund Sites. DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The estimated response cost for remediating this site is \$19.1 million. LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site. In a recent (October 2002) tolling agreement with DEC, they contend to have a claim of over \$15 million in past response costs, in addition to interest, enforcement and future costs.

The EPA and DEC notified LILCO that LIPA may be responsible for the disposal of hazardous substances at the Port Washington Landfill, another municipal landfill property. DEC is pursuing remediation. LIPA is currently unable to determine its share of costs to investigate and remediate this site. In a recent (November 2002) tolling agreement with DEC, they contend to have a claim of over \$15 million in past response costs, in addition to interest, enforcement and future costs.

**Other Matters**

LIPA may from time to time become a party to various legal proceedings arising in the ordinary course of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material effect on the financial position, results of operations or cash flows of LIPA.

**Note 15. Subsequent Events***Additional Power Supplies*

Subsequent to year-end, the Authority entered into agreements for the development of approximately 200MW of new generation capacity to be developed on Long Island. These units are expected to be available for the summer of 2003 and, an additional 50 MW to be constructed and in service for the summer of 2004. The 2003 facilities are to be constructed and operated by three different developers. One of the facilities is to be located in Queens County, New York and two in Suffolk County, New York. The single facility to be constructed in 2004 will be located in Nassau County, New York.

*2003 Plan of Finance*

The Authority has approved a plan of finance that it expects to complete over the next several months that includes various borrowings. The plan of finance is expected to include the following components: (i) the Authority plans to remarket its \$27.3 million Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds scheduled to mature on April 1, 2010; (ii) the Authority plans to issue approximately \$625 million of uninsured, fixed rate, senior lien bonds (the "Series 2003A & B Bonds"). The Series 2003 A & B Bonds will be issued to refund certain series of the Electric System General Revenue Bonds Series 1998A, 1998B, and 2000A that are currently insured by Financial Security Assurance ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"); (iii) in connection with the expiration of certain letters of credit supporting the Authority's \$700 million Electric System Subordinated Bonds, Series 1 through 3, the Authority plans to remarket \$600 million of such Bonds as subordinate lien variable rate or auction rate bonds, and refund the remaining \$100 million with fixed rate senior lien bonds; the Authority plans to issue \$200 million of fixed rate senior lien bonds to fund certain capital expenditures; and (iv) the Authority plans to issue approximately \$600 million Refunding VR Bonds on or near June 1, 2003 to refund approximately \$587 million Electric System General Revenue Bonds Series 1998A (2029

**Notes to Consolidated Financial Statements**

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maturity, 5.50%). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003, as more fully described in Notes 5.



## GLOSSARY OF DEFINED TERMS

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

**"Account"** means one of the special accounts created and established pursuant to the Resolution.

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

**"Act"** means the Long Island Power Authority Act, being Title 1-A of Article 5 (§ 1020 *et seq.*) of the Public Authorities Law of the State, as amended.

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

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

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

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

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

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

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

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

**"Authorized Representative"** means in the case of both the Authority and LIPA, their respective Chairman, Chief Executive Officer, Executive Director, Chief Financial Officer, Controller or Chief Operating Officer, or such other person or persons so designated by resolution of the Authority or LIPA, as the case may be.

**“Beneficial Owner”** shall have the meaning assigned thereto in Appendix G to this Official Statement.

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

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

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

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

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

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

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

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

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

**“Change of Control”** means (i) the acquisition of beneficial ownership of 35% or more of the outstanding shares of securities the holders of which are generally entitled to vote for the election of directors of the Manager, the Energy Manager or the Guarantor, as the case may be (including securities convertible into, or exchangeable for, such securities or rights to acquire such securities or securities convertible into, or exchangeable for such securities, “Voting Stock”), on a fully diluted basis, by any Person or group of Persons (within the meaning of Section 13 or 14 of the 1934 Act); (ii) any sale, transfer or other disposition of beneficial ownership of 35% or more of the outstanding shares of the Voting Stock, on a fully diluted basis, of the Manager, the Energy Manager or the Guarantor, as the case may be; (iii) any merger, consolidation, combination or similar transaction of the Manager, the Energy Manager or the Guarantor, as the case may be, with or into any other Person; (iv) any sale, lease, assignment, transfer or other disposition of the beneficial ownership in 35% or more of the property, business or assets of the Manager, the Energy Manager or the Guarantor, as the case may be; (v) a Person other than the current shareholders of the Manager, the Energy Manager or the Guarantor, as the case may be, obtains, directly or indirectly, the power to direct or cause the direction of the management or policies

of the Manager, the Energy Manager or the Guarantor, as the case may be; (vi) during any period of 12 consecutive calendar months, when individuals who were directors of the Manager, the Energy Manager or the Guarantor, as the case may be, on the first day of such period cease to constitute a majority of the board of directors of the Manager, the Energy Manager or the Guarantor, as the case may be; or (vii) any liquidation, dissolution or winding up of the Energy Manager or the Guarantor, as the case may be.

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

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

**"Construction Fund"** means the fund by that name established pursuant to the Resolution.

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

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

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

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

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

**"Costs"** means costs of any System Improvements or any other purpose related to the System for which bonds, notes or other obligations of the Authority may be issued under the Act or under other

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

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

**“Debentures”** means the unsecured debentures of LILCO retained by LIPA. The Debentures constitute a portion of the Retained Debt.

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

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

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

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

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

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

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

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

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

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

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

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

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

**“EMA”** or **“Energy Management Agreement”** means the Energy Management Agreement, dated as of June 26, 1997, between the Energy Manager and LIPA, as amended and supplemented, pursuant to which the Energy Manager, among other things, procures and manages fuel supplies for the GENCO Generating Facilities.

**“Encumbrances”** means any lien, lease, mortgage, security interest, charge, judgment, judicial award or encumbrance with respect to the T&D System (other than those associated with any retainage holdback on construction materials, supplies and equipment).

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

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

**“FERC”** means the Federal Energy Regulatory Commission.

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

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

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

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

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

**“Fitch”** means Fitch, Inc., formerly known as Fitch Investors Services, L.P. and its successors and their assigns.

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

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

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

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

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

**“Fuel Services”** means those services required to be furnished and done for and relating to the delivery of Fuel to the GENCO Generating Facilities by the Energy Manager pursuant to the EMA subsequent to the LIPA/LILCO Merger Closing Date. A reference to “Fuel Services” shall mean “any part and all of the Fuel Services” unless the context otherwise requires.

**“GENCO”** means the KeySpan Sub that is the owner of the generating assets used to supply power and energy under the PSA and that is the party to the PSA responsible to LIPA for furnishing such power and energy.

**“GENCO Generating Facilities”** or **“Generating Facilities”** means the electric generating facilities owned by GENCO and under contract at any time with LIPA under the Power Supply Agreement.

**“Generation Purchase Option”** means the right of LIPA to acquire the GENCO Generating Facilities at fair market value during the period beginning on November 28, 2004 and ending on May 28, 2005 that is granted to LIPA by GENCO under the Generation Purchase Right Agreement.

**“Generation Purchase Right Agreement”** means the Generation Purchase Right Agreement, dated as of June 26, 1997, as amended and supplemented, by and between GENCO, as seller, and LIPA, as buyer (if the Generation Purchase Option is exercised), and their respective successors and assigns.

**“Governmental Body”** means any federal, State or local legislative, executive, judicial or other governmental board, agency, authority, commission, administration, court or other body, or any official thereof having jurisdiction with respect to any matter which is a subject of the Agreement other than LIPA.

**“Guarantor”** means KeySpan and its successors and assigns permitted under the Guaranty Agreement.

**“Guaranty Agreement”** or **“Guaranty”** means the Guaranty Agreement entered into at the time of completion of the LIPA/LILCO Merger pursuant to which KeySpan has guaranteed to the Authority payment when due of all amounts payable by the KeySpan Subs under the Operating Agreements and the performance of the covenants and agreements of the KeySpan Subs under the Operating Agreements.

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

**“Independent Consultant”** or **“Navigant Consulting”** means Navigant Consulting, Incorporated, an independent consultant to the Authority and author of the Independent Consultant’s Report.

**“Independent Consultant’s Report”** means the Independent Consultant’s Report contained in Appendix A to this Part 2.

**“Insurance Requirement”** means any rule, regulation, code, or requirement issued by any fire insurance rating bureau or any body having similar functions or by any insurance company which has issued a policy of construction work insurance or operation period insurance under the Agreement, as in effect during the term thereof.

**“Investment Securities”** means and includes any of the following securities, if and to the extent the same are at the time legal investments by the Authority of the funds to be invested therein and conform to the policies set forth in any investment guidelines adopted by the Authority and in effect at the time of the making of such investment: (i) direct obligations of, or obligations guaranteed as to principal and interest by, any state or direct obligations of any agency, public authority or political subdivision thereof, provided such obligations are rated, at the time of purchase, in one of the three highest Rating Categories by a Rating Agency; (ii) (a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are guaranteed by the United States of America, including obligations of any agency thereof or corporation which has been or may be created pursuant to an Act of Congress as an agency or instrumentality of the United States of America to the extent unconditionally guaranteed by the United States of America or (b) any other receipt, certificate or other evidence of an ownership interest in obligations or in specified portions thereof (which may consist of specified portions of the interest thereon) of the character described in subclause (a) of this clause (ii); (iii) obligations of any agency, subdivision, department, division or instrumentality of the United States of America, or obligations fully guaranteed as to interest and principal by any agency, subdivision, department, division or instrumentality of the United States of America; (iv) banker’s acceptances or certificates of deposit issued by a commercial bank with its principal place of business within the State and having capital and surplus of more than \$100 million; (v) corporate securities, including commercial paper and fixed income obligations, which are, at the time of purchase, rated by a Rating Agency in one of its three highest Rating Categories for comparable types of obligations; (vi) repurchase agreements or other investment agreements collateralized by securities described in clause (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated “investment grade” by each Rating Agency, provided that (a) a specific written repurchase agreement governs the transaction, (b) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is either a direct member of the Federal Reserve Bank or a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus and undivided profits of not less than \$25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (c) the repurchase agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five business days of such valuation, and (d) the fair market value of the collateral securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 102%; (vii) investment agreements or guaranteed investment contracts with any financial institution whose senior long term debt obligations, or whose obligations under such an investment agreement or guaranteed investment contract, are guaranteed by a financial institution whose senior long term debt obligations, have a rating (at the time such agreement or contract is entered into) in one of the three highest Rating Categories for comparable types of obligations by a Rating Agency; (viii) money market funds rated in one of the three highest Rating Categories for comparable types of obligations by a Rating Agency; (ix) municipal obligations, the payment of principal and redemption price, if any, and interest on which is irrevocably secured by obligations of the type referred to in clauses (i), (ii) or (iii) above and which obligations have been deposited in an escrow arrangement which is irrevocably pledged to the payment of such municipal obligations and which municipal obligations are rated in the highest Rating Category by a Rating Agency,



or any other municipal obligation rated in the highest Rating Category by a Rating Agency; (x) obligations of any person or entity which shall be rated at the time of the investment in one of the three highest Rating Categories by a Rating Agency; and (xi) any other investment in which the Authority is permitted to invest under applicable law, notwithstanding any limitations set forth in clauses (i) through (x) above. Obligations of any Fiduciary or an affiliate thereof may be Investment Securities, provided that they otherwise qualify.

**"IRS"** means the United States Internal Revenue Service.

**"KeySpan"** means KeySpan Corporation, doing business as KeySpan Energy, and its successors and assigns.

**"KeySpan Sub"** means any particular subsidiary company of KeySpan that is a party to an Operating Agreement or another agreement with LIPA or the Authority.

**"Lien"** means any and every lien against the T&D System, the T&D System Site, the Construction Work, the Operation and Maintenance Services or against any monies due or to become due from the Subsidiary to the Manager under the Agreement, for or on account of the Construction Work or the Operation and Maintenance Services.

**"LILCO"** means the Long Island Lighting Company, the publicly-owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger.

**"LIPA"** means the Long Island Lighting Company as it exists after the LIPA/LILCO Merger as a wholly-owned electric utility subsidiary company of the Authority, and which is conducting its business under the name "LIPA," and any successor thereto.

**"LIPA Assets"** means the assets of LILCO retained by LIPA on the LIPA/LILCO Merger Closing Date.

**"LIPA Budget"** means the annual budget of LIPA, as amended or supplemented, adopted or in effect for a particular Fiscal Year as provided in the Financing Agreement.

**"LIPA Expenses"** means all Operating Expenses incurred by LIPA.

**"LIPA General Fund"** means the special fund by that name established by LIPA and held by a bank, trust company or banking association designated by LIPA to act as a depository for the general funds of LIPA.

**"LIPA Note"** means the promissory note or notes of LIPA delivered to the Authority in accordance with the Financing Agreement evidencing the obligation of LIPA to pay to the Authority all amounts necessary to pay Authority Obligations.

**"LIPA Unsecured Debt Fund"** means the fund established in accordance with the Resolution for payment of the principal of and interest on Outstanding LIPA Unsecured Debt, subject to the provisions of the Resolution.

**"LIPA/LILCO Merger"** means (i) the merger which took place on May 28, 1998 and which resulted in LILCO (doing business as LIPA) becoming the wholly-owned electric utility subsidiary of the Authority and (ii) all transactions which were contemporaneously completed as part of or as a condition to said LIPA/LILCO Merger.

**"LIPA/LILCO Merger Agreement"** means the Agreement and Plan of LIPA/LILCO Merger, dated as of June 26, 1997.

**“LIPA/LILCO Merger Closing Date”** means May 28, 1998.

**“LIPA/LILCO Merger Closing”** means the consummation of the LIPA/LILCO Merger.

**“Loss-and-Expense”** means any and all losses, liabilities, obligations, damages, delays, fines, penalties, judgments, deposits, costs, claims, demands, charges, assessments, taxes, or expenses, including all Fees-And-Costs.

**“Major Capital Improvement”** means any repair, replacement, improvement, alteration or addition to the T&D System or any part thereof (other than any repair, replacement, improvement, alteration or addition constituting routine maintenance of the T&D System) contained in the Major Capital Plan and Budget and that has a useful life at least equal to three years.

**“Major Capital Improvement Cost”** means the cost of any Major Capital Improvement which the Manager reasonably incurs and substantiates under the Agreement including, without limitation, expenditures for material, equipment, incremental labor, and services supplied by architects, engineers and Subcontractors, and expenses related to managing and administering the Major Capital Improvement. “Major Capital Improvement Cost” shall not include amounts for an allowance for overhead, profit, or contingency.

**“Major Capital Plan and Budget”** means such plan and budget as defined in the MSA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Major Capital Improvements—Major Capital Plan and Budget”).

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

**“Manager”** means the KeySpan Sub that is party to the MSA and that, under the MSA, operates and maintains the T&D System for LIPA.

**“Manager Fault”** means any breach, failure of compliance, or nonperformance by the Manager with its obligations under the MSA or any negligence or willful misconduct by the Manager under the MSA.

**“Manager Indemnified Parties”** means the Manager and its Affiliates and their respective officers, directors, Subcontractors and employees.

**“Monthly Fuel Payment”** means such payment as defined in the EMA (and as summarized in this Appendix E, under the caption “Summary Certain Provisions of the Energy Management Agreement—Fuel Management—Monthly Fuel Payment”).

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

**“Moody’s”** means Moody’s Investors Service and its successors and their assigns.

**“MSA”** or **“Management Services Agreement”** means the Management Services Agreement, dated as of June 26, 1997, between the Manager and LIPA, as amended and supplemented, pursuant to which the Manager operates and maintains the T&D System.

**"New York Facilities Agreement"** means the New York Facilities Agreement, dated as of January 1, 1994, by and among Consolidated Edison Company of New York, The Brooklyn Union Gas Company and LILCO relating to certain natural gas transmission facilities.

**"New York Power Pool"** means the member system formerly comprised of Consolidated Edison Company of New York, Inc., Central Hudson Gas and Electric Company, Long Island Lighting Company, Orange and Rockland Utilities, Rochester Gas and Electric Company, New York State Electric and Gas Corporation, Niagara Mohawk Power Corporation, and the Power Authority of the State of New York, as such organization or membership may change from time to time. Such system has been restructured into the NYISO.

**"Nine Mile Point"** means the two-unit nuclear power station located on Lake Ontario near the Town of Scriba, New York.

**"NMP2"** means Unit 2 of Nine Mile Point.

**"NYISO"** means the New York not-for-profit corporation formed by NYPA and the Participants which is intended to provide non-discriminatory open-access usage of the electric transmission lines in the State of the Participants and which will schedule the use of said transmission lines.

**"NYPA"** means the Power Authority of the State of New York.

**"NYSERDA"** means New York State Energy Research and Development Authority, a public benefit corporation of the State, which issued bonds to finance for LILCO certain pollution control facilities and facilities for the local furnishing of electricity and to which LILCO issued its NYSERDA Financing Notes to evidence its obligation to repay such bonds.

**"NYSERDA Financing Notes"** means the notes of LILCO supporting the bonds issued on behalf of LILCO by NYSERDA retained by LIPA. Such NYSERDA Financing Notes constitute a portion of the Retained Debt.

**"OASIS"** means an electronic "Open Access Same-time Information System," which is a system to share transmission-related information (including information about available capacity) on a real-time basis.

**"OATT"** means an "Open Access Transmission Tariff" under which one party may use another party's transmission facilities upon payment of the charges and tariffs provided for by the OATT.

**"Off-System Sales"** means the sale of electric capacity and/or energy to wholesale or retail customers located outside the Service Area.

**"Operating Agreements"** means, collectively, the EMA, the MSA and the PSA.

**"Operating Assets"** means the T&D System and all of the assets of the Manager used in the operation and maintenance of the T&D System and the performance of the Manager's obligations under the MSA.

**"Operating Expense Fund"** means the fund by that name established pursuant to the Resolution.

**"Operating Expenses"** means any and all current expenses of maintaining, repairing, operating and managing the System, including but not limited to the costs of supplies, fuel, fuel assemblies and components required for the operation of the System (including but not limited to any payments made under Supply Contracts other than the Debt Service Component thereof); payments relating to fuel or electricity hedging instruments; all payments under any System Agreements; all salaries, administrative, general, commercial, architectural, engineering, advertising, public notices, auditing, billing, collection

and enforcement and legal expenses; insurance and surety bond premiums; consultants' fees and charges; payments to pension, retirement, health and hospitalization funds; any taxes which may lawfully be imposed on the System or the income or operation thereof or of LIPA; costs of public hearings; ordinary and current rentals of equipment or other property; lease payments for real property or interests therein; expenses of maintenance and repair (including replacements); expenses, liabilities and compensation of the Trustee or any other Fiduciary or Depositary; to the extent provided by by-law, agreement or other instrument of the Authority or LIPA, indemnification of Fiduciaries, Trustees, officers and employees of the Authority, directors, officers and employees of LIPA, and others and premiums for insurance related thereto; reasonable reserves for operation, maintenance and repair and for self-insurance; and all other expenses necessary, incidental or convenient for the efficient operation of the System; all costs and expenses associated with or arising out of the research, development (including feasibility and other studies, including but not limited to resource planning and studies and reports relating to demand side management) and/or implementation of any project, facility, system, task or measure related to the System including but not limited to demand side management programs, deemed desirable or necessary by the Authority or LIPA; all other costs and expenses arising out of or in connection with the conduct of LIPA's business or necessary, incidental or convenient for the efficient operation of LIPA; and all expenses necessary, incidental or convenient for the efficient operation of the Authority and the performance of the obligations of the Authority under the Administrative Services Agreement. Notwithstanding the foregoing, Operating Expenses shall not include (i) any costs and expenses attributable to a Separately Financed Project, (ii) any costs or expenses for new construction or for reconstruction other than restoration of any part of the System to the condition of serviceability thereof when new, (iii) the Debt Service Component of any Supply Contract, (iv) to the extent so specified by the Authority, any incentive payments payable by LIPA under any System Agreement, (v) any payments payable by LIPA under any other agreement the terms of which specify that the same shall not constitute an Operating Expense under the Resolution, (vi) any allowance for depreciation, (vii) payment under any Capital Leases, or (viii) any PILOTs.

**"Operation and Maintenance Services"** means the services to be provided and materials to be supplied by the Manager pursuant to the MSA during the Operation Period, except Construction Work. Operation and Maintenance Services shall include, without limitation, the employment and furnishing of all labor, materials, equipment, supplies, tools, storage, transfer, transportation, insurance, delivery and other items and services necessary in order for the Manager to perform its routine operation and maintenance obligations under the MSA, as well as all related administrative, accounting, record-keeping, notification and similar services relating to such obligations.

**"Operation Period"** means the period commencing on the LIPA/LILCO Merger Closing Date and ending on the date the MSA expires in accordance with its terms, or if earlier, on the MSA's Termination Date.

**"Option Securities"** means bonds, notes or other evidences of indebtedness which by their terms may be tendered by and at the option of the Holder thereof for purchase or payment by or on behalf of the Authority prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Holder thereof.

**"Other Costs"** means such costs as defined in the MSA (and as summarized in this Appendix E, under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Annual T&D Budget and Five Year Planning Budget Process—Other Costs").

**"Outstanding"** when used with reference to Parity Reimbursement Obligations, shall have the meaning given to such term in the agreement creating such Parity Reimbursement Obligations, and, when used with reference to Bonds, means, as of any date, all Bonds theretofore or thereupon being

authenticated and delivered under the Resolution **except:** (a) any Bonds canceled by the Trustee at or prior to such date; (b) any Bonds the principal and Redemption Price, if any, of and interest on which have been paid in accordance with the terms thereof; (c) any Bonds in lieu of or in substitution for which other Bonds have been authenticated and delivered pursuant to the Resolution; and (d) any Bonds deemed to have been paid as provided in the Resolution.

**"Outstanding LIPA Unsecured Debt"** means (i) any indebtedness of LIPA outstanding as of the LIPA/LILCO Merger, as described therein, consisting of (a) "Bonds" as defined in the Indenture, dated as of November 1, 1986, between LILCO and State Street Bank and Trust Company, as successor trustee, or as defined in the Indenture, dated as of November 1, 1992, between LILCO and Chemical Bank, as trustee, in each case as amended and supplemented, and (b) the NYSERDA Financing Notes, and (ii) Financial Contracts related to Outstanding LIPA Unsecured Debt and (iii) any reimbursement obligation relating to any letter of credit or other credit support for any indebtedness referred to in (i)(a) or (b) above.

**"Parent"** means KeySpan, and its successors and assigns.

**"Parity Contract Obligation"** means the obligation of the Authority or LIPA to pay the Debt Service Component of Supply Contracts from Revenues and secured by a pledge of and lien on the Trust Estate on a parity with the Bonds.

**"Parity Contract Obligations Fund"** means the fund by that name established pursuant to the Resolution from which amounts shall be applied for the payment of Parity Contract Obligations in accordance with the Resolution.

**"Parity Obligations"** means, collectively, all Parity Contract Obligations and Parity Reimbursement Obligations.

**"Parity Reimbursement Obligation"** shall have the meaning assigned thereto under the heading "Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness" in Appendix D.

**"Paying Agent"** means any paying agent for any Bonds, and its successor or successors and any other person which may at any time be substituted in its place pursuant to the Resolution.

**"Performance Guarantees"** means the minimum reliability standard, the minimum worker safety standard and the minimum customer service standard, all as established pursuant to appendices to the MSA.

**"PILOTs"** means any payment in lieu of taxes due and owing by the Authority or LIPA in accordance with the Act or other applicable law.

**"PILOTs Fund"** means the fund by that name established by the Resolution, and used to make payments to the State or any municipality or other political subdivision of the State, which shall be entitled to receive PILOTs under the Act, subject to the provisions of the Resolution.

**"Power and Energy"** means the electrical energy and capacity available from the System Power Supply.

**"Prime Rate"** means the rate announced by Citibank, N.A. from time to time at its principal office as its prime lending rate for domestic commercial loans, the Prime Rate to change when and as such prime lending rate changes.

**"Principal Installment"** means, as of any date of calculation and with respect to any Outstanding Bonds, (i) the principal amount of such Bonds (including (x) any amount designated in, or

determined pursuant to, the applicable Supplemental Resolution, as the “principal amount” with respect to any Bonds which do not pay full current interest for all or any part of their term and (y) the principal amount of any Parity Reimbursement Obligation) due on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance of any Sinking Fund Installments due on a certain future date for such Bonds, or (iii) if such future dates coincide as to different Bonds, the sum of such principal amount of Bonds and of such unsatisfied balance of Sinking Fund Installments due on such future date.

**“Projected Operating Results”** means the projected operating results of the Authority and LIPA during the Study Period prepared by the Independent Consultant and contained in the Independent Consultant’s Report attached to Part 2 of this Official Statement as Appendix A.

**“Promissory Note Obligor”** means KeySpan and one or more of its subsidiaries that are obligated to make payments to LIPA under the Promissory Notes.

**“Promissory Notes”** means the promissory notes evidencing the obligation of the Promissory Note Obligor to pay to LIPA amounts equal to the principal and interest when due on certain Debentures and certain NYSEDA Financing Notes.

**“Property Tax Settlement”**, as used in the Resolution, means the Authority’s program of rebates and credits to System customers in respect of the amounts otherwise payable by the Suffolk Taxing Jurisdictions as refunds of taxes and payments in lieu of taxes relating to Shoreham.

**“Prudent Utility Practice”** at a particular time means any of the practices, methods, and acts (including but not limited to the practices, methods and acts engaged in or approved by a significant portion of the electrical utility industry prior thereto), which, in the exercise of reasonable judgment in light of the facts and the characteristics of the T&D System, the Service Area, System Power Supply (and, insofar as the delivery of Fuel Service may require, the gas distribution and transmission system serving gas service area formerly served by Long Island Lighting Company and prevailing regulations or regulatory policies applicable to such gas distribution and transmission system), known at the time the decision was made, would have been expected to accomplish the desired result at the lowest reasonable cost consistent with reliability, safety and expedition and good customer relations. Prudent Utility Practice is not intended to be limited to the optimum practice, method or act, to the exclusion of all others, but rather to be a spectrum of possible practices, methods or acts.

**“PSA” or “Power Supply Agreement”** means the Power Supply Agreement, dated as of June 26, 1997, between GENCO and LIPA, as amended and supplemented, pursuant to which LIPA purchases all the capacity from the GENCO Generating Facilities and, to the extent requested by LIPA, the associated energy.

**“PSC”** means the New York State Public Service Commission.

**“Public Works Improvement Costs”** means the cost of any Public Works Improvement which the Manager reasonably incurs and substantiates under the Agreement including, without limitation, expenditures for material, equipment, incremental labor and services supplied by architects, engineers and Subcontractors, and expenses related to managing and administering the Public Works Improvements. “Public Works Improvement Costs” shall not include amounts for an allowance for overhead, profit or contingency.

**“Public Works Improvements”** means Major Capital Improvements performed as a result of requirements or requests of a Governmental Body.

**“Qualified Counterparty”** means an entity (i) whose senior long term debt obligations, other senior unsecured long term obligations, financial program rating, counterparty rating or claims paying ability are rated (at the time the subject Financial Contract is entered into) in any of the three highest Rating Categories from a nationally recognized statistical rating organization, (ii) whose payment obligations under a Financial Contract are guaranteed by an entity whose senior long term debt obligations, other senior unsecured long term obligations, financial program rating, counterparty rating or claims paying ability, are rated (at the time the subject Financial Contract is entered into) in any of the three highest Rating Categories from a nationally recognized statistical rating organization, or (iii) whose obligation, if any, to make payment to the Authority upon the termination of the subject Financial Contract is fully collateralized by Investment Securities of the type described in clause (ii) of the definition of Investment Securities; provided, however, that such obligation shall be deemed to be fully collateralized if the Investment Securities shall have a market value, determined periodically in accordance with the Financial Contract, that is not less than 102% of any termination payment.

**“Rate Consultant”** means the independent accountant or firm of independent accountants, or a management consultant or firm of management consultants, or independent engineer or firm of independent engineers which, in any case, shall be of recognized standing in the field of electric transmission and distribution system consulting selected by the Authority. The Independent Consultant presently serves as the Rate Consultant.

**“Rate Covenant”** means the covenants by the Authority in the Resolution to establish and maintain System fees, rates, rents, charges and surcharges.

**“Rate Stabilization Fund”** means the fund by that name established by the Resolution, and used for any lawful purpose of the Authority or LIPA, including but not limited to making any deposits required by the Resolution to any Fund or Account, in accordance with the Resolution.

**“Rating Agency”** means each of Fitch, Moody’s, and S&P, and their respective successors and assigns, in each case and at any time only if the same is then maintaining a rating on any Bonds at the request of the Authority.

**“Rating Category”** means a general rating category of an applicable Rating Agency or nationally recognized statistical rating organization without regard to any refinement or gradation of such rating by a numerical modifier or otherwise.

**“Redemption Price”** means, when used with respect to a Bond or portion thereof, the principal amount thereof plus the applicable premium, if any, payable upon either optional or mandatory redemption thereof pursuant to the Resolution.

**“Refunding Bond”** means any Bond authenticated and delivered on original issuance pursuant to the Resolution for the purpose of refunding any Outstanding Bonds, or thereafter authenticated and delivered pursuant to the Resolution in lieu of or substitution for such Bond.

**“Reimbursement Obligation”** shall have the meaning provided under the heading “Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness” in Appendix D.

**“Reliability Council”** means the separate not-for-profit corporation which will establish safety and reliability standards for all entities, including the NYISO, engaging in electric power transactions on the NYISO’s transmission system.

**“Required Deposits”** means the amount, if any, payable into the Operating Expense Fund, the Debt Service Fund, the Parity Contract Obligations Fund, the Subordinated Indebtedness Fund, LIPA

Unsecured Debt Fund and the PILOTs Fund, but in each case only to the extent such payments are required to be made from Revenues.

**"Resolution"** means the Electric System General Revenue Bond Resolution, of the Authority, as the same may be amended or supplemented by a Supplemental Resolution or Resolutions.

**"Retained Assets"** has the same meaning as "LIPA Assets".

**"Retained Debt"** means the indebtedness of LILCO retained by LIPA after the completion of the LIPA/LILCO Merger which continues to be outstanding on the date hereof consisting of the outstanding Debentures and the outstanding NYSERDA Financing Notes.

**"Revenue Bonds"** means any bonds, notes or other obligations issued or secured under the Resolution, the Subordinated Resolution or any other bond resolutions to be adopted by the Authority.

**"Revenue Fund"** means the fund into which Revenues are deposited by the Authority or by LIPA, unless required by the Resolution to be deposited to any other Fund or Account, in accordance with the Resolution or the Financing Agreement.

**"Revenues"** means all revenues, rates, fees, charges, surcharges, rents, proceeds from the sale of LIPA Assets, proceeds of insurance, and other income and receipts, as derived in cash, directly or indirectly from any of LIPA's operations, by or for the account of the Authority or LIPA, including but not limited to (i) all payments received by the Authority or LIPA with respect to the Promissory Notes, (ii) any guaranty of performance under any System Agreement and (iii) all dividends received by the Authority as a result of ownership of any stock or other evidences of an equity interest in LIPA; provided, however, that Revenues shall not include (a) any Transition Charge, (b) any of the foregoing attributable directly or indirectly to the ownership or operation of any Separately Financed Project, or (c) any federal or State grant moneys the receipt of which is conditioned upon their expenditure for a particular purpose unless the Authority determines that such grant moneys shall constitute Revenues. Notwithstanding the foregoing, Revenues also shall not include any amounts, or amounts from any sources, as may be specified from time to time by a Supplemental Resolution; provided, however that at the time such Supplemental Resolution becomes effective the tests set forth in paragraph (e)(B) under the heading "Conditions Precedent to Delivery of Bonds" shall be satisfied without regard to either (i) such amounts or (ii) paragraph (e)(D) under the same heading.

**"RI/FS"** means a Remedial Investigation and Feasibility Study provided for under CERCLA.

**"RICO"** means the federal Racketeer Influenced and Corrupt Organization Act.

**"RICO Credits"** means the credits on the bills of the Authority's customers funded by certain payments made to the Authority by KeySpan as a result of the settlement by LILCO of a RICO action brought against it in connection with Shoreham.

**"S&P"** means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors and their assigns.

**"Separately Financed Project"** means any such project financed by revenues or other income derived solely from the ownership or operation of such project or from other funds withdrawn from the Revenue Fund in accordance with the Resolution.

**"Service Area" or "LIPA Service Area"** means the Counties of Suffolk and Nassau and that portion of the County of Queens known as the Rockaways constituting LILCO's electric franchise area as of the effective date of the Act. "Service Area" does not include the Nassau County Villages of ~~Freeport~~ and Rockville Centre, and the Suffolk County Village of Greenport.



**“Service Fee”** means such fee as defined in the MSA (and as summarized in this Appendix E, under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Service Fee”).

**“Shoreham”** means the Shoreham Nuclear Power Station located at Shoreham, Long Island.

**“Shoreham Credits”** means credits to the bills of System ratepayers arising from the settlement of the Shoreham Property Tax Litigation, in each of the five years of 1998-2003 in Nassau County and the Rockaways in the aggregate amount of \$50 million per year and in Suffolk County in the aggregate amount of \$30 million per year.

**“Shoreham Rebates”** shall have the meaning assigned thereto in Part 2 of this Official Statement under the caption “Shoreham Property Tax Settlement”.

**“Shoreham Rebates and Credits”** means, collectively, the Shoreham Rebates and the Shoreham Credits.

**“Shoreham Regulatory Asset”** means the asset recorded on the financial statements of LILCO at the time of completion of the LIPA/LILCO Merger, approximately equal to LILCO’s unrecovered costs of Shoreham, less an allowance for imprudent investment, plus the costs funded by LILCO for PILOTs, decommissioning costs and other expenses. At the time of completion of the LIPA/LILCO Merger, the Shoreham Regulatory Asset not yet recovered by LILCO in its rates was approximately \$4.7 million.

**“Sinking Fund Installment”** means, as of any particular date of calculation, the amount required, as of such date of calculation, to be paid by the Authority on a future date for the retirement of Outstanding Bonds which are stated to mature subsequent to such future date, but does not include any amount payable by the Authority by reason only of the maturity of a Bond.

**“State”** means the State of New York.

**“Subcontract”** means an agreement between the Manager or the Energy Manager and a Subcontractor, or between two Subcontractors, as applicable.

**“Subcontractor”** means every person (other than employees of the Manager or the Energy Manager) employed or engaged by the Manager or the Energy Manager or any person directly or indirectly in privity with the Manager or the Energy Manager (including every sub-subcontractor of whatever tier) for any portion of the services or the materials, supplies, or equipment to be provided by the Manager or the Energy Manager under the MSA or the EMA.

**“Subordinated Contract Obligation”** shall mean the Debt Service Component of a Supply Contract that does not constitute a Parity Contract Obligation.

**“Subordinated Credit Facility”** or **“Subordinated Reimbursement Obligation”** means a letter of credit, revolving credit agreement, standby purchase agreement, surety bond, insurance policy or similar obligation, arrangement or instrument issued by a bank, insurance company or other financial institution which (i) provides for payment of all or a portion of the principal of or interest on any Subordinated Indebtedness, (ii) provides funds for the purchase of any Bonds or Subordinated Indebtedness, or any portion of any thereof, or (iii) secures the payment by the Authority of its obligations under a Financial Contract relating to Bonds or Subordinated Indebtedness.

**“Subordinated Indebtedness”** means any bond, note or other evidence of indebtedness issued by LIPA in furtherance of its corporate purposes under the Act and secured by a pledge of the Trust Estate subordinate to the pledge thereof made by the Resolution in favor of the Bonds and Parity

Obligations and otherwise as provided by the Resolution. Subordinated Indebtedness shall include, but shall not be limited to, Option Securities, Reimbursement Obligations other than Parity Reimbursement Obligations, and Financial Contracts to the extent provided by the Resolution.

**“Subordinated Indebtedness Fund”** means the fund established in accordance with the Resolution for payment of the principal and redemption price of and interest on Subordinated Indebtedness, subject to the provisions of the Resolution.

**“Subordinated Resolution”** means the Authority’s Electric System General Subordinated Revenue Bond Resolution, as amended and supplemented.

**“Subsidiary Fault”** means any breach, failure of compliance, or nonperformance by the Subsidiary with its obligations under an Agreement or any negligence or willful misconduct by the Subsidiary under an Agreement (whether or not attributable to any officer, trustee, member, agent, employee, representative, contractor, subcontractor of any tier, or independent contractor of the Subsidiary other than the Manager or Energy Manager and its Subcontractors) that materially and adversely affects the Manager’s or Energy Manager’s performance or the Manager’s or Energy Manager’s rights or obligations under the Agreement.

**“Suffolk Taxing Jurisdictions”** means, collectively, Suffolk County, the Town of Brookhaven, the Shoreham-Wading River Central School District, the Wading River Fire District, and the Shoreham-Wading River Library District.

**“Supplemental Resolution”** means a resolution of the Authority authorizing the issuance of a Series of Bonds or otherwise amending or supplementing the Resolution, adopted in accordance with the Resolution.

**“Supply Contract”** means any contract of the Authority or LIPA with another entity for fuel, energy or power.

**“System”** means the Retained Assets and any System Improvements, but shall not include any Separately Financed Projects.

**“System Agreements”** means any agreements relating to the operation or maintenance of the System, the supply of power and energy to the System, and the provision of transmission and distribution services and capacity for the System, including, but not limited to, the MSA, EMA and PSA.

**“System Budget”** means the combined Authority Budget and LIPA Budget, as amended or supplemented, adopted or in effect for a particular Fiscal Year, as provided in the Resolution and in the Financing Agreement.

**“System Improvement”** means any project, facility, system, equipment, or material related to or necessary or desirable in connection with the generation, production, transportation, transmission, distribution, delivery, storage, conservation, purchase or use of energy or fuel, whether owned jointly or singly by LIPA, including any capacity or output in which LIPA has an interest, heretofore or hereafter authorized by the Act or by other applicable State statutory provisions, including but not limited to demand side management programs; provided, however, that the term “System Improvement” shall not include any Separately Financed Project.

**“System Manager”** shall mean, collectively, the Manager and the Energy Manager.

**“System Policies and Procedures”** means the policies and procedures adopted from time to time by the Subsidiary with respect to the T&D System and the System Power Supply in accordance with Applicable Law and Prudent Utility Practice.

**“System Power Supply”** means the electrical capacity and energy from all power supply sources owned by or under contract to LIPA, including, but not limited to, the Existing Power Supply Agreements, the Power Supply Agreement, LIPA’s rights and interests with respect to the NMP2 power plant, LIPA’s interest in any future generating facilities, spot market capacity and energy purchases made by the Energy Manager on behalf of LIPA, and any load control programs or energy efficiency measure adopted by LIPA.

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

**“System Power Supply Performance Incentive/Disincentive”** means such fee as defined in the EMA (and as summarized in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—System Power Supply Management—System Power Supply Management Compensation—System Power Supply Performance Incentive/Disincentive”).

**“System Power Supply Services”** means any or all of the services required to be furnished and done for and relating to the administration and management of System Power Supply pursuant to the Power Supply Agreement.

**“T&D System”** means the electric transmission and distribution system located in the Service Area which provides the means for transmitting and distributing electricity.

**“T&D System Site”** means the real property and interests therein upon which the components of the T&D System are and will be located.

**“Termination Date”**, as appropriate, means such date as defined in the EMA, the MSA or the PSA (and as summarized, with respect to the EMA, in Appendix E under the caption “Summary of Certain Provisions of the Energy Management Agreement—Term; Events of Default—Procedure for Termination by Cause,” and as summarized, with respect to the MSA, in Appendix E under the caption “Summary of Certain Provisions of the Management Services Agreement—Default, Termination for Cause and Dispute Resolution—Termination for Cause,” and as summarized, with respect to the PSA, in Appendix E under the caption “Summary of Certain Provisions of the Power Supply Agreement—Term and Termination—Procedure for Termination for Cause”).

**“Third Party Cost Budget”** has the meaning set forth in the MSA (see “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Annual T&D Budget Preparation” contained in Appendix E).

**“Third Party Costs”** has the meaning set forth in the MSA (see “Summary of Certain Provisions of the Management Services Agreement—Annual T&D Budget and Five Year Planning Budget Process—Annual T&D Budget Preparation” contained in Appendix E).

**“Total Cost”** means the sum of the actual Direct Costs and the actual Third Party Costs.

**“Transition Charge”** means any rates, fees, charges or surcharges relating to the System or the customers thereof established by irrevocable rate order or other action or instrument, and applicable to or by the Authority or LIPA, in conjunction with the issuance of debt or other securities under a separate resolution, indenture or similar instrument (other than the Resolution) to the extent such rates, fees, charges or surcharges are pledged or otherwise encumbered or conveyed as security for such debt or other securities.

**“Trust Estate”** means collectively: (i) all payments received by the Authority from LIPA under the Financing Agreement, and all rights to collect and receive the same; (ii) all Revenues and all right, title and interest of the Authority in and to the Revenues, including all rights of the Authority to collect and receive the same, including but not limited to (a) all payments received by the Authority with respect to the Promissory Notes and all right, title and interest of the Authority in and to the Promissory Notes, including all rights of the Authority to collect and receive amounts payable thereunder and (b) any dividends received by the Authority as a result of ownership of any common or preferred stock or other evidences or an equity interest of the Authority in LIPA, and all rights to receive the same; (iii) the proceeds of sale of Bonds until expended for the purposes authorized by the Resolution; (iv) all Funds, Accounts and subaccounts established by the Resolution, including securities credited thereto and investment earnings thereon; and (v) all funds, moneys and securities and any and all other rights and interests in property, whether tangible or intangible, from time to time hereafter by delivery or by writing of any kind conveyed, mortgaged, pledged, assigned or transferred as and for additional security under the Resolution for the Bonds by the Authority, or by anyone on its behalf, or with its written consent, to the Trustee, which is authorized by the Resolution to receive any and all such property at any and all times, and to hold and apply the same subject to the terms of the Resolution.

**“Trustee”** means, (i) when such term is used in the Resolution and the Financing Agreement, The Bank of New York as successor to United States Trust Company of New York, New York, New York, as Trustee, and its successor or successors and any other person which may at any time be substituted in its place pursuant to the Resolution and (ii) when such term is used in the Operating Agreements, the trustee acting under the Resolution, the Subordinated Resolution or any other bond resolutions to be adopted by the Authority for the benefit of the holders of the Revenue Bonds.

**“Uncontrollable Circumstance”** means any act, event or condition, whether affecting the T&D System, the System Power Supply, LIPA, the Manager, or any of LIPA’s subcontractors or the Manager’s Subcontractors to the extent that it materially and adversely affects the ability of either party to perform any obligation under the Agreement (except for payment obligations), if such act, event or condition is beyond the reasonable control and is not also the result of the misconduct or negligent action or omission or failure to exercise reasonable diligence on the part of the party relying thereon as justification for not performing an obligation or complying with any condition required of such party under the Agreement; provided, however, that the contesting in good faith or the failure in good faith to contest such action or inaction shall not be construed as willful or negligent action or a lack of reasonable diligence of either party. None of the following acts or conditions shall constitute Uncontrollable Circumstances:

- (a) general economic conditions, interest or inflation rates, or currency fluctuations or exchange rates;
- (b) the financial condition of LIPA, the Manager, the Guarantor, any of their Affiliates or any Subcontractor;
- (c) the consequences of error, neglect or omissions by the Manager, the Guarantor, any Subcontractor, any of their Affiliates or any other person in the performance of any work under the Agreement;
- (d) any increase for any reason in premiums charged by the Manager’s insurers or the insurance markets generally for the construction work insurance or operating period insurance, each as required by the Agreement;
- (e) the failure of the Manager to secure patents or licenses in connection with the technology necessary to perform its obligations under the Agreement;
- (f) equipment malfunction or failure;

(g) union work rules, requirements or demands which have the effect of increasing the number of employees employed at the T&D System, reducing the operating flexibility of the Manager or otherwise increase the cost to the Manager of operating and maintaining the T&D System;

(h) any impact of prevailing wage laws on the Manager's operation and maintenance costs with respect to wages and benefits;

(i) the failure of any Subcontractor or supplier to furnish labor, materials, services or equipment for any reason;

(j) strikes, work stoppages or other labor disputes or disturbances; or

(k) any act, event or circumstance occurring outside of the United States.

**"Underwriters"** means the underwriters listed on the cover page of this Official Statement.

**"Variable Payment"** has the meaning set forth in the MSA (see "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Service Fee—Variable Payment" contained in Appendix E).

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## SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

The following is a brief summary of certain provisions of the Resolution. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Resolution, a copy of which is on file with the Trustee.

### Resolution to Constitute Contract

In consideration of the purchase and acceptance of the Bonds by those who hold the same from time to time, the provisions of the Resolution constitute a contract between the Authority, the Trustee and the Holders from time to time of the Bonds; and the pledge made in the Resolution and the provisions, covenants and agreements therein set forth to be performed by or on behalf of the Authority are for the equal benefit, protection and security of the Holders of any and all the Bonds, each of which, regardless of the time or times of its issue or maturity, are of equal rank without preference, priority or distinction over any other thereof except as expressly provided in the Resolution.

### Obligation of Bonds

The Bonds are special obligations of the Authority payable solely from the Trust Estate, and no other revenues or assets of the Authority shall be, or shall be deemed to be, pledged to the payment of the Bonds; provided, however, that nothing contained in the Resolution shall prevent the pledge of any Credit Facility relating to any particular Bonds, or the proceeds of such Credit Facility, to the payment of Bonds. The bonds, notes and other obligations of the Authority (including but not limited to the Bonds) shall not be a debt of the State or of any municipality, and neither the State nor any municipality shall be liable thereon. Neither the credit, the revenues nor the taxing power of the State or of any municipality shall be, or shall be deemed to be, pledged to the payment of any bonds, notes or other obligations of the Authority (including but not limited to the Bonds).

### Conditions Precedent to Delivery of Bonds

Bonds may be issued pursuant to a Supplemental Resolution in such principal amount or amounts for each such Series as may be specified in such Supplemental Resolution. Such Bonds shall be delivered by the Authority under the Resolution upon the delivery of, among other things, a Supplemental Resolution authorizing such Bonds, an opinion of Bond Counsel with respect to the validity of the Bonds and a certificate of an Authorized Representative of the Authority to the effect that, upon delivery of the Bonds, the Authority will not be in default in the performance of the terms and provisions of the Resolution or of any of the Bonds, and a certificate of an Authorized Representative of LIPA to the effect that LIPA is not in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Financing Agreement.

Except in the case of Refunding Bonds issued pursuant to the Resolution, the Trustee shall also receive the Certificate referred to in either paragraph (a) or (b) below, unless not required pursuant to subparagraph (d), as follows:

- (a) A Certificate of an Authorized Representative of the Authority setting forth (i) the Revenues for any 12 consecutive calendar months out of the 18 calendar months immediately preceding the month in which such Bonds are to be issued, (ii) the Debt Service, and the amount payable under all Parity Contract Obligations, during such 12 month period for which Revenues are set forth pursuant to clause (i), excluding in each case any amount thereof paid from sources other than Revenues, and (iii) the sum of the Required Deposits for such 12 month period (excluding Required Deposits for the payment of Outstanding Bonds and Parity Obligations), and showing that the amount set forth in clause (i) is at least equal to the sum of (x) 120% of the amount set forth in clause (ii) and (y) 100% of the amount set forth in (iii).

(b) A Certificate of a Rate Consultant setting forth (i) the estimated Revenues for each of the full Fiscal Years in the period beginning with the Fiscal Year in which such Bonds are authenticated and delivered and ending with the fifth full Fiscal Year after such date of authentication and delivery, (ii) the estimated Debt Service, and estimated amounts payable under all Parity Contract Obligations, during each Fiscal Year for which Revenues are estimated, (iii) the projected Debt Service, and projected amounts payable under Parity Contract Obligations, projected to be issued for any purpose during each Fiscal Year for which Revenues are estimated, and (iv) the sum of the estimated and projected Required Deposits for each such Fiscal Year (excluding Required Deposits for the payment of Outstanding Bonds and Parity Obligations), and showing that for each such Fiscal Year the amount set forth in clause (i) is at least equal to the sum of (x) 120% of the sum of the amounts set forth in clauses (ii) and (iii), and (y) 100% of the amount set forth in clause (iv). The Rate Consultant may base its estimates and projections upon such factors as it shall consider reasonable, a statement to which effect shall be included in such Certificate.

(c) For purposes of this section, (i) Revenues shall include any amounts withdrawn in any Fiscal Year from the Rate Stabilization Fund which were either (1) on deposit therein prior to such Fiscal Year or (2) proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits, (ii) Revenues shall not include any proceeds from the sale of LIPA assets or proceeds of insurance, and (iii) any Debt Service, Parity Contract Obligations and Required Deposits shall not include any amounts thereof expected by the Authority to be paid from any funds, other than Revenues, reasonably expected by the Authority to be available therefor (including without limitation the anticipated receipt of proceeds of sale of Bonds or Subordinated Indebtedness, or moneys not a part of the Trust Estate, expected by the Authority to be used to pay the principal of Bonds, Parity Obligations, Outstanding LIPA Unsecured Debt or Subordinated Indebtedness), which expectations, if included in a resolution of the Authority or Certificate of an Authorized Representative of the Authority filed with the Trustee, shall be conclusive.

(d) The provisions of this section shall not apply (i) to any Bonds constituting Acquisition Debt, (ii) to any Bonds, issued for any of the purposes described in the next succeeding sentence, and (iii) at any time after the Authority first shall have retired, other than from proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the Promissory Notes. The purposes referenced in clause (ii) of the preceding sentence include the refinancing of the Debentures and the NYSERDA Financing Notes, certain capital expenditures and other initial costs, and costs of issuance relating to the additional debt issued for such purposes.

Any Supplemental Resolution may provide that (i) so long as a Credit Facility providing security (but not liquidity) is in full force and effect, and payment on the Credit Facility is not in default and the issuer of the Credit Facility is qualified to do business, the issuer of the Credit Facility shall be deemed to be the sole Owner of the Outstanding Bonds the payment of which such Credit Facility secures when the approval, consent or action of the Owners of such Bonds is required or may be exercised under the Resolution, or, in the alternative, that the approval, consent or action of the issuer of the Credit Facility shall be required in addition to the approval, consent or action of the applicable percentage of the Owners of Outstanding Bonds and including, without limitation, the Resolution and following an Event of Default, and (ii) in the event that the principal, Sinking Fund Installments, if any, and Redemption Price, if applicable, and interest due on any Outstanding Bonds shall be paid under the provisions of a Credit Facility, all covenants, agreements and other obligations of the Authority to the Owners of such Bonds shall continue to exist and such issuer of the Credit Facility shall be subrogated to the rights of such Owners in accordance with the terms of such Credit Facility.



Any Supplemental Resolution authorizing Bonds may delegate to any officers or employees of the Authority the determination of any details of such Bonds, within limitations which shall be set forth in such Supplemental Resolution. Any such determination shall be in writing, and each such written determination shall be deemed to be part of the Supplemental Resolution providing for the same.

### **Conditions Precedent to Delivery of Refunding Bonds**

All Refunding Bonds shall be executed by the Authority for issuance and delivered to the Trustee, and thereupon shall be authenticated by the Trustee and delivered to the Authority or upon its order, but only upon the receipt by the Trustee of: (i) the documents required under the heading entitled "Conditions Precedent to Delivery of Bonds" and (ii) such documents, instructions, moneys and securities as are required by the provisions of the Resolution or any Supplemental Resolution adopted pursuant to the Resolution to cause the Bonds or portions thereof to be refunded to be paid or deemed to have been paid within the meaning and with the effect expressed in the Resolution.

### **Special Provisions Relating to Option Securities, Financial Contracts, Subordinated Credit Facilities, Parity Obligations and Subordinated Indebtedness**

The Resolution provides that all Option Securities will be issued as Subordinated Indebtedness.

Payments to Qualified Counterparties under Financial Contracts shall constitute Subordinated Indebtedness, except that such payments under Financial Contracts relating to Outstanding LIPA Unsecured Debt shall constitute Outstanding LIPA Unsecured Debt.

In connection with any Bonds, the Authority may obtain or cause to be obtained one or more Credit Facilities and agree with the issuer of a Credit Facility to reimburse such issuer directly for amounts paid under the terms of such Credit Facility, together with interest thereon; provided, however, that no obligation to reimburse an issuer of a Credit Facility shall be created, for purposes of the Resolution, until amounts are paid under such Credit Facility. Such payments to reimburse the issuer of a Credit Facility are referred to as "Reimbursement Obligations." Any Reimbursement Obligation (a "Parity Reimbursement Obligation") may be secured by a pledge of and a lien on the Trust Estate on a parity with the lien created thereon by the Resolution. Any such Parity Reimbursement Obligation shall be deemed to be a part of the Series to which the Credit Facility which gave rise to such Parity Reimbursement Obligation relates.

Payments to reimburse the issuer of a Subordinated Credit Facility (a "Subordinated Reimbursement Obligation") shall constitute Subordinated Indebtedness.

With respect to any contract of the Authority or LIPA with another entity for fuel, energy or power (a "Supply Contract"), the obligation of the Authority or LIPA, as the case may be, to pay that portion of any rates, fees, charges, surcharges or payments for the specific purpose of meeting principal or interest or both on that entity's obligations directly associated with such contract and payable to such entity regardless of whether fuel or energy is delivered or made available for delivery and the principal and/or interest component of any Capital Lease, (such portion or component, the "Debt Service Component") shall be (i) payable from Revenues and secured by a pledge of, and lien on, the Trust Estate on a parity with the lien created by the Resolution to secure the Bonds (a "Parity Contract Obligation") only if, when such Supply Contract or Capital Lease is entered into, the Authority shall have satisfied the test set forth above in either paragraph (a) or (b) under the heading "Conditions Precedent to Delivery of Bonds", subject to paragraph (d) under the same heading, with respect to such Debt Service Component or (ii) payable from funds withdrawn from the Revenue Fund as permitted by the Resolution, in all other events.

### **Separately Financed Project**

Nothing in the Resolution shall prevent the Authority from authorizing and issuing bonds, notes, or other obligations or evidencing of indebtedness other than Bonds, for any purpose of the Authority authorized by the Act or by other applicable State statutory provisions, or from financing any such purpose from other available funds (such purpose being referred to in the Resolution as a "Separately Financed Project"), if the debt service on such bonds, notes, or other obligations or evidences of indebtedness, if any, and the Authority's share of any operating expenses related to such Separately Financed Project, are payable solely from the revenues or other income derived from the ownership or operation of such Separately Financed Project or from other funds withdrawn from the Revenue Fund as permitted by the Resolution, and may be secured by the Authority's or LIPA's ownership interest therein.

### **Pledge of Funds and Revenues**

The Trust Estate is pledged for the payment of the Bonds and Parity Obligations in accordance with their terms and the provisions of the Resolution, subject only to the provisions of the Resolution, the Act and the Financing Agreement permitting the application thereof. As further security for the payment of the Bonds and Parity Obligations, the Authority assigns, transfers and pledges to the Trustee all of its rights and interests under and pursuant to the Financing Agreement (excluding rights to notice and other procedural rights, its rights to indemnification and rights and interests not material to Bondholders).

The Resolution establishes the following funds:

- (1) Construction Fund, to be held by the Authority;
- (2) Revenue Fund, to be held by the Authority;
- (3) Operating Expense Fund, to be held by the Authority;
- (4) Debt Service Fund, to be held by the Trustee;
- (5) Parity Contract Obligations Fund, to be held by the Authority;
- (6) Subordinated Indebtedness Fund, to be held by the Authority, except as may otherwise be permitted by the Resolution;
- (7) LIPA Unsecured Debt Fund, to be held by the Authority;
- (8) PILOTs Fund, to be held by the Authority; and
- (9) Rate Stabilization Fund, to be held by the Authority.

The Trustee shall, at the request of the Authority, establish within any Fund held by the Trustee such Accounts or sub-accounts. The Authority may do likewise with respect to any Fund held by it.

### **Construction Fund**

The Resolution provides that the Authority shall deposit into the Construction Fund any amount required to be deposited therein pursuant to the Resolution or the Financing Agreement, and any other amounts received by the Authority for or in connection with the System and determined by the Authority to be deposited therein, which are not otherwise required to be applied in accordance with the Resolution. The Authority shall also deposit in the Construction Fund, the proceeds of insurance, if any, maintained by the Authority or LIPA against physical loss of or damage to the System, or of contractors' performance bonds with respect thereto, pertaining to the period of acquisition or construction of System Improvements, to the extent not deposited to the Revenue Fund. Except as otherwise provided in the Resolution, amounts in the Construction Fund shall be expended only to pay Costs of System Improvements as determined by the Authority from time to time. To the extent that other moneys are not

available therefor in any of the other Funds and Accounts established under the Resolution, amounts in the Construction Fund shall be applied to the payment of the Principal Installments of and interest on Bonds.

### **Revenue Fund**

The Resolution provides that the Authority shall, as promptly as practicable after receipt thereof by the Authority, deposit all Revenues in the Revenue Fund, unless required by the Resolution to be deposited to any other Fund or Account. There shall also be deposited in the Revenue Fund all other amounts required by the Resolution or the Financing Agreement to be so deposited.

### **Payments Into Certain Funds**

The Resolution provides that amounts on deposit from time to time in the Revenue Fund shall be withdrawn and deposited as follows and, as of any time, in the following order of priority:

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

SECOND: (A) to the Debt Service Fund, the amounts required to pay or provide for the payment of the Principal Installments and Redemption Price of and interest on Bonds and Parity Reimbursement Obligations; provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

(B) to the Parity Contract Obligations Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Parity Contract Obligations provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

provided, however, that if the balance remaining to make all such deposits is less than sufficient to do so in full, deposits shall be made pro rata between the Debt Service Fund and the Parity Contract Obligations Fund in the same ratio that the amount required to be deposited thereto bears to the sum of the amount required to be deposited to each such Fund;

THIRD: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST or SECOND above, to the Subordinated Indebtedness Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of principal and redemption price of and interest on Subordinated Indebtedness in accordance with the Resolution; provided, however, that no such amount shall be required to be deposited therein in advance of one business day prior to the due date of any such payment;

FOURTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND or THIRD above, to the LIPA Unsecured Debt Fund, the amount determined by the Authority to be required to be deposited therein to pay or provide for the payment of Outstanding LIPA Unsecured Debt in accordance with the Resolution;

FIFTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD or FOURTH above, to the PILOTs Fund, the amount determined by the Authority to be required to be deposited in such Fund to pay or provide for the payment of PILOTs in accordance with the Resolution in accordance with the System Budget or the entire balance if less than sufficient; and

SIXTH: if such amounts are not expected by the Authority to be required thereafter for purposes of paragraphs FIRST, SECOND, THIRD, FOURTH or FIFTH above, to the Rate Stabilization Fund, the

amount determined by the Authority to be deposited therein to provide for any payments or deposits from Revenues thereafter.

Any moneys remaining in the Revenue Fund at any time and not deposited as set forth above may be retained in the Revenue Fund or may be withdrawn and used for any lawful purpose of the Authority or LIPA as determined by the Authority, including but not limited to the purchase or redemption of any bonds, notes or other obligations of the Authority or LIPA and, to the extent specified by the Authority, the payment of any incentive payments payable by LIPA under any System Agreements which are not payable as an Operating Expense; provided, however, that prior to any such withdrawal, the Authority shall have determined, taking into account, among other considerations, anticipated future receipts of Revenues and other moneys constituting part of the Trust Estate, that the moneys to be withdrawn are not needed for any other purpose provided in paragraphs FIRST through SIXTH set forth above. Amounts paid out or withdrawn pursuant to this paragraph shall be free and clear of the lien and pledge created by the Resolution unless deposited into any Fund or Account; provided, however, that to the extent amounts are paid out or withdrawn for the purpose of paying any expense of LIPA, such amounts shall remain subject to the lien and pledge of the Resolution until such amounts are actually applied by the Authority or LIPA to the payment of such expense.

Purchases of Bonds or Subordinated Indebtedness from amounts in the Revenue Fund shall be made at the direction of the Authority, with or without advertisement and with or without notice to other Holders of Bonds or Subordinated Indebtedness. Such purchases shall be made at such price or prices as determined by the Authority. If Sinking Fund Installments have been established for the maturities of Bonds purchased by the Authority, then the Authority shall direct the Trustee to credit the principal amount purchased against the applicable Sinking Fund Installments in such order and amounts as are determined by the Authority.

### **Operating Expense Fund**

Amounts credited to the Operating Expense Fund shall be applied from time to time solely to the payment of Operating Expenses at the times, in the manner, and on the other terms and conditions as determined by the Authority from time to time. If and to the extent provided in a Supplemental Resolution authorizing Bonds, amounts from the proceeds of such Bonds may be credited to the Operating Expense Fund and set aside therein as specified in the Supplemental Resolution for any purpose of such Fund.

### **Debt Service Fund**

The Trustee shall for all Outstanding Bonds and Parity Reimbursement Obligations, pay (i) on each Bond Payment Date, (1) from the moneys on deposit in the Debt Service Fund the amounts required for the payment of the Principal Installments, if any, due on such Bond Payment Date and (2) from the moneys on deposit in the Debt Service Fund, including the moneys credited to the sub-account, if any, established for such Series in the Capitalized Interest Account, the interest due on such Bond Payment Date, and (ii) on any redemption date or date of purchase, the amounts required for the payment of accrued interest on Bonds to be redeemed or purchased on such date unless the payment of such accrued interest shall be otherwise provided.

As soon as practicable after the forty-fifth day preceding the due date of any Sinking Fund Installment, the Trustee shall proceed to call for redemption, pursuant to the Resolution, Bonds of the Series and maturity for which such Sinking Fund Installment was established in such amount as shall be necessary to complete the retirement of the principal amount specified for such Sinking Fund Installment of the Bonds of such Series and maturity. The Trustee shall so call such Bonds for redemption whether or not it then has moneys in the Debt Service Fund sufficient to pay the applicable Redemption Price thereof

on the redemption date. The Trustee shall apply to the redemption of the Bonds on each such redemption date the amount required for the redemption of such Bonds.

#### **Parity Contract Obligations Fund**

Amounts credited to the Parity Contract Obligations Fund shall be applied from time to time solely to pay or provide for the payment of Parity Contract Obligations at the times, in the manner, and on the other terms and conditions as determined by the Authority from time to time, subject to the Resolution which provides that if at any time any amount remains on deposit in the Parity Contract Obligations Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

#### **Subordinated Indebtedness Fund**

Amounts on deposit in the Subordinated Indebtedness Fund shall be applied by the Authority solely to pay or provide for the payment of the principal and redemption price of and interest on Subordinated Indebtedness, or as otherwise provided by the resolution of the Authority authorizing each issue of Subordinated Indebtedness, subject to the provisions set forth below under this heading.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund or Parity Contract Obligations Fund shall be less than the current requirements thereof, the Authority shall withdraw from the Subordinated Indebtedness Fund and deposit in such other Funds the amounts necessary (or all the moneys in the Subordinated Indebtedness Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

If at any time any amount remains on deposit in the Subordinated Indebtedness Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

#### **LIPA Unsecured Debt Fund**

Amounts on deposit in the LIPA Unsecured Debt Fund shall be applied by the Authority solely to the payment of the principal of and interest on Outstanding LIPA Unsecured Debt, subject to the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund or Subordinated Indebtedness Fund shall be less than the current requirements thereof, LIPA shall withdraw from the LIPA Unsecured Debt Fund and deposit in such other Funds the amounts necessary (or all the moneys in said Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

If at any time any amount remains on deposit in the LIPA Unsecured Debt Fund which the Authority determines is not required thereafter for purposes thereof, such amount shall be transferred to the Revenue Fund.

#### **PILOTs Fund**

Amounts on deposit in the PILOTs Fund shall be applied by the Authority, or paid to LIPA for application by LIPA, solely to make payments to the State, or any municipality or other political subdivision of the State, which shall be entitled to receive PILOTs under the Act, at such times and in such amounts as the Authority shall determine to be required to make such payments, subject to the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund, Subordinated Indebtedness Fund or LIPA Unsecured Debt Fund shall be less than the current requirements thereof, the Authority shall withdraw from the PILOTs Fund and deposit in such

other Funds the amounts necessary (or all the moneys in the PILOTs Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

Amounts on deposit in the PILOTs Fund which the Authority may determine to be in excess of the amount required to be maintained therein for the purposes of such Fund shall be transferred to the Revenue Fund.

### **Rate Stabilization Fund**

Amounts on deposit in the Rate Stabilization Fund may be used for any lawful purpose of the Authority or LIPA, including but not limited to making any deposits required by the Resolution to any Fund or Account, as determined by the Authority; provided, however, that no such deposit to any such Fund or Account shall be required except as specified by the provisions below.

If at any time the amounts in the Operating Expense Fund, Debt Service Fund, Parity Contract Obligations Fund, Subordinated Indebtedness Fund, LIPA Unsecured Debt Fund or PILOTs Fund shall be less than the current requirements thereof, the Authority shall withdraw from the Rate Stabilization Fund and deposit in such other Funds the amounts necessary (or all the moneys in the Rate Stabilization Fund, if less than the amounts necessary, applying available amounts in the order of priority and otherwise as specified in the Resolution), to make up such deficiency.

Amounts on deposit in the Rate Stabilization Fund which the Authority may determine to be in excess of the amount required to be maintained therein for the purposes of such Fund shall be transferred to the Revenue Fund.

### **Investment of Certain Funds**

Moneys held in all Funds and Accounts shall be invested and reinvested by the Authority or the Trustee, as the case may be, to the fullest extent practicable in Investment Securities which mature not later than at such times as shall be necessary to provide moneys when needed for payment to be made from such Funds and Accounts, subject, in the case of the Subordinated Indebtedness Fund and LIPA Unsecured Debt Fund, to the terms of any resolutions, indentures, or other instruments securing any issue of Subordinated Indebtedness or Outstanding LIPA Unsecured Debt, as the case may be. The Trustee shall make all such investments of moneys held by it in accordance with written instructions from any Authorized Representative of the Authority. In making any investment in any Investment Securities with moneys in any Fund or Account established under the Resolution, the Authority may, and may instruct the Trustee to, combine such moneys with moneys in any other Fund or Account, but solely for purposes of making such investment in such Investment Securities.

Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) and other investment earnings on any moneys or investments in the Funds and Accounts, other than the Construction Fund and Capitalized Interest Account, shall be paid into the Revenue Fund as and when received. Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment) and other investment earnings on any moneys or investments in the Construction Fund and Capitalized Interest Account shall remain in such Fund or Account, respectively, unless the Authority elects to pay the same into the Revenue Fund.

### **Rate Covenants; Related Obligations**

The Authority shall establish and maintain System fees, rates, rents, charges and surcharges sufficient in each Fiscal Year so that Revenues reasonably expected to be produced in such Fiscal Year will be at least equal to the sum of (i) 120% (except, after the Authority shall have retired, other than from proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of

the then outstanding balance of the Promissory Notes, 100%) of Debt Service, and amounts under all Parity Contract Obligations, payable by the Authority in such Fiscal Year, (ii) 100% of the Operating Expenses payable in such Fiscal Year, (iii) 100% of the amount necessary to pay all PILOTs payable in such Fiscal Year, and (iv) 100% of the amount necessary to pay other Required Deposits, all other payments required pursuant to the Resolution and the Financing Agreement, and all other payments required for the System, for such Fiscal Year; provided, however, that if at any time such fees, rates, rents, charges and surcharges are or will be insufficient to meet the requirements of the Resolution, it shall not constitute a violation of the Resolution if and to the extent the Authority promptly takes action reasonably expected by the Authority to cure or avoid any such deficiency or to cause the same to be cured or avoided, or if the Authority complies with the provisions of the last paragraph set forth under this heading. Revenues shall include (i) any amount withdrawn or expected to be withdrawn thereafter in any Fiscal Year from the Rate Stabilization Fund which were either (a) on deposit therein prior to such Fiscal Year or (b) proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits, (ii) Revenues shall not include any proceeds from the sale of LIPA assets or proceeds of insurance and (iii) Debt Service, Parity Contract Obligations, PILOTs and other Required Deposits shall not include any amounts thereof expected by the Authority to be paid from any funds, other than Revenues, reasonably expected by the Authority to be available therefor (including without limitation the anticipated receipt of proceeds of sale of Bonds or Subordinated Indebtedness, or moneys not a part of the Trust Estate, expected by the Authority to be used to pay the principal of Bonds, Parity Contract Obligations, Outstanding LIPA Unsecured Debt or Subordinated Indebtedness other than proceeds of Bonds or Subordinated Indebtedness issued to fund the Shoreham Credits), which expectations, if included in a resolution of the Authority or Certificate of an Authorized Representative, shall be conclusive.

The Authority shall review, or cause LIPA to review, the adequacy of System fees, rates, rents, charges and surcharges at least annually. If such annual or more frequent review, or the report of the Rate Consultant pursuant to the Resolution, indicates that the rates, fees, rents, charges and surcharges are, or will be, insufficient to meet the requirements of the provisions stated in the preceding paragraph, the Authority shall promptly take, or cause LIPA to take, the necessary action to cure or avoid any such deficiency, except as otherwise may be provided by the last paragraph under this heading.

Except to the extent required by law, the Authority will not permit LIPA to furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private, unless and to the extent the Authority shall have determined that other adequate consideration has been or is expected to be received by LIPA in connection therewith, and the Authority will cause LIPA to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

The failure in any Fiscal Year to comply with the covenant in clauses (i) (but only to the extent of the excess, if any, over 100% of Debt Service and amounts under all Parity Contract Obligations), (iii) and (iv) of the first sentence of the first paragraph above (the "non-debt service and operating expense rate covenant") shall not constitute an Event of Default if the Authority shall comply with the provisions contained in this paragraph. If the Authority shall fail in any Fiscal Year to comply with the non-debt service and operating expense rate covenant, the Authority shall retain a Rate Consultant and a Consulting Engineer for the purpose of reviewing System fees, rates, rents, charges and surcharges and reviewing the System Budget in the manner described in the Resolution. If the Rate Consultant (relying upon the certificate of the Consulting Engineer) shall be of the opinion, as shown by a certificate filed with the Trustee pursuant to the Resolution, that a schedule of fees, rates, rents, charges and surcharges for the System which would provide funds to meet the requirements specified in the non-debt service and operating expense rate covenant is impracticable at that time and the Authority therefore cannot comply with the non-debt service and operating expense rate covenant, then the Authority shall fix and establish such schedule of System fees, rates, rents, charges and surcharges as is recommended in such certificate

by the Rate Consultant to comply as nearly as practicable with the non-debt service and operating expense rate covenant and in such event the failure of the Authority to comply with the non-debt service and operating expense rate covenant, shall not constitute an Event of Default. The Rate Consultant's certificate shall be accompanied by a certificate of the Consulting Engineer setting forth estimates of amounts required as provided by the Resolution for the then-current and the ensuing two Fiscal Years.

### **Tax Covenant**

In the Supplemental Resolution authorizing the Offered Securities, the Authority has covenanted not to take or omit to take any action which would cause interest on any Offered Security to be included in the gross income of any Owner thereof for Federal income tax purposes by reason of subsection (b) of Section 103 of the Internal Revenue Code of 1986 (Title 26 of the United States Code) as in effect on the date of original issuance of the Offered Securities (for purposes of this paragraph, the "Code") and, without limiting the generality of the foregoing, that no part of the proceeds of any Bonds or any other funds of the Authority shall be used directly or indirectly to acquire any securities or obligations the acquisition of which would cause any Offered Security to be an "arbitrage bond" as defined in section 148 of the Code and to be subject to treatment under subsection (b)(2) of Section 103 of the Code as an obligation not described in subsection (a) of said section. Notwithstanding any other provision of the Resolution to the contrary, upon the Authority's failure to observe, or refusal to comply with, this covenant, remedies are limited to specific performance and the Owners and Trustee shall not be entitled to any other rights and remedies provided under the Resolution.

### **Consulting Engineer and Rate Consultant**

Subject to the Resolution, the Authority shall employ or cause LIPA to employ a Consulting Engineer and a Rate Consultant whose duties, respectively, shall be to make any certificates and perform any other acts required or permitted of the Consulting Engineer and the Rate Consultant under the Resolution or under the Financing Agreement.

Commencing with Fiscal Year 1999 and no less frequently than every other Fiscal Year thereafter, the Consulting Engineer and the Rate Consultant shall make an examination of, and shall report on, the properties and operations of the System. Such report shall be submitted to the Authority, LIPA, and the Trustee no later than eight months after the close of the Fiscal Year to which such examination relates and shall set forth the following: (i) the Consulting Engineer's advice and recommendation as to the proper operation, maintenance and repair of the System during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes; (ii) the Consulting Engineer's advice and recommendations as to improvements which should be made during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes, showing the amount projected to be expended during such Fiscal Years from the proceeds of Bonds or Subordinated Indebtedness issued under or pursuant to the Resolution; (iii) the Rate Consultant's recommendation as to any necessary or advisable revisions of rates, fees, rents, charges and surcharges and such other advice and recommendation as it may deem desirable; and (iv) the Consulting Engineer's findings as to whether the System has been maintained in good repair and sound operating condition, and its estimate of the amount, if any, required to be expended to place such properties in such condition and the details of such expenditures and the approximate time required therefor.

The Authority covenants that if any such report shall set forth that the properties of the System have not been maintained in good repair and sound operating condition, it will cause LIPA to promptly restore the properties to good repair and sound operating condition with all expedition practicable.

At any time after the expiration of the term of the initial Management Services Agreement the Authority may perform any duty or obligation of the Consulting Engineer or Rate Consultant for certain purposes as provided in the Resolution.



### **Further Assurance**

At any and all times the Authority shall, so far as it may be authorized by law, pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for better assuring, conveying, granting, pledging, assigning and confirming all and singular, the rights, assets, revenues and other moneys, securities, funds and property pledged or assigned by the Resolution, or intended so to be, or which the Authority may become bound to pledge or assign.

### **Indebtedness and Liens**

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

The Authority may issue either (i) Subordinated Indebtedness payable from the Subordinated Indebtedness Fund, secured by a pledge of and lien or charge on the Trust Estate, and further secured by an assignment of rights and interests under and pursuant to the Financing Agreement to the extent provided by the Resolution, in each case subject and subordinate in all respects to the pledge thereof and lien and charge thereon, or assignment thereof, as the case may be, created by the Resolution in favor of Bonds and Parity Obligations, or (ii) other bonds, notes or other evidences of indebtedness for borrowed money payable from funds withdrawn from the Revenue Fund as permitted by the Resolution.

### **Agreement of the State**

The Resolution provides that, in accordance with Section 1020-o of the Act, the Authority, as agent for the State, agrees with the holders of obligations issued under the Resolution that the State will not limit or alter the rights vested in the Authority by the Act until such obligations together with the interest thereon are fully met and discharged, provided that nothing contained in the Resolution shall preclude such limitation or alteration if and when adequate provision shall be made by law for the protection of the Holders of such obligations of the Authority.

### **Annual System Budget**

Prior to the beginning of each Fiscal Year, the Authority shall file with LIPA and the Trustee an annual System Budget for the ensuing Fiscal Year which shall set forth in reasonable detail the estimated Revenues and Operating Expenses for the System for such year. Such annual System Budget shall include the LIPA Budget (as such term is defined in the Financing Agreement) and the Authority Budget and also may set forth such additional material as the Authority may determine. At the end of each quarter, the Authority shall review its estimates for such Fiscal Year, and in the event such estimates do not substantially correspond with actual Revenues or Operating Expenses, or if there are at any time during any such Fiscal Year extraordinary receipts or payments of unusual costs, the Authority shall prepare an amended annual System Budget for the remainder of the then current Fiscal Year. The Authority also may at any time adopt an amended annual System Budget for the remainder of the then-current Fiscal Year.

If for any reason the Authority shall not have adopted the System Budget by the time required by the Resolution, the System Budget for the then-current Fiscal Year shall be deemed to be the System Budget for the ensuing Fiscal Year until a new System Budget is adopted.

## **Deposits to Funds**

The Resolution provides that the Authority will take such action as may be required to cause all Revenues to be deposited in the Revenue Fund (or, if so required by the Resolution, any other Fund or Account).

## **Enforcement and Amendment of Financing Agreement**

The Authority shall enforce or cause to be enforced the provisions of the Financing Agreement and duly perform its covenants and agreements under the Financing Agreement. The Authority will not consent or agree to or permit any rescission of or amendment to or otherwise take any action under or in connection with the Financing Agreement except in accordance with the Resolution.

## **Amendments to Financing Agreement**

Except as otherwise provided in the Resolution, the Financing Agreement may not be amended, changed, modified or terminated, nor may any provision thereof be waived, without the consent of the Holders of Outstanding Bonds as provided in the Resolution, if such amendment, change, modification, termination or waiver adversely affects the interest of the Holders of Outstanding Bonds in any material respect.

No such amendment, change, modification, termination or waiver shall take effect unless the prior written consent of (a) the Holders of at least a majority in principal amount of the Bonds then Outstanding, or (b) in case less than all Bonds then Outstanding are affected by the amendment, change, modification, termination or waiver, the Holders of not less than a majority in principal amount of the Bonds so affected and then Outstanding; provided, however, that if such amendment, change, modification, termination or waiver will, by its terms, not take effect so long as any specified Bonds remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any such calculation of Outstanding Bonds.

For purposes of this section, any purchasers of the Bonds, whether purchasing as underwriters, for resale or otherwise, upon such purchase, may consent to an amendment, change, modification, termination or waiver permitted by this section with the same effect as a consent given by the Holders of such Bonds.

For the foregoing purposes, a Bond shall be deemed to be adversely affected by an amendment, change, modification, termination or waiver of the Financing Agreement if the same adversely affects or diminishes the rights of the Holder of such Bond in any material respect. The Trustee may in its discretion determine whether or not, in accordance with the foregoing provisions, any particular Bond would be adversely affected in any material respect by any amendment, change, modification, termination or waiver, and any such determination shall be binding and conclusive on the Authority and all Holders of Bonds.

For the foregoing purposes, the Trustee shall be entitled to rely upon an opinion of counsel, which counsel shall be satisfactory to the Trustee, with respect to whether any amendment, change, modification, termination or waiver adversely affects the interests of any Holders of Bonds then Outstanding in any material respect.

## **No Competitive Facilities**

The Authority shall not construct, acquire or operate any plants, structures, facilities or properties which will provide electric transmission or distribution service in the Service Area (as defined in the Act) in competition with and not as part of the System unless such construction, acquisition or operation, in the judgment of the Authority, does not materially impair the ability of the Authority to comply with the rate covenant in the Resolution.

## **Disposition of Assets**

The Authority shall not sell or otherwise dispose of, or encumber or grant a security interest in, any common or preferred stock or other evidence of the Authority's equity interest in LIPA, unless the Authority or any subsidiary thereof shall thereupon own or effectively control the operation of the System. Except as provided by the Financing Agreement, the Authority shall not dispose of, or cause the disposition of, or permit to be disposed of, any real or personal properties of the System unless such disposal, in the judgment of the Authority, (i) is desirable in the conduct of the business of the System and (ii) does not materially impair the ability of the Authority to comply with the rate covenant in the Resolution.

## **Supplemental Resolutions; Amendments**

The Authority may adopt (without the consent of any Holder) supplemental resolutions to, among others, authorize additional Bonds; to add to the restrictions contained in the Resolution upon the issuance of additional indebtedness; to add to covenants of the Authority contained in, or surrender any rights reserved to or conferred upon it by, the Resolution; to confirm any pledge under the Resolution or subject other property to the pledge; to permit qualification of the Resolution under, or add provisions permitted by, the Trust Indenture Act of 1939 or any similar Federal statute, and permit the qualification of the Bonds for sale under the securities laws of any state in the United States; to comply with such regulations and procedures as are from time to time in effect relating to establishing and maintaining a book-entry-only system; to comply with the requirements of any Rating Agency in order to maintain or improve a rating on the Bonds by such Rating Agency; to implement the last sentence of the definition of Revenues in the Resolution; to modify any provision of the Resolution, provided that such modification is effective upon or prior to the issuance of any Bonds affected or is effective only after all Bonds theretofore Outstanding cease to be Outstanding; to cure any ambiguity, supply any omission or to correct any defect or inconsistent provision in the Resolution; or to modify any provision provided that such modification shall not adversely affect the interests of the Bondholders in any material respect (and also provided that the Trustee consents thereto).

Any of the provisions of the Resolution may be amended by the Authority upon the written consent of the Holders of at least a majority in principal amount of the Bonds Outstanding at the time such consent is given, and in case less than all Bonds then Outstanding are affected by the modification or amendment, of the Holders of at least a majority in principal amount of such Outstanding Bonds that are or may be so affected; except that if such modification or amendment will, by its terms, not take effect so long as any particular Bonds remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under the Resolution. No such modification or amendment shall permit a change in the terms of redemption or maturity of the principal of any Outstanding Bond or of any installment of interest thereon or a reduction in the principal amount or the Redemption Price thereof or in the rate of interest thereon without the consent of the Holder of such Bond, or shall reduce the percentages or otherwise affect the classes of Bonds the consent of the Holders of which is required to effect any such modification or amendment, or shall change or modify any of the rights or obligations of any Fiduciary without its written assent thereto. For the purposes of this paragraph, a Bond shall be deemed to be affected by a modification or amendment of the Resolution if the same materially and adversely affects or diminishes the rights of the Holder of such Bond.

## **Events of Default; Remedies Upon Default**

Pursuant to the Resolution, any of the following events set forth in clauses (1) through (6) constitutes an "Event of Default" if: (1) the Authority defaults on the payment of Principal or the Redemption Price of any Bond; or (2) the Authority defaults on the payment of any installment of interest on any Bond, and such default shall continue for a period of five (5) days; or (3) the Authority defaults in

the performance or observance of any other of the covenants, agreements or conditions on its part in the Resolution, any Supplemental Resolution or in the Bonds contained, and such default shall continue for a period of sixty (60) days after written notice thereof (and stating that it is a "Notice of Default") to the Authority by the Trustee, or to both by the Holders of not less than sixty-six and two-thirds percent ( $66\frac{2}{3}\%$ ) of the principal amount of Bonds Outstanding, provided that if such default shall be such that it cannot be corrected within such sixty day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; or (4) LIPA defaults under the Financing Agreement and such default continues for a period of sixty (60) days after written notice thereof (and stating that it is a "Notice of Default") to the Authority by the Trustee, or to both by the Holders of not less than sixty-six and two-thirds percent ( $66\frac{2}{3}\%$ ) of the principal amount of Bonds Outstanding, provided that if such default shall be such that it cannot be corrected within such sixty day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; or (5) if the Authority or LIPA (a) files a petition seeking a composition of its indebtedness under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (b) consents to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of the Authority or LIPA or any substantial portion of either of their property; (c) makes any assignment for the benefit of creditors; or (d) admits in writing its inability generally to pay its debts generally as they become due; or (6) if (a) a decree or order for relief is entered by a court having jurisdiction of the Authority or LIPA adjudging the Authority or LIPA a bankrupt or insolvent or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition in respect of the Authority or LIPA in an involuntary case under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (b) a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of the Authority or LIPA or of any substantial portion of either of their property is appointed; or (c) the winding up or liquidation of its affairs is ordered and the continuance of any such decree or order unstayed and in effect for a period of sixty (60) consecutive days.

Upon an Event of Default, the Trustee may and, upon the written request of the Holders of not less than sixty-six and two-thirds percent ( $66\frac{2}{3}\%$ ) of the principal amount of the Bonds Outstanding the Trustee shall declare the principal of all the Bonds then Outstanding to be due and payable immediately. Such declaration may be annulled or rescinded as described in the Resolution.

Under the Resolution the Authority covenants that upon an Event of Default, the books of record and account of the Authority shall at all times be subject to the inspection and use of the Trustee and of its agents and attorneys, and the Authority will, upon demand of the Trustee, account for all Revenues and other moneys, securities and funds pledged or held under the Resolution for such period as shall be stated in such demand. Upon a default, the Trustee may proceed to protect and enforce its rights and the rights of the Holders of the Bonds under the Resolution by a suit in equity or at law, whether for the specific performance of any covenant contained in the Resolution, in aid of the execution of any power granted therein, or for an accounting against the Authority as if the Authority were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee. No Holder of any Bond shall have any right to institute any suit, action or proceeding at law or in equity for the enforcement of any provision of the Resolution or the execution of any trust under the Resolution or for any remedy under the Resolution, unless the Trustee has been requested by not less than sixty-six and two-thirds percent ( $66\frac{2}{3}\%$ ) in principal amount of the Bonds then Outstanding, and such Holders shall have offered the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee has failed to commence such suit in the manner provided in the Resolution.

## **Defeasance**

Bonds or any portion thereof for the payment or redemption of which moneys shall have been set aside and shall be held in trust by the Trustee (through deposit by the Authority of funds for such payment or redemption or otherwise) at the maturity or redemption date thereof shall be deemed to have been paid within the meaning of the Resolution and shall cease to be entitled to any lien, benefit or security under the Resolution either (A) as provided in the Supplemental Resolution authorizing their issuance or (B) if the following conditions are met: (i) in case any Bonds to be redeemed on any date prior to their maturity, the Authority shall have given to the Trustee instructions accepted in writing by the Trustee to mail as provided in the Resolution notice of redemption of such Bonds (other than Bonds which have been purchased by the Trustee at the direction of the Authority as provided prior to the mailing of such notice of redemption) on said date, (ii) there shall have been deposited with the Trustee either moneys in an amount which shall be sufficient, or Defeasance Obligations the principal installments of and/or the interest on which when due, without reinvestment, will provide moneys which, together with the moneys, if any, deposited with the Trustee at the same time, shall be sufficient, to pay when due the Principal Installments or Redemption Price, if applicable, and interest due and to become due on said Bonds or portion thereof on or prior to the redemption date or maturity date thereof, as the case may be, and (iii) in the event said Bonds are not to be redeemed within the next succeeding 60 days, the Authority shall have given the Trustee in form satisfactory to it irrevocable instructions to mail, as soon as practicable, a notice to the Holders of such Bonds that the deposit required by clause (ii) above has been made with the Trustee and that said Bonds or portion thereof (as the same thereafter may change) are deemed to have been paid in accordance with the Resolution and stating such maturity or redemption date (as the same thereafter may change) upon which moneys are to be available for the payment of the Principal Installments or Redemption Price, if applicable, on said Bonds or portion thereof (other than Bonds which have been purchased by the Trustee at the direction of the Authority as provided prior to the publication of the notice of redemption referred to above). The Trustee shall, as and to the extent necessary, apply moneys held by it pursuant to the Resolution to the retirement of said Bonds (or portions thereof) in amounts equal to the unsatisfied balances of any Sinking Fund Installments with respect to such Bonds (or portions thereof), all in the manner provided in the Resolution.

## **Unclaimed Moneys**

Any moneys held by a Fiduciary in trust for the payment and discharge of the principal or of interest on any Bonds which remain unclaimed for two years after the date when such principal or interest, respectively, has become due and payable, either at their stated maturity dates or by call for earlier redemption, if such moneys were held by the Fiduciary at such date, or for two years after the date of deposit of such moneys if deposited with the Fiduciary after the said date when such principal or interest, as the case may be, becomes due and payable, shall, at the written request of the Authority, be repaid by the Fiduciary to the Authority, as its absolute property and free from trust, and the Fiduciary shall thereupon be released and discharged with respect thereto and the Bondholders shall look only to the Authority for the payment of such principal or interest, as the case may be. Notwithstanding the foregoing, any moneys held by a Fiduciary in trust for the payment and discharge of the principal or of interest on any Bonds which remain unclaimed after such moneys were to be applied to the payment of such principal or interest, as the case may be, in accordance with the Resolution may be applied in accordance with the provisions of the Abandoned Property Law of the State, being Chapter 1 of the Consolidated Laws of the State, or any successor provision thereto, and upon such application, the Fiduciary shall thereupon be released and discharged with respect thereto and the Holders of Bonds shall look only to the Authority or the Comptroller of the State for the payment of such principal or interest, as the case may be. Before being required to make any such payment to the Authority or to apply such moneys in accordance with the Abandoned Property Law (or its successor) of the State, the Fiduciary shall, at the expense of the Authority, cause to be mailed to the Bondholders entitled to receive such moneys a notice that said moneys remain unclaimed and that, after a date named in said notice, which

date shall be not less than 30 days after the date of the mailing, the balance of such moneys then unclaimed will be returned to the Authority or applied in accordance with the Abandoned Property Law (or its successor) of the State, as the case may be.

#### **SUMMARY OF CERTAIN PROVISIONS OF THE FINANCING AGREEMENT**

The following is a brief summary of certain provisions of the Financing Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Financing Agreement, a copy of which is on file with the Trustee.

##### **Agreement to Finance Acquisition of System and Cost of System Improvements**

The Authority agreed in the Financing Agreement to finance (i) the Property Tax Settlement, (ii) the retirement of certain outstanding debt of LILCO, and (iii) all or a part of the Cost of System Improvements, by the issuance of Authority Obligations from time to time in accordance with the Resolution, in each case unless and to the extent funded from other sources. The Authority and LIPA agree that the issuance of Authority Obligations, including the issuance of Authority Obligations for the purpose of refunding Authority Obligations or Outstanding LIPA Unsecured Debt in accordance with the Financing Agreement and the Resolution, shall be deemed to constitute a loan to LIPA. The obligation of LIPA to repay such loan and to make payments in accordance with the Financing Agreement shall be evidenced by the delivery of the LIPA Note.

##### **Obligation to Make Payments to the Authority; Grant of Revenues and Certain Other Security to the Authority**

On or before one business day prior to each due date for the payment of the principal of and redemption price, if any, or interest on, or other payments required under, Authority Obligations, until the same shall have been paid in full or provision for the payment thereof in full shall have been made in accordance with the Resolution or the provisions thereof, LIPA shall make or cause to be made payments on the LIPA Note to the Authority in an amount which, when added to any moneys then on deposit under the Resolution and available therefor, including any dividends theretofore paid to the Authority and held thereunder, shall be equal to the amount payable on such due date with respect to the Authority Obligations, as provided in the Resolution, including amounts due for the payment of the principal of and sinking fund installments and premium, if any, and interest on the Bonds. The principal amount from time to time due and owing under the LIPA Note and the scheduled amortization thereof and related interest rates (or the method of determining the same) shall be evidenced by the periodic delivery to LIPA of a certificate of an Authorized Representative of the Authority setting forth the same.

Outstanding LIPA Unsecured Debt shall be paid pursuant to and in accordance with the Resolution and the respective resolutions, indentures or similar instruments authorizing and providing for the issuance thereof.

LIPA has granted and transferred to the Authority all of its right, title and interest in and to the Revenues and the Promissory Notes, including all of its rights to collect and receive the same, subject only to the provisions of the Financing Agreement and the Resolution permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Financing Agreement and the Resolution.

LIPA has further pledged and assigned to the Authority, and granted to the Authority a security interest in, the System Agreements, subject however to the right and obligation of LIPA to exercise its rights and to carry out its obligations and duties thereunder, and further subject to the terms of the Financing Agreement and the Resolution, the right and obligation to enforce or realize upon its rights and interests in the System Agreements.

### **Powers as to Grant, Conveyance and Transfer and as to Revenues of the System**

LIPA warrants and agrees that the Revenues, the System Agreements and other moneys, securities and funds and the rights under contracts so granted, conveyed, pledged and transferred are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, of equal rank with, the pledge created or authorized by the Resolution, and all corporate action on the part of LIPA to that end has been duly and validly taken. LIPA shall at all times, to the extent permitted by law, defend, preserve and protect the pledge of the Revenues, the System Agreements and other moneys, securities and funds and the rights under the contracts pledged under the Financing Agreement and the Resolution and all the rights of the Authority and the Bondholders under the Financing Agreement and the Resolution against all claims and demands of all persons whomsoever.

Subject to the provisions of the Financing Agreement, upon consummation of the LIPA/LILCO Merger, LIPA became, and agrees that so long as any Authority Obligations remain outstanding it will at all times continue to be, the owner of the System.

LIPA shall, so long as any Authority Obligations remain outstanding, perform all acts and duties required to be performed by it with respect to the System Agreements, and shall not permit any rescission or termination or amendment thereof, or otherwise take any action under or in connection with either, not expressly provided for by the terms thereof, which will in any manner impair or adversely affect the rights of LIPA thereunder, or the rights or security of the holders of or parties to Authority Obligations under the provisions thereof or of the Resolution, and any action by LIPA in violation of this covenant shall be null and void as to LIPA.

### **Powers as to System and Collection of Revenues**

The Financing Agreement provides that so long as any Authority Obligations remain outstanding, LIPA will have or will use its best efforts to obtain good right and lawful authority to maintain, operate and improve the System; to impose and collect such fees, rates, rents and charges for the use or services of the System as are established from time to time by the Authority in accordance with the Resolution and the Act; and to demand and collect all Revenues becoming due to it for the use or services of the System.

### **State not Liable with Respect to LIPA Note**

The LIPA Note and other obligations of LIPA under the Financing Agreement shall not be a debt of the State or of any municipality, and neither the State nor any municipality shall be liable thereon. Neither the credit, the revenues nor the taxing power of the State or of any municipality shall be, or shall be deemed to be, pledged to the payment of the LIPA Note or other obligations of LIPA.

### **Payment From Construction Fund**

The Costs incurred by LIPA with respect to System Improvements shall be evidenced to the Authority by a certificate signed by an Authorized Representative of LIPA which shall contain the information required to be set forth in a Disbursement Request. Upon receipt of such certificate the Authority shall pay or cause to be paid to the person entitled thereto amounts sufficient to pay all such certified Costs but solely from amounts available therefor in the Construction Fund.

### **Revenue Fund**

The Financing Agreement provides that all Revenues, as promptly as practicable after receipt thereof by or on behalf of LIPA, shall be deposited by LIPA or by the System Manager into the Revenue Fund. LIPA shall take such actions as it shall determine necessary and appropriate to assure that the System Manager complies with the applicable provisions of the Management Services Agreement and that the Energy Manager complies with the applicable provisions of the Energy Management Agreement relating to the application of moneys of LIPA.

## **LIPA General Fund**

There shall be deposited in the LIPA General Fund all amounts received by LIPA from the Authority or the Trustee pursuant to the Resolution for the purpose of paying LIPA Expenses and any necessary and proper renewals, replacements and extensions of the System or, as provided in the Financing Agreement, PILOTs. All amounts in the LIPA General Fund shall be held in trust by LIPA and applied only as provided in the Financing Agreement, in the Act or in the Resolution. Amounts on deposit in the LIPA General Fund shall be applied by LIPA solely for the payment of LIPA Expenses or any such renewals, replacements, extensions, or PILOTs.

## **Application of Revenues After Event of Default**

LIPA covenants that if an "Event of Default", as defined in the Resolution, shall occur, LIPA, upon demand of the Trustee, shall pay over or cause to be paid over to the Trustee all moneys and securities then held by LIPA or by any System Manager in LIPA General Fund, and thereafter, as promptly as practical, the Revenues, for application in accordance with Section 1003 of the Resolution.

## **Rate Covenant**

LIPA and the Authority have covenanted and agreed that fees, rates, rents, charges and surcharges for the use of, or services furnished, rendered or made available by, the System shall be established by the Authority in accordance with the Resolution and the Act such that such fees, rates, rents, charges and surcharges shall be adequate, together with any other available funds, to provide for, among other things, (i) the timely payment of the Principal Installments of and interest on all Bonds, the principal of and interest on any other Authority Obligations payable from Revenues, and the principal of and interest on the Outstanding LIPA Unsecured Debt, (ii) the proper operation and maintenance of the System, (iii) all other payments required for the System not otherwise provided for and (iv) all other payments required pursuant to the Financing Agreement and any System Agreements.

If the periodic review of System fees, rates, rents, charges and surcharges conducted by the Authority in accordance with the Resolution, or the report prepared pursuant to the Resolution, indicates that such rates, fees, rents, charges and surcharges are, or will be, insufficient to meet the requirements of Section 701 of the Resolution, LIPA, in accordance with the directions, if any, of the Authority, shall promptly take and diligently pursue all necessary actions within its reasonable control to cure or avoid any such deficiency.

Except to the extent required by law, LIPA will not furnish or supply or cause to be furnished or supplied any product, use or service of the System free of charge (or at a nominal charge) to any person, firm or corporation, public or private unless and to the extent the Authority shall have determined that other adequate consideration has been or is expected to be received by LIPA in connection therewith, and LIPA will use reasonable efforts to enforce or cause to be enforced the payment of any and all amounts owing to LIPA for use of the System in accordance with the Financing Agreement.

Nothing contained in the Financing Agreement shall be deemed to limit or restrict the right or obligation of the Authority or LIPA to comply with any covenant relating to rates to be charged for the use of, or services provided by, the System which may be made with the holders of or parties to Authority Obligations in accordance with the Act.

## **Compliance with Report as to System Condition**

LIPA covenants that if any report prepared in accordance with the Resolution shall set forth that the properties of the System have not been maintained in good repair and sound operating condition, it will restore the properties or cause the properties to be restored to good repair and sound operating condition as promptly as practicable.



## **Operation and Maintenance**

LIPA has covenanted that it shall, at all times:

(a) In accordance with the advice and recommendations set forth in the reports prepared from time to time in accordance with the Resolution, operate the System properly and in a sound and economical manner and shall maintain, preserve, and keep the same preserved and kept with the appurtenances and every part and parcel thereof, in good repair, working order and condition, and shall from time to time make, or cause to be made, all necessary and proper repairs, replacements, renewals and extensions so that at all times the operation of the System may be properly and advantageously conducted; provided, however, that nothing contained in the Financing Agreement shall require LIPA to operate, maintain, preserve, repair, replace, renew or reconstruct any part of the System if, in the case of any part of the System having a market value of greater than \$1 million, there shall be filed with LIPA, the Authority and the Trustee a certificate of an Authorized Representative of LIPA stating that, in the opinion of LIPA, abandonment of operation of such part of the System will not adversely affect the operation of the System or impair the ability of LIPA and the Authority to comply with the provisions of the Financing Agreement and the Rate Covenant set forth in the Resolution;

(b) enforce the rules and regulations governing the operations, use and services of the System established from time to time by LIPA or the Authority; and

(c) observe and perform all of the terms and conditions contained in the Act, and comply with all valid acts, rules, regulations, orders and directions of any legislative, executive, administrative or judicial body having competent jurisdiction of LIPA or the System; provided, however, that the failure of LIPA to comply with the covenant contained in this paragraph (c) for any period shall not constitute a default on its part so long as LIPA (i) is taking reasonable and timely steps to permit compliance and (ii) LIPA shall have delivered to the Trustee and to the Authority a Certificate of an Authorized Representative of LIPA which (1) sets forth in reasonable detail the facts and circumstances attendant to such non-compliance, (2) sets forth the steps being taken by LIPA to permit compliance, (3) sets forth the estimated date on which LIPA will be in compliance and (4) states that in the opinion of such Authorized Representative such non-compliance during the period described will not adversely affect the operation of the System or the amount of Revenues to be derived therefrom.

## **Annual LIPA Budget**

Not less than thirty (30) days prior to the beginning of each Fiscal Year, LIPA shall file with the Authority and the Trustee a LIPA Budget for the ensuing Fiscal Year which shall set forth in reasonable detail the estimated Revenues, LIPA Expenses and renewals, replacements and extensions for the System for such year. At the end of each quarter, LIPA shall review its estimates for such Fiscal Year, and in the event such estimates do not substantially correspond with actual Revenues or LIPA Expenses, or if there are at any time during any such Fiscal Year extraordinary receipts or payments of unusual costs, LIPA shall prepare an amended LIPA Budget for the remainder of the then current Fiscal Year. LIPA also may at any time adopt an amended LIPA Budget for the remainder of the then current Fiscal Year.

## **Compliance with Agreements; Tax Exemption**

LIPA has covenanted with the Authority that it will take all such actions or refrain from taking all such actions, as the case may be, so as to comply with the terms and provisions of the Financing Agreement and the Resolution. The Authority has covenanted with LIPA that it will take all such actions or refrain from taking any such actions, as the case may be, so as to comply with the terms and provisions of the Resolution and the Financing Agreement.

LIPA has covenanted with the Authority, so long as any Bonds or other Authority Obligations, issued with the intent that the interest thereon not be included in gross income for Federal income tax purposes, shall be outstanding, that it will not take any action, or fail to take any action, which, if taken or not taken, as the case may be, would adversely affect the tax-exempt status of the interest payable on any such Bonds or other Authority Obligations.

### **Compliance with Resolution**

LIPA shall take all such actions and refrain from taking all such actions, as the case may be, and otherwise shall operate the System as shall ensure their compliance, and the compliance of the Authority, with the terms and provisions of the Resolution, or any other agreement entered into by the Authority in connection with the financing or operation of the System and which shall, by its terms, directly or indirectly apply to LIPA.

### **Enforcement of Rules and Regulations**

LIPA shall enforce or cause any System Manager of the System to enforce the rules and regulations providing for discontinuance of or disconnection from the provision of electric service, for non-payment of fees, rates, rents or other charges imposed by the Authority and LIPA, provided that such discontinuance or disconnection shall not be carried out except in the manner and upon notice consistent with the Act.

### **Books, Records and Accounts**

Each of the Authority and LIPA shall keep or cause to be kept, proper books of record and account in which complete and correct entries shall be made of all transactions relating to their corporate purposes under the Act and the Financing Agreement.

### **Liens**

Until all Authority Obligations have been paid in full or provision has been made therefor in accordance with the Resolution, LIPA shall not create, and, except to the extent permitted by the Financing Agreement and to the extent it has the power to do so, shall not permit to be created, any lien upon or pledge of the System, any real or personal properties comprising any part of the System, or the Trust Estate including but not limited to the Revenues, except the lien and pledge thereon created by the Financing Agreement, the Resolution, and the Act.

### **Compliance with Law**

The Authority and LIPA have covenanted and agreed each for itself that it will observe and perform all of the terms and conditions contained in the Act, and comply with all valid laws, acts, rules, regulations, orders and directions of any legislative, executive, administrative or judicial body having competent jurisdiction over its property or affairs.

### **Insurance**

LIPA shall maintain or cause the System Manager to maintain with responsible insurers all insurance required and reasonably obtainable in the amounts and of the types customarily maintained by electric utilities consistent with prudent utility practice, to indemnify for loss of or damage to the System, and against public and other liabilities relating to the operations of LIPA and the System. LIPA shall also maintain or cause to be maintained any additional or other insurance which is required by the System Agreements. LIPA may insure itself against any risk at the recommendation of an insurance consultant chosen by or acceptable to an Authorized Representative of LIPA; provided, however, that LIPA shall provide adequate funding of such self-insurance if and to the extent recommended by such insurance consultant.

### **Covenant Regarding Additional System Agreements**

Any additional System Agreement executed by LIPA shall contain such terms and conditions as will enable LIPA to retain such overall supervision and control of the business, design, operating, management, transportation, maintenance, planning and research and development functions of the System as may be required by law, the Financing Agreement or the Resolution.

### **Limitations on Operating Expenses and Costs of Major Renewals and Replacements**

LIPA shall not incur or allow any System Manager to incur Operating Expenses or costs of major renewals, replacements and extensions for the System in any year in excess of the reasonable and necessary amount of such Operating Expenses or costs, respectively, and, except as may be necessary to respond to emergency conditions and to assure the continuing operation of the System, shall not expend any amount from the Operating Expense Fund for Operating Expenses or from the Construction Fund for costs of major renewals, replacements and extensions for the System for such year in excess of the respective amounts provided therefor in the LIPA Budget as originally adopted or as amended.

### **Maintenance of Existence**

LIPA covenants and agrees that during the term of the Financing Agreement it will maintain its existence as a corporation, will continue to be a corporation either organized under the laws of or duly qualified to do business in the State, will not dissolve or otherwise dispose of all or substantially all of its assets and will not consolidate with or merge into one or more other entities or permit one or more other entities to consolidate with or merge into it. LIPA may, however, consolidate with or merge into one or more other entities or permit one or more other entities to consolidate with or merge into it, or sell or otherwise transfer to one or more other entities all or substantially all of its assets as an entirety and thereafter liquidate or dissolve if (a) LIPA is the surviving, resulting or transferee entity, or (b) in the event LIPA is not the surviving, resulting or transferee entity, such entity (i) is solvent, and either organized under the laws of or duly qualified to do business subject to service or process in the State, (ii) assumes in writing all of the obligations of LIPA as set forth in the Financing Agreement and (iii) is either the Authority or is wholly owned by the Authority, and (c), in either event, the Trustee shall have been furnished (1) an opinion of Bond Counsel to the effect that under then existing statutes and court decisions, such consolidation, merger, sale or transfer does not adversely affect the exclusion of interest on any obligations of the Authority then outstanding the interest on which is excluded from gross income for federal income tax purposes, and (2) written confirmation from each Rating Agency to the effect that such consolidation, merger, sale or transfer, in and of itself, will not result in a withdrawal, suspension or downward revision of the rating assigned by such Rating Agency to the Bonds.

### **Disposition of Property**

LIPA may, with the approval of the Authority, dispose of properties if such disposal, in the judgment of LIPA, (i) is desirable in the conduct of its business, (ii) is not disadvantageous in any material respect to the Holders of Authority Obligations and (iii) does not materially impair the ability of the Authority and LIPA to comply with the Financing Agreement and the rate covenant set forth in the Resolution.

### **Competitive Facilities**

LIPA has covenanted that it will not construct, acquire, or operate, any plants, structures, facilities or properties which will provide electric service in the Service Area (as defined in the Act) unless the same are a part of the System.

### **Payment of Lawful Charges**

LIPA shall pay or cause to be paid, to the extent not paid by the Authority, all taxes and assessments or other municipal or governmental charges, if any, and all PILOTs to the extent not paid by the Authority, lawfully levied or assessed upon or in respect of the System, or upon any part thereof or upon the Revenues, when the same shall become due, and shall duly observe and comply in all material respects with all valid requirements of any municipal or governmental authority relative to any part of the System, and shall not create or suffer to be created any lien or charge upon the System or any part thereof or upon the Revenues therefrom, except the pledge and lien created by the Financing Agreement and by the Resolution for the payment of the principal and redemption price of and interest on, and other payments under, Authority Obligations. Nothing in the Resolution or the Financing Agreement shall be construed to prevent LIPA or the Authority from entering into agreements to make PILOTs.

### **Tax Rulings**

LIPA shall not do or omit to do any act that would result in (i) the revocation of the rulings that were issued by the Internal Revenue Service to the Authority, dated March 4, 1998, and (ii) a resultant material federal income tax liability.

### **Agreement of the State**

In accordance with the Act, the Authority, as agent for the State, pledges to and agrees with the holders of any obligations issued under the Act and the parties to any contracts with the Authority thereunder that the State will not limit or alter the rights thereby vested in the Authority until such obligations together with the interest thereon are fully met and discharged and/or such contracts are fully performed on the part of the Authority, provided that nothing in the Financing Agreement shall preclude such limitation or alteration if and when adequate provision shall be made by law for the protection of the holders of such obligations of the Authority, or those entering into such contracts with the Authority.

### **Events of Default**

An "event of default" means any one or more of the following events: (a) failure by LIPA to make the payments required to be made to the Authority pursuant to the Financing Agreement; (b) failure by LIPA to remit or cause to be remitted the Revenues, or any portion thereof, to the extent received by LIPA, for deposit in the Revenue Fund; (c) failure of LIPA to observe any covenant, term or condition of the Financing Agreement, provided that such failure shall have continued for a period of sixty (60) days after written notice, specifying such failure and requesting that it be remedied, is given to LIPA by the Authority, unless the Authority shall agree in writing to an extension of such time prior to its expiration, and provided further that such extension shall not be unreasonably withheld if LIPA has instituted and is diligently pursuing corrective action within the applicable period; (d) if LIPA (1) files a petition seeking a composition of its indebtedness under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (2) consents to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of LIPA or any substantial portion of its property; (3) makes any assignment for the benefit of creditors; (4) admits in writing its inability to pay its debts generally as they become due; or (5) takes action in furtherance of any of the foregoing; (e) if (1) a decree or order for relief is entered by a court having jurisdiction of LIPA adjudging LIPA a bankrupt or insolvent or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition in respect of LIPA in an involuntary case under the Federal bankruptcy laws, or under any other applicable law or statute of the United States of America or of the State; (2) a receiver, liquidator, assignee, custodian, trustee, sequestrator or other similar official of LIPA or of any substantial portion of its property is appointed; or (3) the winding up or liquidation of its affairs is ordered and the continuance of any such decree or order unstayed and in effect for a period of sixty (60) consecutive days; or (f) the respective provisions of the Act pursuant to which

the Resolution has been adopted or Authority Obligations have been issued or entered into, including, without limitation, those provisions pursuant to which the lien upon the Revenues has been created pursuant to the Financing Agreement and the Resolution and those provisions authorizing the establishment of LIPA, shall be materially and adversely limited, altered or impaired by any legislative action or any formal judgment or the terms, conditions and security provided under the Financing Agreement, Authority Obligations and the Resolution shall be materially and adversely limited, altered or impaired by any legislative action or any final judgment.

### **Remedies**

Whenever an event of default shall have occurred and be continuing, and written notice of the event of default, if required, shall have been given to LIPA by the Authority or by the Trustee and the event of default shall not have been cured within the period provided therefor, the Authority and the Trustee may take whatever action at law or in equity to collect the payments then due and as they thereafter become due, and the Authority and the Trustee, so long as any Bonds are outstanding, may take whatever action at law or in equity to enforce performance and observance of any obligation, agreement or covenant of LIPA under the Financing Agreement.

### **Termination**

The Financing Agreement terminates and the covenants and other obligations contained in the Financing Agreement are discharged and satisfied, when (i) payment of all Authority Obligations has been made or provided for in accordance with the Resolution and (ii) either all payments required thereunder have been made in full, or provision for such payments satisfactory to the Authority and the Trustee has been made or the Authority pays or assumes all liabilities, obligations, duties, rights and powers of LIPA thereunder.

### **Amendments to Agreement; Consents**

The parties to the Financing Agreement may enter into any amendment, change or modification of the Financing Agreement; provided, the parties shall not enter into or consent to, any amendment, change or modification which materially adversely affects the rights of the Owners of the Bonds by modifying or revoking certain enumerated provisions of the Financing Agreement without first obtaining the consent of the holders of or parties to Authority Obligations in accordance with and to the extent provided by the provisions of the Resolution.

### **Indemnity by LIPA**

To the extent permitted by law, LIPA releases and agrees to hold harmless and indemnify the Authority and its trustees, officers, officials, agents and employees from and against all, and agrees that the Authority and its trustees, officers, officials, agents and employees shall not be liable for any, (i) liabilities, suits, actions, claims, demands, damages, losses, expenses and costs of every kind and nature resulting from any action taken in accordance with, or permitted by the Financing Agreement, or the Resolution, or arising from or incurred by the Authority by reason of its incurrence of Authority Obligations pursuant to the Financing Agreement and the Resolution, or (ii) loss or damage to property or any injury to or death of any or all persons that may be occasioned by any cause whatsoever pertaining to the System arising by reason of or in connection with the presence on, in or about the premises of the System of any person; provided, however, that the indemnity shall be effective only to the extent of any loss or liability that may be sustained by the Authority or another party so indemnified by LIPA in excess of net proceeds received from any insurance carried with respect to such loss or liability.

## **Conflicts**

The Financing Agreement provides that its provisions shall not change or in any manner alter the terms of the Resolution, or the security, rights or remedies of the Trustee or the holders or owners of Authority Obligations. In the event any provision of the Financing Agreement conflicts at any time, or in any manner, with the provisions of the Resolution or any Authority Obligations, the provisions of the Resolution or Authority Obligations shall be controlling and conflicting provisions of the Financing Agreement shall be disregarded.

**SUMMARY OF OPERATING AGREEMENTS**  
**SUMMARY OF CERTAIN PROVISIONS OF THE**  
**MANAGEMENT SERVICES AGREEMENT**

The following is a brief summary of certain provisions of the Management Services Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Management Services Agreement, a copy of which is on file with the Trustee.

**General**

The Management Services Agreement establishes the terms and conditions under which the Authority has contracted with KeySpan and its subsidiaries (the "Manager") for the purpose of providing the Operation and Maintenance Services and the Construction Work relating to the T&D System in a manner consistent with policies established by LIPA in order to assure the continued delivery of electric energy to the customers of the T&D System.

**Ownership of the T&D System**

The Agreement provides that the Manager will not have any ownership or leasehold interest in the T&D System. LIPA has engaged the Manager as an independent contractor to furnish the services described in the Agreement.

The Agreement provides that the Manager will not, without LIPA's prior written consent, create or permit to be created or to remain, and will promptly discharge at its expense, any Encumbrance on the T&D System, other than (1) Encumbrances existing as of the date of the Agreement, or (2) any Lien affecting the T&D System (i) resulting solely from any action or failure to act by LIPA or anyone claiming by, through or under LIPA; or (ii) created by Subcontractors that are promptly discharged or bonded against by the Manager. The Agreement provides that nothing in the Agreement will be deemed to create any Lien or Encumbrance in favor of the Manager on any asset of LIPA as security for the obligations of LIPA under the Agreement.

**Operation of the T&D System**

**General.** The Agreement provides that the Manager will not transmit or distribute Power and Energy other than Power and Energy obtained by, on behalf of, or with the approval of LIPA, and will not use the T&D System for any purpose other than the purposes contemplated by the Agreement or to serve or benefit any person other than LIPA and its customers in the Service Area.

**Operation and Maintenance.** The Agreement provides that the Manager will provide Operation and Maintenance Services and Construction Work for the T&D System on behalf of LIPA in accordance with the Contract Standards. The Manager will be responsible for the safe and reliable operation and maintenance of the T&D System, management and/or performance of construction of improvements thereto and delivery of Power and Energy to LIPA's customers and will be responsible for the following tasks and services, among others: (a) day-to-day operation and maintenance of the T&D System; (b) construction activities performed by the Manager's work force; (c) supervision of routine and major capital improvements; (d) preparation of recommended and monitoring of approved annual capital and operating expenditure budgets, load and energy forecasts and long and short range system and strategic plans; (e) preparation of long and short range transmission and distribution planning analyses; (f) performance of accounting and tax and payment in lieu of tax reporting functions and preparation of monthly reports concerning the T&D System; (g) operation of the T&D System in compliance with applicable provisions of the bond resolutions, and with other requirements pertaining to qualification of the bonds for tax-exemption under the Code; (h) other actions necessary to safely and reliably operate the

T&D System in accordance with Prudent Utility Practice; (i) administration and management, at the direction of LIPA, of LIPA's interest in NMP2; and (j) billing and collection, in accordance with LIPA's direction, of all fees and charges in connection with the use or availability of the T&D System for wheeling services.

***Maintenance and Repair of T&D System.*** The Agreement provides that the Manager will maintain the T&D System, the T&D System Site and the Common Facilities in good working order and repair and in a neat and orderly condition, and will conduct periodic, corrective, and preventive maintenance and repair of the T&D System consistent with the Contract Standards for the purpose of, among other things, mitigating and preventing abnormal wear, tear and usage.

All additions to the T&D System purchased in conjunction or for the use with any part of the T&D System during the term of the Agreement shall be the property of LIPA, except those which are leased or constitute part of the Common Facilities.

***Performance Guarantees.*** The Agreement provides that the Manager will at all times comply with the Performance Guarantees, except to the extent excused by Uncontrollable Circumstances or Authority Fault. If the Manager fails to comply with any Performance Guarantee, the Manager shall, without relief under any other Performance Guarantee under the Agreement, (1) promptly notify LIPA of any such noncompliance, (2) promptly provide LIPA with copies of any notices sent to or received from any Governmental Body having regulatory jurisdiction with respect to any violations of Applicable Law, (3) promptly make any applicable payments provided for in the Agreement, and (4) at its own cost and expense to the extent required under the Agreement, promptly take any action necessary in order to comply with such Performance Guarantee, continue or resume performance under the Agreement and eliminate the cause of, and avoid or prevent recurrence of noncompliance with such Performance Guarantee.

***Rights and Responsibilities of LIPA.*** The Agreement provides that LIPA will retain the ultimate authority and control over the assets and operations of the T&D System and the right to direct the Manager in connection with the performance of the Manager's obligations under the Agreement. Without limiting the generality of the foregoing, LIPA's specific rights and responsibilities with respect to the T&D System include: (a) the right to determine all T&D System rates and charges, line extension policies and service rules and regulations applicable to the T&D System and System Power Supply; (b) the right to determine and to change from time to time, in its sole discretion, all policies and procedures for the T&D System consistent with Applicable Law and Prudent Utility Practice; (c) the right to review, amend as appropriate and approve annual capital and operating expenditure budgets pursuant to the procedures outlined in the Agreement and approve or in its discretion, develop, all long-range strategic plans for the T&D System and System Power Supply; and (d) to the extent the Manager acts as the representative of LIPA in connection with the North American Electric Reliability Council, Northeast Power Coordinating Council, the New York Power Pool, the NYISO and any other similar institutions or organizations, the right to direct the Manager's actions with respect thereto.

***Customer Services, Rates and Rules of Service.*** The Agreement provides that the Manager shall perform normal and customary customer services in a manner designed to achieve the highest level of customer service, including, but not limited to: customer account service and maintenance; service restorations account inquiry work; customer assistance, credit and collection services; cashiering; account connection and disconnection; and conservation advice.

The Agreement provides that the Manager shall, unless otherwise directed by LIPA, read the meters of electric commercial, industrial, residential heating and residential multiple rate period customers on a monthly basis and all other electric customer meters on a bi-monthly basis. The Manager shall, according to the schedule of rates, tariffs and policies (the "Schedule of Rates") then in effect, render bills to all T&D System customers in the name of LIPA for electric service delivered on behalf of



LIPA and in the format determined by LIPA. To the extent directed by LIPA, such bills will also reflect electric services provided to T&D System customers by other parties. LIPA may implement changes to such rates, rules of service, regulations and procedures by giving written notice to the Manager not later than sixty (60) days prior to the effective date of such change to the extent practicable given the nature of the change. The Manager will maintain customer bills and records as LIPA reasonably requests.

The Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for service provided to customers, and for other services, in accordance with the Schedule of Rates for the periods in which services were provided, and (2) other monies owed to LIPA pursuant to the operation of the T&D System. The Manager's responsibilities will also include the institution of legal proceedings in LIPA's name to collect utility billings and other monies owed LIPA related to the T&D System. All monies collected by the Manager or its Subcontractors will be the property of LIPA and will be deposited by the Manager daily in an account of LIPA specified pursuant to the Agreement. In collecting such monies, the Manager and any Subcontractor will act solely as an agent for LIPA and will have no right or claim to such moneys and, without limiting the generality of the foregoing, will have no right to assert a claim of set-off, recoupment, abatement, counterclaim or deduction for any amounts which may be owed to the Manager under the Agreement or with respect to any other matter in dispute thereunder.

In the event any electric customer who is also a gas customer who is billed in a single statement for gas and electric service pays less than the total amount due at any time under a single statement, the amounts collected will be applied pro rata between the amounts owed by such customer with respect to electric service and gas service. To the extent moneys are collected for any power supply services provided by any unrelated party, amounts collected will be allocated in accordance with the directions of LIPA. The Manager may elect to bill gas customers separately, provided that the Manager will bear all incremental costs arising by reason of any such election.

***Licenses, Permits and Approvals.*** The Manager will identify for LIPA, prepare, and with LIPA approval, make and prosecute all filings, applications and reports necessary to obtain and maintain all permits, licenses and approvals required to be made, obtained or maintained by each under Applicable Law in order to operate the T&D System.

***Operating Period Insurance.*** During the term of the Agreement, the Manager will obtain and maintain, the Required Operating Period Insurance as specified in accordance with the Agreement and will comply with all applicable Insurance Requirements.

#### ***Manager's Reporting Requirements***

***Monthly Reports.*** The Manager will provide LIPA and the Consulting Engineer with monthly reports no later than 15 Business Days after the end of each month, which include the following data: (1) on a monthly and year-to-date basis, the actual T&D System costs versus the Annual T&D Budget and the prior year's costs at such time, (2) a description and explanation of significant variations (at least \$1,000,000 and 3%) from the Annual T&D Budget or the prior year's results, (3) a description of partial or total shutdowns for maintenance and repairs during the prior month and anticipated during the current month, (4) any known or anticipated adverse conditions which may be expected to arise during the next 30 day period that may affect the ability of the Manager to transmit and distribute Power and Energy in accordance with the Performance Guarantees and the annual operating plan established for the T&D System, (5) identification of those costs which are classified as capital versus operating in sufficient detail in order to allow LIPA to determine which costs qualify for bonding under the Resolution and which are to be recovered through T&D System rates, and (6) any other information or statement which is requested by LIPA and which may be reasonably produced from records maintained by the Manager in the normal course of business. The Manager will also provide a quarterly forecast of projected expenditures by line item through year-end.

*Semi-Annual Reports.* The Manager will, on a semi-annual basis within 60 days after the end of each half of the Contract Year, provide LIPA and the Consulting Engineer with a report of actual Direct Costs and Third Party Costs together with identification of any material Direct Costs projects or Third Party Costs projects which were included in the Direct Cost Budget or the Third Party Cost Budget from the previous Contract Year which were deferred to the current Contract Year or proposed to be deferred to a subsequent Contract Year, or such costs in the current Contract Year which the Manager proposes deferring beyond the current Contract Year.

*Other Costs Reports.* The Manager will promptly notify LIPA when an event occurs, or is anticipated to occur, that the Manager believes qualifies for treatment as an Other Cost.

*Annual Reports.* The Manager will furnish LIPA and the Consulting Engineer with the Annual Settlement Statement, an annual summary of the statistical data provided in the monthly reports, certified by the Manager and the Manager's independent public accountants.

*Operations Reports.* The Manager will prepare appropriate reports concerning matters reasonably related to the operation of or planning for the T&D System, including, but not limited to: source of Power and Energy supply; revenues and unit sales of Power and Energy supplied to customers in the aggregate and by customer class; environmental requirements and compliance; compliance with Applicable Law; safety requirements and compliance; and reports relating to any incentive and penalty provisions set forth in the Agreement.

*Fiscal Affairs, Accounting and Record Keeping.* The Manager will maintain possession of operating equipment, buildings, materials and supplies, maps, plans, specifications, and customer billing records during the term of the Agreement in accordance with the Manager's customary practices or in such manner as LIPA may reasonably require. The Manager also will maintain LIPA's fixed asset books and records for those activities performed by the Manager in general conformity with municipal electric utility accounting standards or such other standards as reasonably requested by LIPA.

All cash held by the Manager for the account of LIPA and all cash collected by the Manager for the account of LIPA after the LIPA/LILCO Merger Closing Date will be deposited on each business day in bank accounts in such bank as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

*Purchase of Equipment, Materials and Services.* The Agreement provides that the Manager will arrange for the purchase or rental for the account of LIPA of equipment, materials, and supplies and services which are not purchased directly by LIPA or other items necessary to properly operate and maintain the T&D System and to maintain the records of LIPA, and to make such additions and extensions to the T&D System, all as may be required by LIPA. Subcontractors will be subject to approval by LIPA in accordance with the Agreement.

*Other Services.* The Manager will timely pay all bills related to the T&D System which are proper, appropriate and not otherwise disputed and which it has authority to pay and will assure that, to the extent within the Manager's control, no mechanic's or similar liens are filed against any portion of the T&D System.

## **Major Capital Improvements**

*Major Capital Improvements Generally.* The Major Capital Plan and Budget provided for in the Agreement is intended to provide for the implementation of major repairs and replacements not constituting routine maintenance of the T&D System. In addition, the Major Capital Plan and Budget is intended to recognize that it will be necessary or desirable from time to time during the term of the Agreement to modify, alter or improve the T&D System from its then-current condition. All such projects which constitute Major Capital Improvements will be made in accordance with the Agreement and will be

owned by LIPA. The Manager will not make a Major Capital Improvement without notifying LIPA and receiving written consent from LIPA unless such Major Capital Improvement is included in the then current annual Major Capital Plan and Budget. LIPA will have the right, when the Manager has materially exceeded the Major Capital Plan and Budget as of an interim date, to require the Manager to defer specific Major Capital Improvements planned for the remainder of the year.

**Major Capital Plan and Budget.** Contemporaneously with the preparation of the "Annual T&D Budget", the Manager is obligated to prepare a proposed annual and five year Major Capital Plan and Budget concerning planned Major Capital Improvement projects.

The annual Major Capital Plan and Budget will be approved by LIPA before or contemporaneously with the adoption of the Annual T&D Budget, provided that in the event the Major Capital Plan and Budget has not been adopted by LIPA as of the beginning of a Contract Year, the Manager may undertake such Major Capital Improvements as reasonably approved by LIPA on a project-by-project basis.

**Cost Determination.** Major Capital Improvements, except those awarded to the Manager as a result of the competitive procurement procedures established pursuant to the Agreement, will be performed at the cost of the service without any multiplier fee or mark-up.

The Manager will be entitled to incentive payments for cost savings and disincentive payments for cost overruns and delays in scheduled completion of approved Major Capital Improvements equal to 50% of all variances from the approved Major Capital Plan and Budget; provided, however, that no such incentive or disincentive will be payable for cost variances in excess of 15% of the approved Major Capital Plan and Budget. Incentives and disincentives will be trued-up upon the closing and acceptance by LIPA of approved capital projects.

**Public Works Improvements.** The Agreement provides that the budget for each Public Works Improvement will be subject to LIPA approval and the Manager will not undertake any Public Works Improvement until the budget therefor has been adopted.

Public Works Improvements will be performed at the cost of the service without any multiplier fee or mark-up; provided, however, that such costs will be reduced by all reimbursements or payments received from the applicable "Governmental Body" for the planning, engineering, procurement and completion of the Public Works Improvement. The Manager will be entitled to certain incentive payments for cost savings and disincentives for cost overruns and delays in scheduled completion that result in incremental costs for approved Public Works Improvement.

**Major Capital Improvements for which Manager is Responsible.** If the T&D System is damaged or destroyed by reason of circumstances for which the Manager is responsible, described below under the heading "Allocation of Risks of Certain Costs and Liabilities", the Manager shall promptly proceed to make or cause to be made all Major Capital Improvements reasonably necessary to permit the Manager to perform its obligations under this Agreement. All such Major Capital Improvements for which the Manager is responsible as described under the heading "Allocation of Risks of Certain Costs and Liabilities" shall be made at the Manager's sole cost and expense, and the Manager shall not be entitled to any compensation from LIPA as a result thereof.

## **Compensation and Budgets**

### **Service Fee**

**Formula.** Commencing with the first "Billing Period" and for each Billing Period during the term of the Agreement, LIPA will pay the Manager a Service Fee for the services provided by the Manager under the terms of the Agreement in accordance with the following formula:

$$SF = FDF + TPC + VP + CIF + NCPI$$

Where

SF	=	Service Fee
FDF	=	Fixed Direct Fee
TPC	=	Third Party Costs
VP	=	Variable Payment
CIF	=	Cost Incentive Fee
NCPI	=	Non-cost Performance Incentives and Disincentives

Each component of the Service Fee will be computed in accordance with the Agreement and may be adjusted from time to time as provided in the Agreement. In addition to the Service Fee, Manager will be entitled to payment for cost overruns as and to the extent as discussed below.

*Fixed Direct Fee.* LIPA will make a monthly payment to the Manager equal to ninety percent (90%) of the approved annual Direct Cost Budget (the "Fixed Direct Fee").

*Third Party Costs.* LIPA will make a monthly payment to the Manager for the monthly allocation of the approved annual Third Party Cost Budget.

*Variable Payment.* The Manager will be entitled to a Variable Payment equal to the lesser of (a) the difference between actual Total Costs (the sum of the actual Direct Costs and the actual Third Party Costs), less the sum of the Fixed Direct Fee and the lesser of actual or budgeted Third Party Costs or (b) the difference between the approved Total Cost Budget (the sum of the Direct Cost Budget and the Third Party Cost Budget) less the sum of the Fixed Direct Fee and the lesser of the actual or budgeted Third Party Costs. Monthly allocation of such payment will be determined by the parties based on historical monthly trends to minimize working capital costs.

*Management Fee, Cost Incentive Fee and Non-cost Performance Incentives and Disincentives.* To the extent actual Total Costs are less than the approved Total Cost Budget for the year, the Manager will be paid the portion of its Management Fee, described within the definition of Direct Costs as discussed below under the heading "Annual T&D Budget and Five Year Planning Budget" (relating to cost savings), in an amount equal to such cost savings up to a maximum of \$5 million. Beyond such \$5 million level, the Manager will be paid a Cost Incentive Fee equal to 50% of such additional savings, provided that no incentive will be paid for savings in excess of 15% of the Total Cost Budget. All savings above this cap will be for the benefit of LIPA.

*Cost Overruns.* To the extent actual Total Costs, excluding the Management Fee, are greater than the Total Cost Budget, excluding the net Management Fee, for the applicable Contract Year, the Manager will absorb the first dollars of such overruns, up to a maximum total of \$15 million in each Contract Year. For cost overruns in excess of this amount, the Manager will be entitled to a payment through the Annual Settlement Statement equal to the amount of such excess overruns (the "Overrun Payment").

*Limitations.* The Agreement provides that the ratio of (1) the sum of the Variable Payment plus the Cost Incentive Fee plus the sum of the Non-cost Performance Incentives and Disincentives (as discussed below under the heading "Non-Cost Performance Incentives and Disincentives") plus the Overrun Payment divided by (2) the sum of (a) the amounts described in (1) above and (b) the Fixed Direct Fee, will not be greater than twenty percent (20%) in any Contract Year.

### ***Annual T&D Budget and Five Year Planning Budget Process***

*General.* The Agreement provides that the Annual T&D Budget and the Five-Year Planning Budget will be established in the manner described below and will provide for the determination and payment of the Manager's costs of operating and maintaining the T&D System and performing its obligations under the Agreement, inclusive of fees paid to the Manager. The Annual T&D Budget and the Five-Year Planning Budget will be comprised of two broad categories: Direct Costs and Third Party Costs. These categories of costs will exclude Incremental Internal Costs and additional Third Party Costs relating to Major Capital Improvements, Public Works Improvements, and Other Costs.

In establishing the Direct Cost Budget for the initial Annual T&D Budget under the Agreement, the Direct Cost Budget will include (1) amounts to compensate the Manager for Operation and Maintenance Services costs anticipated to be reasonably predictable and incurred by the Manager through the utilization of either its work force, or its owned assets, in carrying out its responsibilities under the Agreement and (2) the Manager's fee.

The Third Party Cost Budget will include amounts for reimbursement of, on a dollar for dollar basis, all recurring capital or operating costs incurred by the Manager in carrying out its responsibilities under the Agreement and paid to parties other than the Manager, its parent or affiliates, and any of their employees.

The Manager will be entitled to receive Cost Incentive Fees, as discussed above under the heading "Service Fee", for costs savings from the amounts included for Direct Costs and Third Party Costs in the approved Annual T&D Budget.

*Annual T&D Budget Preparation.* The Agreement provides that no later than six months prior to the end of each Contract Year, the Manager will prepare a recommended annual budget for the operation and maintenance, including routine capital projects not constituting Major Capital Improvements or Public Works Improvements, of the T&D System and a recommended annual budget for total revenue requirements, inclusive of LIPA's own costs, with the costs that will be paid by LIPA to Manager under the Agreement specifically and separately identified (together, the "Annual T&D Budget"). The recommended Annual T&D Budget will be accompanied by the Five-Year Planning Budget. The Authority will hold at least one hearing to solicit public input on the initial budgets.

LIPA has established an initial Direct Cost Budget. Subsequent annual Direct Cost Budgets will be calculated based upon the initial Direct Cost Budget, subject to adjustments for the "Direct Cost Budget Indices" described in an appendix to the Agreement.

The Agreement provides that the Annual T&D Budget and Five-Year Planning Budget prepared by the Manager and submitted to LIPA for review and approval will be accompanied by any Manager-recommended rate adjustments for the upcoming year at least six months before the beginning of each subsequent Contract Year. The Agreement provides that LIPA will have 60 days to review the proposed Annual T&D Budget and Five-Year Planning Budget and any rate adjustments and to propose modifications as it deems appropriate, so as to have the Annual T&D Budget and the Five-Year Planning Budget adopted at least two months before the beginning of the next Contract Year. All rate proposals will be subject to public hearings prior to approval by LIPA.

*Other Costs.* The Agreement provides that "Other Costs" are those costs which cannot reasonably be anticipated and will include those costs the Manager and LIPA agree are not included in the Direct Cost Budget, Third Party Cost Budget or Major Capital Plan and Budget ("Other Costs"). Other Costs include the Incremental Internal Costs and additional Third Party Costs incurred by the Manager as a result of events (including but not limited to major storms and extreme weather) that the Manager and LIPA agree have caused costs to be incurred by the Manager to respond to significant (i) damage to or

adverse affects on the T&D System, (ii) changes in the level of required maintenance or operation of the T&D System, or (iii) tasks which are necessary for safety reasons.

Although Other Costs will not be budgeted, the Manager will recommend, and LIPA will adopt, an annual reserve level for Other Costs for each Annual T&D Budget and Five-Year Planning Budget to enable estimation of total "System Revenue Requirements," consisting of the sum of the annual Service Fee, plus an estimate of other costs plus debt service requirements on the Authority's Revenue Bonds plus the Authority's costs as reported to the Manager pursuant to the Agreement. The Manager will be reimbursed for reasonably incurred Other Costs.

***Non-Cost Performance Incentives and Disincentives.*** In addition to the cost saving incentives discussed above under the heading "Annual T&D Budget and Five Year Planning Budget Process," the Manager will be eligible for incentives for performance above certain threshold target levels of performance standards ("Non-cost Performance Incentives") and subject to disincentives for performance below certain other threshold minimum performance standard levels ("Non-cost Performance Disincentives"), with an intermediate band of performance in which neither incentives nor disincentives will apply, for reliability, worker safety, and customer service, all as provided in or established pursuant to the Agreement.

In any Contract Year in no event will the total of the Non-cost Performance Incentives, net of any applicable Non-cost Performance Disincentives, together with the System Power Supply Performance Incentive/Disincentive, be greater than \$7.5 million, nor will the total Non-cost Performance Disincentives, net of any applicable Non-cost Performance Incentives together with the System Power Supply Performance Incentive/Disincentive be greater than \$7.5 million.

***LIPA Non-Performance.*** If caused by an event the costs of which LIPA is responsible for as discussed below under the heading "Allocation of Risk of Certain Costs and Liabilities," there will be an increase in the Manager's cost of Construction Work or Operation and Maintenance Services, the amount of any such incremental cost increase will be borne by LIPA to the extent it is responsible therefor and will not be considered for purposes of calculating any incentive or disincentive thereunder.

If at any time the T&D System is damaged or destroyed due to an event for which LIPA is responsible, LIPA will pay all Major Capital Improvement Costs and adjustments as are required to be made by LIPA pursuant to applicable provisions of the Agreement.

***Manager Non-Performance.*** If due to an event for which the Manager is responsible as discussed below under the heading "Allocation of Risk of Certain Costs and Liabilities," there will be an increase in the Manager's cost of Construction Work or Operation and Maintenance Services, or in LIPA's costs associated with performing obligations under the Agreement, the amount of any such incremental cost increase will be borne by the Manager to the extent it is responsible therefor.

***Annual Settlement.*** The Agreement provides that the Manager will deliver to LIPA within 60 days after the end of each Contract Year, an Annual Settlement Statement, setting forth the actual aggregate Service Fee payable with respect to such Contract Year and a reconciliation of such amount with the amounts actually paid by LIPA pursuant to the billing statements. The Annual Settlement Statement will also include an accounting of any incentives or disincentives accrued during the applicable Contract Year which LIPA will have an opportunity to review prior to payment.

During the first quarter of the following Contract Year, the monthly payments made to the Manager by LIPA will be (i) reduced by any overpayment by LIPA or (ii) increased to reflect any Non-Cost Performance Incentive earned by the Manager during the previous year and/or any Overrun Payment due.

***LIPA's Payment Obligations.*** The Agreement provides that amounts payable to the Manager under the Agreement will be paid from T&D System revenues and other funds of LIPA available for such purposes in accordance with the terms of the Resolution.

The Agreement contemplates that if any billing disputes cannot be resolved within 30 days, either party may refer such dispute for resolution as discussed below under the heading "Non-Binding Mediation; Arbitration."

***Allocation of Risks of Certain Costs and Liabilities.*** The Agreement provides that except to the extent due to Subsidiary Fault (as determined by either a final non-appealable order or judgment of a court of competent jurisdiction (including administrative tribunals) or a final non-appealable binding arbitration decision), the Manager will be responsible and liable to LIPA for, and will not be entitled to reimbursement from LIPA for any Loss-and-Expense incurred by the Manager or LIPA,

(a) due to any gross negligence or willful misconduct by the Manager during the period commencing six months prior to the LIPA/LILCO Merger Closing Date to the extent LILCO knew or should have known of such gross negligence or willful misconduct and during the term of the Agreement in carrying out its obligations thereunder,

(b) due to any violation of or failure of compliance with Applicable Law by the Manager (except as provided below) during the period commencing six months prior to the LIPA/LILCO Merger Closing Date to the extent LILCO knew or should have known of such violation or failure of compliance and during the term of the Agreement which materially and adversely affects

(i) the condition or operations of the T&D System,

(ii) the financial condition of LIPA,

(iii) the performance or ability of the Manager to perform its obligations under the Agreement, or

(iv) the cost of providing electric service to the customers of the T&D System, provided, however, that Manager will not be responsible and liable to LIPA under the provisions of the Agreement described in this clause (b) with respect to any violation of, failure of compliance with, or liability under, Environmental Laws (as defined in the LIPA/LILCO Merger Agreement) for which LIPA or the Manager may be strictly liable provided that Manager (or for actions prior to the LIPA/LILCO Merger Closing Date, LILCO) acted in a manner consistent with Prudent Utility Practice. Notwithstanding the foregoing, Manager will in all events be liable for any fine or penalty arising by reason of any violation of or failure of compliance with Applicable Law for acts or omissions of the Manager not consistent with Prudent Utility Practice,

(c) due to any criminal violation of Applicable Law by the Manager (or for actions prior to the LIPA/LILCO Merger Closing Date, LILCO), or

(d) due to an event which gives rise to a cost not included in the Direct Cost Budget or Third Party Cost Budget or a cost incurred with respect to Major Capital Improvements or Public Works Improvements, that is incurred by reason of actions or omissions of the Manager not consistent with Prudent Utility Practice.

***Default, Termination For Cause And Dispute Resolution***

***Remedies for Breach.*** Subject to the provisions of the Agreement described below under the heading "Non-Binding Mediation; Arbitration," in the event that either party breaches any other

obligation under the Agreement or any representation made by either party under the Agreement is untrue in any material respect, the other party will have the right to take any action at law or in equity it may have to enforce the payment of any damages or the performance of such other obligation under the Agreement and such right to recover damages or to be reimbursed as provided therein will ordinarily constitute an adequate remedy for any breach of such other obligation or any material untruth in any such representation. Either party may enforce by an action for specific performance the other party's obligations under the Agreement in the event a material breach thereof has occurred and is continuing. Neither party will have the right to terminate the Agreement for cause except after an Event of Default determined in accordance with the provisions of the Agreement has occurred.

***Events of Default by the Manager***

(1) *Events of Default Not Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement without any requirement of cure opportunity:

(a) *Change of Control.* Change of Control of the Manager, the Parent or the Guarantor; provided, however, that the combination effectuated under the BUG/LILCO Agreement or the LIPA/LILCO Merger Agreement shall not constitute a Change of Control of the Manager for purposes of this provision.

(b) *Worker Safety/Customer Service.* Failure for two out of three consecutive years, for reasons other than major storms or extreme weather, to achieve the "Minimum Worker Safety Standard" or "Minimum Customer Service Standard," as such standards are established in accordance with appendices to the Agreement.

(c) *Bankruptcy.* Certain voluntary or involuntary events relating to bankruptcy affecting the Manager, the Parent or the Guarantor.

(d) *Credit Enhancement.* Failure of the Manager to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see "General—Credit Enhancement in Certain Circumstances" below).

(e) *Letter of Credit Draw.* Failure of the Manager to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see "General—Credit Enhancement in Certain Circumstances" below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

(2) *Events of Default Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

(a) *System Reliability.* Failure to achieve, for two out of three consecutive years, the "Minimum Reliability Standard" specified in the Agreement.

(b) *Failure to Pay or Credit.* Failure of the Manager to pay or credit undisputed amounts owed to LIPA under the Agreement within 90 days following the applicable due date.

(c) *Failure to Comply with Agreement or Guaranty.* The failure or refusal of the Manager to perform any material obligation under the Agreement, or the failure of the Guarantor to comply with any of its material obligations under the Guaranty unless such failure or refusal is excused by an Uncontrollable Circumstance or Subsidiary Fault; except that no such failure or refusal in clause (b) or (c) will constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to the Manager or the Guarantor and the Manager or the Guarantor, as applicable, has neither challenged in an



appropriate forum LIPA's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if the Manager or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as the Manager or the Guarantor is continuing to take such steps to correct such default).

**Events of Default by LIPA.** Each of the following shall constitute an Event of Default on the part of LIPA for which the Manager may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

(a) *Failure to Pay.* The failure of LIPA to pay undisputed amounts owed to the Manager under the Agreement within 90 days following the due date for such payment.

(b) *Failure to Comply with Agreement.* The failure or refusal by LIPA to perform any material obligation under the Agreement unless such failure or refusal is excused by an Uncontrollable Circumstance or Manager Fault; except that no such failure or refusal will constitute an Event of Default giving the Manager the right to terminate the Agreement for cause unless the Manager has given prior written notice to LIPA and LIPA has neither challenged in an appropriate forum the Manager's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA is continuing to take such steps to correct such default).

(c) *Change of Control of LIPA.* A change of control of LIPA which results in ownership control of LIPA by other than a state public benefit corporation, authority, political subdivision or other instrumentality of the State or any political subdivision thereof.

**Procedure for Termination for Cause.** If any party has a right of termination for cause, the right may be exercised by giving a notice of termination for cause to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default or a Change of Control, simultaneously with, or, in the case of an Event of Default as discussed above under the heading "Events of Default by LIPA," six months) the date of termination specified in such notice (the "Termination Date").

#### ***Non-Binding Mediation; Arbitration***

The Agreement provides that any dispute arising out of or relating to the Agreement will be resolved in accordance with the mediation and arbitration procedures for the resolution of such disputes established by the Agreement, which shall constitute the sole and exclusive procedures for the resolution of such disputes.

Either party may, without prejudice to any negotiation, mediation, or arbitration procedures, proceed in any court to obtain provisional judicial relief if, in such party's sole discretion, such action is necessary to avoid imminent irreparable harm, to provide uninterrupted electrical and other services, or to preserve the status quo pending the conclusion of the dispute procedures specified in the Agreement.

#### ***Provisional Relief***

**LIPA Emergency Powers.** The Agreement provides that if the Manager, due to Uncontrollable Circumstances or any other reason whatsoever, fails to provide any Operation and Maintenance Services and Construction Work contemplated by the Agreement and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then LIPA will have the right, upon notice to the Manager, during the period of such emergency, to take possession of and use any or all of the Operating Assets necessary to transmit and distribute Power and Energy which the Manager would

otherwise be obligated to transmit and distribute. The Manager will fully cooperate with LIPA to effect such a temporary transfer of possession of the Operating Assets for LIPA's use of the same.

## **Term**

***Term of Agreement.*** The Agreement commenced on June 26, 1997 and will continue in effect until December 31, 2008, unless earlier terminated in accordance with its terms.

***Competitive Selection of Future Managers.*** LIPA will conduct a competitive procurement for T&D System management services following December 31, 2005. The Manager will have the right or be ineligible to submit a bid in such procurement on the same basis as other bidders unless the Agreement is terminated due to an Event of Default of the Manager. The Manager is obligated to cooperate with LIPA during such procurement process.

## **Miscellaneous Provisions**

***Affiliate.*** Pursuant to the Agreement, the Manager has agreed to remain an Affiliate of the Guarantor.

***Credit Enhancement in Certain Circumstances.*** The Agreement provides that if the Guarantor's credit rating declines below investment grade, then the Manager shall provide credit enhancement of its obligations under the Agreement in the form of either (i) an unconditional guarantee of all of GENCO's obligations under the Power Supply Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, in a face amount of \$60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade. The amount of such letter of credit shall be reduced by \$30,000,000 if the Energy Management Agreement has theretofore been or is thereafter terminated and by \$4,000,000 if the Power Supply Agreement has theretofore been or is thereafter terminated, such obligation to continue until the expiration or termination of the Agreement, the Power Supply Agreement and the Energy Management Agreement.

***Uncontrollable Circumstances Generally.*** Except as otherwise specifically provided in the Agreement, neither LIPA nor the Manager will be liable to the other for any failure or delay in performance of any obligation under the Agreement to the extent due to the occurrence of an Uncontrollable Circumstance.

***Indemnification.*** The Agreement provides that the Manager, to the extent permitted by law, will protect, indemnify and hold harmless LIPA and its respective representatives, trustees, officers, employees and subcontractors (as applicable in the circumstances), (the "LIPA Indemnified Parties") from and against (and pay the full amount of) any Loss-and-Expense and will defend LIPA Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of any matter for which the Manager is responsible under the caption "Allocation of Risk of Certain Costs and Liabilities" in the Agreement and LIPA, to the extent permitted by law, will protect, indemnify and hold harmless the Manager Indemnified Parties from and against (and pay the full amount of) any Loss-and-Expense, and will defend the Manager Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of any matter for which LIPA is responsible under the caption "Allocation of Risk of Certain Costs and Liabilities" in the Agreement. The foregoing indemnifications are subject to certain exceptions, including the negligence or other wrongful conduct of any indemnified party and any Uncontrollable Circumstance.

**Assignment and Transfer.** The Agreement may be assigned by either party only with the prior written consent of the other party, except that without the consent of the other party (1) LIPA may make such assignments, create such security interests in its rights thereunder and pledge such monies receivable thereunder as may be required in connection with issuance of Revenue Bonds; (2) LIPA may assign its rights, obligations and interests thereunder, or transfer such rights and obligations by operation of law, to any other governmental entity or to a subsidiary of LIPA provided that the successor entity gives reasonable assurances to the Manager that it will be able to fulfill LIPA's obligations thereunder; and (3) the Manager may assign its rights, obligations and interests thereunder to the Parent or any Affiliate thereof except that the Manager may not, without the consent of LIPA, make any assignment or other transfer to any person of its rights and obligations under the Agreement unless the Guaranty is and remains in full force and effect and unless the Guarantor or a majority-owned direct or indirect subsidiary of the Guarantor will have control of and responsibility for the Operation and Maintenance Services and any Construction Work. The Authority may assign its rights, obligations and interests under the Agreement to LILCO (then a wholly-owned subsidiary of the Authority) and the Manager shall assign all of its rights, obligations and interests under the Agreement to the Parent or any Affiliate thereof.

### **SUMMARY OF CERTAIN PROVISIONS OF THE POWER SUPPLY AGREEMENT**

The following is a brief summary of certain provisions of the Power Supply Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Power Supply Agreement, a copy of which is on file with the Trustee.

#### **General**

The Power Supply Agreement sets forth the terms and conditions for the sale and delivery of electric capacity and energy by BL Holding Corp. and its subsidiaries ("GENCO") to LIPA.

#### **Power Supply**

**Delivery of Power.** The Agreement provides that during the term of the Agreement GENCO shall sell and deliver to LIPA, and LIPA shall purchase and accept delivery from GENCO of, (i) all the capacity from the GENCO Generating Facilities, and (ii) all the energy that GENCO produces from the GENCO Generating Facilities, in accordance with the Agreement, that LIPA requests to meet the electricity requirements of its retail and wholesale electricity customers (regardless of whether located inside or outside the Service Area). The Agreement also provides that GENCO will provide the various Ancillary Services as required by LIPA, and LIPA shall pay for any associated costs not otherwise compensated by LIPA.

**Sale or Assignment of Generating Units.** The Agreement provides that GENCO shall not sell or otherwise assign any interest in any of its generating units (as set forth in an appendix to the Agreement) except for (i) liens securing bona fide debt or other encumbrances incurred in the ordinary course of business, (ii) capital leases, or (iii) sales or assignments made with LIPA's prior written consent, which consent shall be deemed to have been given in respect of certain easements specified in the Agreement.

**Transmission Requirements.** The Agreement provides that LIPA is responsible for all transmission reinforcements required in conformance with Prudent Utility Practice for any new generation, including any new interconnections and other T&D System requirements regardless of their location, sufficient to maintain the delivery of electricity from the GENCO Generating Facilities onto the T&D System. The additional costs charged to GENCO for such transmission reinforcements will not be greater than if such costs were allocated to all of the LIPA Electricity Customers and transmission service customers on an average system basis.

### **Purchase Price and Payment**

The Agreement provides that during the term of the Agreement LIPA will pay to GENCO monthly an amount equal to the aggregate of the following components:

- (i) a capacity charge to compensate GENCO for its fixed costs of generating electricity from the GENCO Generating Facilities,
- (ii) a variable charge based on the variable operation and maintenance costs as established by the Agreement, multiplied by the actual MWh of operation of the GENCO Generating Facilities,
- (iii) a charge for any costs incurred by GENCO in providing certain Ancillary Services to LIPA, if any such services are required by LIPA which are not otherwise compensated by the charges described in items (i) and (ii) above,
- (iv) a charge for non-variable related expenses net of insurance proceeds, that cannot be planned for with any certainty and are outside the control of GENCO, and
- (v) certain other miscellaneous charges as specified in the Agreement.

### **Budgets**

Pursuant to the Agreement, GENCO and LIPA have agreed to an initial five-year plan which provides details on the fixed and variable costs of operating the GENCO Generating Facilities. The budget establishes the monthly capacity charge and the monthly variable charge for the first year of the five-year period, which forms the basis for adjustment for subsequent years in such period in accordance with the terms of the Agreement.

The Agreement provides that prior to the commencement of each successive five-year period during the term of the Agreement, GENCO shall prepare and submit to LIPA for review and approval a proposed five-year budget plan. If GENCO and LIPA are unable to reach agreement concerning the budget plan, those portions that are in dispute shall be resolved in a proceeding before the FERC.

The Agreement also provides that GENCO shall annually prepare and submit to LIPA a rolling Five Year Capital Improvement Budget for incremental capital expenditures and associated rate adjustments for LIPA's review and approval.

### **Capacity Ramp Down Option**

The Agreement provides that, commencing in the seventh year of the Agreement, LIPA may determine to reduce the amount of capacity purchased from GENCO. In any such an event, LIPA shall immediately reimburse GENCO for the capacity charges in the amount set forth in the Agreement that would have been recovered from LIPA over the remaining portion of the original term of the Agreement. The Agreement provides that such reduction may not be greater than 1500 MW.

### **Term and Termination**

**Term.** The Agreement commenced on May 28, 1998 for an initial term of fifteen (15) years. The Agreement provides that it shall terminate upon the purchase of the GENCO Generating Facilities by LIPA as provided for under the Generation Purchase Right Agreement attached to the LIPA/LILCO Merger Agreement.

**Termination for Cause by GENCO.** The Agreement provides that GENCO shall have the right to terminate the Agreement for cause if one of the following events shall have occurred:

(1) *Failure to Pay.* The failure of LIPA to pay undisputed amounts owed to GENCO under the Agreement within 90 days of such amounts having become due.

(2) *Failure to Comply with Agreement.* The failure or refusal by LIPA substantially to perform any material obligation under the Agreement unless such failure or refusal is excused by force majeure (as defined in the Agreement), except that the Agreement further provides that no such failure or refusal to pay or perform as referenced in these clauses (1) and (2) shall constitute an Event of Default giving GENCO the right to terminate the Agreement for cause unless GENCO has given prior written notice to LIPA stating that a specified failure or refusal to perform exists and LIPA has neither challenged in an appropriate forum GENCO's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA is continuing to take such steps to correct such default).

***Termination For Cause by LIPA.*** The Agreement provides that LIPA shall have the right to terminate the Agreement for cause after one of the following Events of Default as determined in accordance with the provisions of the Agreement shall have occurred:

(1) *Events of Default Not Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement without any requirement of cure opportunity:

(a) *Change of Control of GENCO.* Change of Control of GENCO or the Guarantor has occurred; provided, however, that the combination effectuated under the LIPA/LILCO Merger Agreement shall not constitute a Change of Control of GENCO for purposes of this provision.

(b) *Bankruptcy.* Certain voluntary or involuntary events relating to bankruptcy affecting GENCO or the Guarantor.

(c) *Credit Enhancement.* Failure of GENCO to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement in the event there is a Material Decline in the Guarantor's Credit Standing (see below, "Credit Enhancement in Certain Circumstances" below).

(d) *Letter of Credit Draw.* Failure of GENCO to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see "Credit Enhancement in Certain Circumstances" below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

(2) *Events of Default Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions of the Agreement described below:

(a) *Failure to Comply with Agreement.* The failure or refusal by GENCO to substantially perform any material obligation under the Agreement, except that no such failure or refusal shall constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to GENCO or the Guarantor, as applicable, stating that a specified failure or refusal to perform exists and GENCO or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if GENCO or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an

Event of Default for as long as GENCO or the Guarantor is continuing to take such steps to correct such default).

***Procedure for Termination for Cause.*** If either GENCO or LIPA shall have a right of termination for cause in accordance with the provisions of the Agreement outlined above, the same may be exercised by notice of termination given to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default or a Change of Control, simultaneously with or, in the case of an event of default described in clauses (1)(c) or (1)(d) above, six months) the date of termination specified in such notice.

#### **Non-binding Mediation; Arbitration**

The Agreement provides that any dispute arising out of or relating to the Agreement shall be resolved in accordance with the mediation and arbitration procedures for the resolution of such disputes established by the Agreement which shall constitute the sole and exclusive procedures for the resolution of such disputes.

#### **Affiliate**

Pursuant to the Agreement, GENCO has agreed to remain an Affiliate of the Guarantor.

#### **Credit Enhancement in Certain Circumstances**

The Agreement provides that if the Guarantor's credit rating declines below investment grade, then GENCO shall provide credit enhancement of its obligations under the Agreement at its sole cost and expense in the form of either (i) an unconditional guarantee of all of GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, in a face amount of \$60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade.

#### **Allocation of Risk of Certain Costs and Liabilities**

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Allocation of Risks of Certain Costs and Liabilities."

### **SUMMARY OF CERTAIN PROVISIONS OF THE ENERGY MANAGEMENT AGREEMENT**

The following is a brief summary of the Energy Management Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Energy Management Agreement, a copy of which is on file with the Trustee.

#### **General**

The Energy Management Agreement establishes the terms and conditions for the management by the KeySpan subsidiary party thereto (the "Energy Manager") of fuel supplies used at the GENCO Generating Facilities to produce electric energy for delivery to LIPA, and for management and administration of the System Power Supply on behalf of LIPA in a manner consistent with policies established by LIPA.

## **Scope of Energy Management Services**

As described in the Agreement, the Energy Manager is responsible for (a) fuel procurement, delivery, storage, and management for GENCO Generating Facilities to meet the energy generation requirements of the Electricity Customers, (b) the dispatch of all System Power Supply available to LIPA to meet total capacity and energy requirements of the Electricity Customers and Off-System Sales, (c) the purchase, on behalf of LIPA, of all capacity and energy to meet the needs of the Electricity Customers and (d) the sale, on behalf of LIPA, of Electricity owned by, or under contract to, LIPA which is not otherwise required to meet the needs of the Electricity Customers. The Agreement provides that all such responsibilities will be discharged in a manner consistent with Prudent Utility Practice, the System Policies and Procedures and New York State Public Service Commission policies and procedures pertaining to retail gas customer service. In discharging all such functions, the Energy Manager is obligated to use best efforts to obtain the least-cost fuel and least-cost capacity and energy for the benefit of the Electricity Customers.

The Energy Manager agrees to establish policies and procedures satisfactory to LIPA designed to assure that the Energy Manager's responsibilities are performed without consideration of the ownership or economic return to the Energy Manager or its Affiliates, except for the incentive provisions of the Agreement (described below at "Fuel Management—Fuel Management Compensation—Fuel Purchase Performance Incentives/Disincentive Payments"), and comply with such policies and procedures.

The Agreement provides that in no event will the Energy Manager take title to Electricity being purchased or sold thereunder.

## **Fuel Management**

**Fuel Management Services.** The Agreement provides that the Energy Manager will manage all aspects of the Fuel supply for the GENCO Generating Facilities, including determinations regarding the type of Fuel used for operating the GENCO Generating Facilities and the source of such Fuel supply taking into account the purchase of alternate sources of Electricity in lieu of Electricity from the GENCO Generating Facilities when economic. LIPA agrees to compensate the Energy Manager for such Fuel management services, including a Fuel Purchase Performance Incentive/Disincentive Payment, in accordance with the terms of the Agreement (see "Fuel Management—Fuel Purchase Performance Incentives/Disincentive Payments" below). The Energy Manager will not contract for additional firm assets specifically for use in the GENCO Generating Facilities unless LIPA and the Energy Manager agree to the contract.

**Fuel Management Compensation.** During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the Monthly Fuel Management Fee, plus (ii) the Monthly Fuel Payment, plus or minus (iii) the Fuel Purchase Performance Incentive/Disincentive.

**Fuel Management Fee.** The Energy Manager will be paid an annual Fuel Management Fee in consideration for the Energy Manager's performance of the Fuel Services contemplated in the Agreement. The Agreement provides that the cost-related component of the initial Fuel Management Fee, once established and approved by LIPA, will be indexed in the same manner as the Direct Cost Budget under the Management Services Agreement until the termination of the Management Services Agreement and thereafter will be subject to mutually agreeable adjustments. LIPA is obligated to pay the Fuel Management Fee to the Energy Manager in twelve equal monthly installments.

**Monthly Fuel Payment.** LIPA will, in accordance with the provisions discussed below at "Fuel Management—Payment," pay the total monthly cost of all Fuel for use in the GENCO Generating Facilities that are under contract to LIPA pursuant to the Power Supply Agreement, including but not limited to any current or future fuel related taxes or other fuel related fees or costs reasonably incurred by

the Energy Manager. This cost will be based upon (a) the actual variable cost of gas delivered to the delivery points for such fuel plus (i) any incremental Firm Gas Supply costs which are incurred based on use of Firm Gas Supplies in the operation of the GENCO Generating Facilities, (ii) any costs the Energy Manager incurs based on non-use of gas it has otherwise contracted to purchase for use in the operation of the GENCO Generating Facilities, and (iii) the Local Transportation Charge and (b) the delivered cost of oil for use in GENCO's Generating Facilities.

***Fuel Purchase Performance Incentives/Disincentive Payments.*** The Energy Manager will receive a Fuel Purchase Performance Incentive/Disincentive Payment, which will be calculated at the end of each month, with the results reflected in the following month's invoice. The total Fuel Purchase Performance Incentive/Disincentive Payment will not exceed \$5.0 million on an annual basis.

***Payment.*** The Energy Manager will submit monthly invoices to LIPA for the Monthly Fuel Management Fee and the Fuel Purchase Performance Incentive/Disincentive Payment by the tenth (10th) Business Day following the month of service, consistent with the provisions in this description of "Fuel Management." Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15) Business Days of LIPA receiving such invoices.

***Minimization of Costs.*** In providing the Fuel, Energy Manager shall use best efforts to minimize Fuel costs for the GENCO Generating Facilities, such efforts being consistent with (i) all applicable insurance policies, (ii) all applicable prudent industry practices and standards, including Prudent Utility Practice, (iii) all applicable operating and contract constraints for Fuel delivery, (iv) Energy Manager's collective bargaining agreements and (v) Applicable Law.

#### **Off-System Sales**

The Agreement provides that the Energy Manager will use best efforts to market to Off-System Sales customers, on LIPA's behalf, Electricity from the System Power Supply that is not otherwise needed by the Electricity Customers in a manner which will reduce the net cost of Electricity provided to the Electricity Customers. The Energy Manager will receive 33 percent of the revenue net of incremental costs from Off-System Sales of Electricity from the System Power Supply and LIPA will receive 67 percent of the revenue net of incremental costs from these Off-System Sales of Electricity from the System Power Supply. The incremental costs for such Off-System Sales will be based upon the incremental cost of energy for such Electricity sales including any other costs or charges (including applicable taxes) incurred to produce and deliver the Electricity and/or Ancillary Services for sale by the Energy Manager. The incremental costs associated with capacity sales will include the cost of replacement capacity incurred as a result of the sale, if any, and any other costs or charges related to the sale, including startup, no-load operation, transmission, and applicable taxes.

Notwithstanding any of the above, the Energy Manager will only attempt to sell excess Electricity to the extent that, in GENCO's judgment, such Electricity sales do not jeopardize any of GENCO's tax-exempt debt and to the extent that, in LIPA's judgment, such Electricity sales do not jeopardize the tax-exempt status of any of the Authority's debt. Each party will furnish the other an appropriately detailed description of the constraints imposed on such sales and will update such description from time to time to reflect any applicable changes in law or regulation.

#### **System Power Supply Management**

***Lowest Cost Electricity.*** In connection with the purchase and management of the System Power Supply, on LIPA's behalf, the Energy Manager is obligated to use best efforts to provide the lowest cost Electricity to the T&D System and the Electricity Customers, given (i) the transmission and distribution limitations unique and/or external to the T&D System; (ii) the terms of the Existing Power Supply Agreements; (iii) availability of power through the New York Power Pool or its successor; (iv) regulatory



and reliability council requirements, including, but not limited to system safety and reliability; and (v) System Policies and Procedures, including environmental policies contained therein.

***Specific Energy Manager Responsibilities.*** In implementing its System Power Supply responsibilities, the Energy Manager will, subject to the transmission, contractual and reliability constraints referred to in the preceding paragraph:

- (i) schedule deliveries of and Dispatch energy from the System Power Supply;
- (ii) arrange for LIPA's purchase of Electricity to the extent the System Power Supply is insufficient to meet the requirements of the T&D System;
- (iii) continually monitor the market for LIPA's sale and purchase of wholesale Electricity and purchase Electricity, on LIPA's behalf, on the wholesale market to displace System Power Supply if such purchases, including the cost of transmission services to deliver such Electricity, will reduce total power supply costs;
- (iv) sell Electricity on LIPA's behalf from the System Power Supply that is surplus to the requirements of the T&D System whenever such sales, including consideration of any incremental cost of Transmission for delivery of such sales, are advantageous to LIPA;
- (v) arrange for such additional transmission services and capacity as will be necessary for the purchase or sale of Electricity by LIPA; and
- (vi) with the prior written consent of LIPA, subcontract with power marketers or brokers, or similar entities, to assist in the acquisition of Electricity and the marketing and sale of excess Electricity.

All contracts for the purchase or sale of Electricity will be entered into by LIPA or by the Energy Manager as agent for LIPA. The Agreement provides that no contract for the purchase or sale of Electricity for a term in excess of three months will be entered into without the prior written consent of LIPA.

***System Power Supply Management Compensation.*** Except as otherwise provided in the Agreement, the payments LIPA will make to the Energy Manager pursuant to the Agreement with respect to System Power Supply Services other than Off-System Sales will be calculated as set forth in the Agreement and as summarized below. During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the System Power Supply Management Fee, plus or minus (ii) the System Power Supply Performance Incentive/Disincentive.

***System Power Supply Management Fee.*** The Energy Manager will be paid an annual System Power Supply Management Fee, in consideration for the Energy Manager's performance of the System Power Supply management services contemplated in the Agreement. The amount of such System Power Supply Management Fee includes a fee of \$750,000 and an allowance for certain costs which, for 1998, was established at \$868,000. Such allowance for costs is indexed during the term of the Agreement in the same manner as the Direct Cost Budget under the Management Services Agreement. LIPA will pay the System Power Supply Management Fee to the Energy Manager in twelve equal monthly installments.

***System Power Supply Performance Incentives/Disincentive.*** The Energy Manager will receive a System Power Supply Performance Incentive/Disincentive, calculated in accordance with the Agreement which will not exceed \$2 million on an annual basis.

***Payment.*** The Energy Manager will submit monthly invoices to LIPA for the Monthly System Power Supply Management Fee and the System Power Supply Performance Incentive/Disincentive Payments and Off-System Sales compensation by the tenth (10th) Business Day following the month of service. Such invoices will show separately amounts payable with respect to Off System Sales and System Power Supply Management. Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15) Business Days of LIPA receiving such invoices.

## **Records; Information**

### ***Account Records; Collection of Monies; Availability of Energy Manager***

***Account Records.*** The Energy Manager is obligated to maintain such records as LIPA reasonably requests setting forth in accurate and reasonable detail the information relating to the purchase and sale of Fuel and Electricity under the Agreement requested by LIPA.

***Collection of Monies.*** The Energy Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for Off-System Sales, and (2) any other monies owed to LIPA in connection with System Power Supply and other matters within the purview of the Energy Manager. The Energy Manager will provide current and historical billing information concerning Fuel and System Power Supply to LIPA monthly in such form as reasonably requested by LIPA. All such monies collected by the Energy Manager or any Subcontractor thereto will be the property of LIPA and will be deposited by the Energy Manager daily into such accounts and in the manner as LIPA may from time to time designate. The Energy Manager is unconditionally and absolutely obligated to pay or deposit such moneys as directed by LIPA.

***Compliance with Applicable Law.*** The Energy Manager is obligated to perform all of its obligations under the Agreement in accordance with Applicable Law.

***Information.*** The Agreement requires the Energy Manager to establish and maintain an information system to provide storage and real time retrieval for LIPA review and copying of operating data relating to (i) cost and quantities of Fuel Supply and Power Purchases, (ii) revenues from and quantities of Off-System Sales and (iii) the performance by the Energy Manager of its obligations under the Agreement, including, but not limited to, all information necessary to verify calculations made pursuant to the Agreement.

***Books and Records.*** The Energy Manager will prepare and maintain proper, accurate and complete books, records and accounts regarding Fuel and System Power Supply to the extent necessary (1) to enable LIPA to prepare LIPA's financial statements in accordance with generally accepted accounting principles, (2) to verify data with respect to any operations or transactions in which LIPA has a financial or other material interest under the Agreement, (3) to prepare periodic performance reports and statements relating to purchase of Fuel and System Power Supply, which will be submitted by the Energy Manager to LIPA and (4) to enable LIPA to administer any fuel adjustment clause or similar provision applicable to Electricity sales. The Energy Manager will, upon notice and demand from LIPA, produce for examination and copying by representatives of LIPA, any document showing all acts and transactions relating to the Agreement, any Subcontract or any transactions in which LIPA has or may have a financial or other material interest under the Agreement, and will produce such operation books and records for examination and copying in connection with the costs for which LIPA may be responsible under the Agreement.

### ***Fiscal Affairs, Accounting and Record Keeping***

***General.*** The Energy Manager will maintain possession of equipment, materials and supplies, maps, plans and specifications, and Fuel and System Power Supply billing records during the term of the Agreement and will duly account to LIPA for such items.

**Bank Deposits.** All cash held by the Energy Manager for the account of LIPA and all cash collected by the Energy Manager for the account of LIPA after the LIPA/LILCO Merger Closing Date will be deposited on each Business Day in bank accounts in such bank or banks as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

**Bill Payments.** The Energy Manager will timely pay all bills related to Fuel which are proper and appropriate and which it has authority to pay and will assure that, to the extent within the Energy Manager's control, no liens are filed against any portion of the assets or revenues of LIPA.

#### **Allocation of Risk of Certain Costs and Liabilities**

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budgets—Allocation of Risks of Certain Costs and Liabilities."

#### **Term; Events of Default**

**Term.** The term of the Agreement commenced on May 28, 1998 and, except as otherwise provided therein, will remain in full force and effect for an initial term of (i) fifteen (15) years from such date with respect to the Fuel Services and (ii) eight (8) years from such date with respect to System Power Supply Services.

#### **Events of Default; Procedures for Termination**

The Agreement contains provisions relating to Events of Default by the Energy Manager or LIPA and the procedures for termination that are substantially the same as the provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Events of Default by the Manager—Events of Default by LIPA" and "—Procedure for Termination for Cause."

**LIPA Emergency Assumption of Fuel and System Power Supply Management Services.** Should the Energy Manager, due to Uncontrollable Circumstances or any other reason whatsoever, fail, refuse or be unable to provide any or all Fuel and System Power Supply Services contemplated hereby and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then, in any of those events and to the extent of such failure, LIPA will have the right, upon notice to the Energy Manager, during the period of such emergency, to perform the services which the Energy Manager would otherwise be obligated to perform under the Agreement. The Energy Manager agrees that in such event it will fully cooperate with LIPA to effect such a temporary assumption.

#### **Energy Manager's Reporting Requirements**

**Monthly Reports.** The Energy Manager is obligated to provide LIPA and the Consulting Engineer with monthly reports no later than 20 days after the end of each month, including such data relating to the Fuel Services and System Power Supply Services as may reasonably be requested to be furnished by LIPA.

**Annual Reports.** The Energy Manager will furnish LIPA and, the Consulting Engineer, within 60 days after the end of each Contract Year, an Annual Settlement Statement together with annual summary of the statistical data provided in the monthly reports, certified by the Energy Manager, as well as such other data relating to the services provided under the Agreement as may be reasonably requested to be furnished by LIPA.

***Fuel Consumption Reports.*** Fifteen (15) "Business Days" following the end of each month, Energy Manager is obligated to submit to LIPA a report summarizing the Fuel burned during that month and such other information as the parties may mutually agree.

#### **Indemnification**

The Agreement contains redemmnification provisions that are substantially the same as the indemnification provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Indemnification."

#### **Miscellaneous Provisions**

***Insurance.*** The Agreement provides that Energy Manager shall maintain with financially responsible insurance companies insurance in such amounts and against such risks and losses as are customary for companies engaged in the business of providing services or undertaking activities similar to the Fuel Services and System Power Supply Services to be provided thereunder.

***Assignment and Transfer.*** Agreement contains provisions relating to assignment and transfer that are substantially the same as the assignment and transfer provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Assignment and Transfer."

***Non-Binding Mediation; Arbitration.*** The Agreement contains provisions relating to mediation and arbitration that are substantially the same as the mediation and arbitration provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Non-Binding Mediation; Arbitration."

***Affiliate.*** Pursuant to the Agreement, the Energy Manager has agreed to remain an Affiliate of the Guarantor.

***Credit Enhancement in Certain Circumstances.*** The Agreement contains provisions relating to credit enhancement that are substantially the same as the credit enhancement provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Credit Enhancement in Certain Circumstances."

***Hedging Policies.*** The Energy Manager agrees not to engage in any hedging activities relating to the Fuel Services or System Power Supply Services without express approval from the Boards of Directors of the Energy Manager and its Parent and without notifying and consulting with LIPA at least 60 days prior to implementing such activities. The Agreement provides that in the event that approval for the use of hedging activities is implemented, the incentive/disincentive program will be reexamined by the parties to determine the appropriateness of the inclusion or exclusion of the related costs, gain or losses and appropriate mutually agreeable revisions thereto will be made.

## FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the "Disclosure Certificate") is executed and delivered by the Long Island Power Authority (the "Authority") in connection with the issuance of its Electric System General Revenue Bonds, Series 2003C (the "Bonds"). The Bonds are being issued pursuant to the Electric System General Revenue Bond Resolution adopted by the Authority on May 13, 1998 as amended and supplemented (the "Resolution"). The Authority covenants and agrees as follows:

**SECTION 1. *Purpose of the Disclosure Certificate.*** This Disclosure Certificate is being executed and delivered by the Authority for the benefit of the Holders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with S.E.C. Rule 15c2-12(b)(5).

**SECTION 2. *Definitions.*** In addition to the definitions set forth in the Resolution, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the Authority pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

"Dissemination Agent," if any, shall mean the person or firm, or any successor Dissemination Agent designated in writing by the Authority pursuant to Section 7 of this Disclosure Certificate and which has filed with the Authority and the Trustee a written acceptance of such designation.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently approved by the Securities and Exchange Commission are set forth in Exhibit B.

"Official Statement" shall mean the Authority's final Official Statement relating to the Bonds.

"Participating Underwriter" shall mean any of the original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of New York.

"State Repository" shall mean any public or private repository or entity designated by the State as the State Repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Certificate, there is no State Repository.

"Trustee" shall mean The Bank of New York, New York, New York and its successors and assigns.

Capitalized terms not otherwise defined herein shall have the meanings set forth in the Official Statement.

SECTION 3. *Provision of Annual Reports.* For so long as shall be required by the Rule:

(a) The Authority shall, or shall cause the Dissemination Agent to, not later than 6 months after the end of the Authority's fiscal year (presently December 31), commencing with the report for the 2003 Fiscal Year, provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate with a copy to the Trustee. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the Authority may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the Authority's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(c).

(b) Not later than fifteen (15) Business Days prior to said date, the Authority shall provide the Annual Report to the Dissemination Agent (if other than the Authority). If the Authority is unable to provide to the Repositories an Annual Report by the date required in subsection (a), the Authority shall send a notice to each Repository or the Municipal Securities Rulemaking Board and the State Repository, if any, in substantially the form attached as Exhibit A.

(c) If a Dissemination Agent is appointed by the Authority, the Dissemination Agent shall:

(i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and

(ii) file a report with the Authority certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided.

SECTION 4. *Content of Annual Reports.* The Authority's Annual Report shall contain or include by reference the following:

1. The audited consolidated financial statements of the Authority and its subsidiaries for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the Authority's audited consolidated financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited consolidated financial statements and the audited consolidated financial statements shall be filed in the same manner as the Annual Report when they become available.

2. Operating results for the prior fiscal year of the type set forth in Exhibit 1 to the Independent Consultant's Report attached as Appendix A to Part 2 of the Official Statement to the extent line items in this Exhibit are not included in the audited consolidated financial statements.

3. Capital expenditures for the prior fiscal year of the type set forth in the Official Statement under the heading "The System—Capital Improvement Plan" in Part 2 of the Official Statement.

4. Service area loads for the prior fiscal year of the type set forth in the Official Statement under the heading "The System—Loads" in Part 2 of the Official Statement and in Appendix A—"Independent Consultant's Report—Power and Energy Requirements."

5. The Authority's own rates and charges (but not regional comparisons) for the prior fiscal year of the type set forth in the Official Statement under the heading "Rates and Charges" in Part 2 of the Official Statement and in Appendix A—"Independent Consultant's Report—Rates and Charges."

6. Billings and collections for the prior fiscal year of the type set forth in Part 2 of the Official Statement under the heading "Billing and Collections."

7. A discussion of operating results, cash flows, uses of cash and capital expenditures of the type set forth in Appendix B to Part 2 of the Official Statement—"Consolidated Financial Statements of the Authority—Management's Discussion and Analysis of the Consolidated Results of Operations for the Year Ended December 31, 2002."

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Authority or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The Authority shall clearly identify each such other document so included by reference.

SECTION 5. *Reporting of Significant Events.* For so long thereafter as shall be required by the Rule:

(a) Pursuant to the provisions of this Section 5, the Authority shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies.
2. non-payment related defaults.
3. modifications to rights of Bondholders.
4. optional, contingent or unscheduled bond calls.
5. defeasances.
6. rating changes.
7. adverse tax opinions or events affecting the tax-exempt status of the Bonds.
8. unscheduled draws on the debt service reserves reflecting financial difficulties.
9. unscheduled draws on the credit enhancements reflecting financial difficulties.
10. substitution of the credit or liquidity providers or their failure to perform.
11. release, substitution or sale of property securing repayment of the Bonds.

(b) Whenever the Authority obtains knowledge of the occurrence of a Listed Event, the Authority shall as soon as possible determine if such event would be material under applicable federal securities laws.

(c) If the Authority determines in its sole discretion that knowledge of the occurrence of a Listed Event would be material and would require disclosure under applicable federal securities laws, the Authority shall promptly file a notice of such occurrence with the Repositories or the Municipal Securities Rulemaking Board and the State Repository with a copy to the Trustee. Notwithstanding the foregoing, notice of Listed Events described in subsections

(a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected Bonds pursuant to the Resolution.

SECTION 6. *Termination of Reporting Obligation.* The Authority's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the Authority shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

SECTION 7. *Dissemination Agent.* The Authority may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the Authority pursuant to this Disclosure Certificate. Initially, the Authority will serve as its own dissemination agent.

SECTION 8. *Amendment; Waiver.* Notwithstanding any other provision of this Disclosure Certificate, the Authority may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4, or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of the Bonds in the same manner as provided in the Resolution for amendments to the Resolution with the consent of Holders, or (ii) does not, in the opinion of the Trustee or nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the Authority shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Authority. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(c), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. *Additional Information.* Nothing in this Disclosure Certificate shall be deemed to prevent the Authority from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the Authority chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the Authority shall have no obligation under this Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.



SECTION 10. *Default.* In the event of a failure of the Authority to comply with any provision of this Disclosure Certificate the Trustee may (and, at the request of any Participating Underwriter or the Holders of at least 50% aggregate principal amount of Outstanding Bonds, shall), or any Holder or Beneficial Owner of the Bonds may (unless the Authority has so complied within 20 days after written notice from the Trustee of its failure to comply) take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Authority to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed a default or an Event of Default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the Authority to comply with this Disclosure Certificate shall be an action to compel performance.

SECTION 11. *Duties, Immunities and Liabilities of Dissemination Agent.* The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the Authority agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's default or negligence or willful misconduct. The obligations of the Authority under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

SECTION 12. *Beneficiaries.* This Disclosure Certificate shall inure solely to the benefit of the Authority, the Trustee, the Dissemination Agent, the Participating Underwriters and Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Date: May \_\_, 2003

LONG ISLAND POWER AUTHORITY

By \_\_\_\_\_

**EXHIBIT A**

**NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT**

Name of Authority: Long Island Power Authority

Name of Bond Issue: Long Island Power Authority Electric System General Revenue Bonds,  
Series 2003C

Date of Issuance: May \_\_, 2003

NOTICE IS HEREBY GIVEN that the Authority has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated May \_\_, 2003 of the Authority. The Authority anticipates that the Annual Report will be filed by \_\_\_\_\_.

Dated: \_\_\_\_\_, \_\_\_\_\_

LONG ISLAND POWER AUTHORITY

By \_\_\_\_\_

cc: Trustee

## **EXHIBIT B**

### **NATIONAL REPOSITORIES**

As of the date of this Continuing Disclosure Certificate, the following National Repositories are recognized by the Securities and Exchange Commission:

**Bloomberg Municipal Repositories**

100 Business Park Drive  
Skillman, NJ 08558  
(609) 279-3225  
(609) 279-2066 (FAX)  
e-mail address: Munis@Bloomberg.com

**DPC Data, Inc.**

One Executive Drive  
Fort Lee, NJ 07024  
(201) 346-0701  
(201) 947-0107 (FAX)  
Contact: NRMSIR  
e-mail address: nrmsir@dpcdata.com

**Interactive Data**

Attn: Repository  
100 Williams Street  
New York, New York 10038  
(212) 771-6899  
(212) 771-7390 (FAX)  
email address: NRMSIR@ftid.com

**Standard & Poor's**

55 Water Street, 45th Floor  
New York, NY 10041  
(212) 438-4595  
(212) 438-3975 (FAX)  
email address: nrmsir\_repository@sandp.com

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## BOOK-ENTRY-ONLY SYSTEM

The Depository Trust Company, New York, New York ("DTC"), will act as securities depository for the Offered Securities. The Offered Securities will be issued as fully registered bonds in the name of Cede & Co. (DTC's partnership nominee). One fully registered bond will be issued for each one maturity of the Offered Securities in the aggregate principal amount of each such maturity and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over two million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants (the "Direct DTC Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct DTC Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct DTC Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct DTC Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct DTC Participants and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, each a subsidiary of DTCC, as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct DTC Participant, either directly or indirectly ("Indirect DTC Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to DTC Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of Offered Securities under the DTC system must be made by or through Direct DTC Participants, which will receive a credit for the Offered Securities on DTC's records. The ownership interest of each actual purchaser of Offered Securities ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect DTC Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect DTC Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in Offered Securities are to be accomplished by entries made on the books of Direct and Indirect DTC Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Securities, except as provided in the Resolution in the event that use of the book-entry system for a series of Offered Securities is discontinued.

To facilitate subsequent transfers, all the Offered Securities are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of a series of Offered Securities with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of Offered Securities; DTC's records reflect only the identity of the Direct DTC Participants to whose accounts Offered Securities are credited, which may or may not

be the Beneficial Owners. The Direct and Indirect DTC Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyances of notices and other communications by DTC to Direct DTC Participants, by Direct DTC Participants to Indirect DTC Participants, and by Direct DTC Participants and Indirect DTC Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices will be sent to DTC. If less than all of the Offered Securities are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct DTC Participant in the Offered Securities to be redeemed.

BENEFICIAL OWNERS SHOULD MAKE APPROPRIATE ARRANGEMENTS WITH THEIR BROKER OR DEALER TO RECEIVE NOTICES (INCLUDING NOTICES OF REDEMPTION) AND OTHER INFORMATION REGARDING OFFERED SECURITIES THAT MAY BE SO CONVEYED TO DIRECT DTC PARTICIPANTS AND INDIRECT DTC PARTICIPANTS.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Securities. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct DTC Participants to whose accounts Offered Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

NEITHER THE AUTHORITY NOR THE TRUSTEE NOR ANY UNDERWRITER (OTHER THAN IN ITS CAPACITY, IF ANY, AS DIRECT DTC PARTICIPANTS OR INDIRECT DTC PARTICIPANTS) WILL HAVE ANY OBLIGATION TO THE DIRECT DTC PARTICIPANTS OR THE INDIRECT DTC PARTICIPANTS OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO DTC'S PROCEDURES OR ANY PROCEDURES OR ARRANGEMENTS BETWEEN DIRECT DTC PARTICIPANTS, INDIRECT DTC PARTICIPANTS AND THE PERSONS FOR WHOM THEY ACT RELATING TO THE MAKING OF ANY DEMAND BY CEDE & CO. AS THE REGISTERED OWNER OF OFFERED SECURITIES, THE ADHERENCE TO SUCH PROCEDURES OR ARRANGEMENTS OR THE EFFECTIVENESS OF ANY ACTION TAKEN PURSUANT TO SUCH PROCEDURES OR ARRANGEMENTS.

Principal and interest payments on Offered Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct DTC Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on a payment date in accordance with their respective holdings shown on DTC's records. Payments by DTC Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such DTC Participant and not of DTC, the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC, is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct DTC Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect DTC Participants.

THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE AUTHORITY BELIEVES TO BE RELIABLE, BUT THE AUTHORITY TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, BENEFICIAL OWNERS OR OTHER NOMINEES OF SUCH BENEFICIAL OWNERS FOR (1) SENDING TRANSACTION

STATEMENTS; (2) MAINTAINING, SUPERVISING OR REVIEWING, OR THE ACCURACY OF, ANY RECORDS MAINTAINED BY DTC OR ANY DTC PARTICIPANT OR OTHER NOMINEES OF SUCH BENEFICIAL OWNERS; (3) PAYMENT OR THE TIMELINESS OF PAYMENT BY DTC TO ANY DTC PARTICIPANT, OR BY ANY DTC PARTICIPANT OR OTHER NOMINEES OF BENEFICIAL OWNERS TO ANY BENEFICIAL OWNER, OF ANY AMOUNT DUE IN RESPECT OF THE PRINCIPAL OF OR REDEMPTION PREMIUM, IF ANY, INTEREST OR PURCHASE PRICE ON OFFERED SECURITIES; (4) DELIVERY OR TIMELY DELIVERY BY DTC TO ANY DTC PARTICIPANT, OR BY ANY DTC PARTICIPANT OR OTHER NOMINEES OF BENEFICIAL OWNERS TO ANY BENEFICIAL OWNERS, OF ANY NOTICE (INCLUDING NOTICE OF REDEMPTION) OR OTHER COMMUNICATION WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE RESOLUTION TO BE GIVEN TO HOLDERS OR OWNERS OF OFFERED SECURITIES; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF OFFERED SECURITIES; OR (6) ANY ACTION TAKEN BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER OF OFFERED SECURITIES.

The Authority and the Trustee may treat DTC (or its nominee) as the sole and exclusive registered owner of the Offered Securities registered in its name for the purposes of payment of the principal and redemption premium, if any, Sinking Fund Installments for, or interest on, the Offered Securities, giving any notice permitted or required to be given to registered owners under the Bond Indenture, registering the transfer of the Offered Securities, or other action to be taken by registered owners and for all other purposes whatsoever. The Authority and the Trustee shall not have any responsibility or obligation to any DTC Participant, any person claiming a beneficial ownership interest in the Offered Securities under or through DTC or any DTC Participant, or any other person which is not shown on the registration books of the Authority (kept by the Bond Registrar) as being a registered owner, with respect to the accuracy of any records maintained by DTC or any DTC Participant; the payment by DTC or any DTC Participant of any amount in respect of the principal, redemption premium, if any, Sinking Fund Installments for, or interest on the Offered Securities; any notice which is permitted or required to be given to registered owners thereunder or under the conditions to transfers or exchanges adopted by the Authority; or other action taken by DTC as a registered owner. Interest, redemption premium, if any, Sinking Fund Installments, and principal will be paid by the Trustee to DTC, or its nominee. Disbursement of such payments to the DTC Participants is the responsibility of DTC and disbursement of such payments to the Beneficial Owners is the responsibility of the DTC Participants or the Indirect DTC Participants.

For every transfer and exchange of a beneficial ownership interest in Offered Securities, the Beneficial Owner may be charged a sum sufficient to cover any tax, fee or other governmental charge, that may be imposed in relation thereto.

#### *Discontinuation of Book-Entry-Only System*

DTC may discontinue providing its services as securities depository with respect to the Offered Securities at any time by giving reasonable notice to the Authority and by discharging its responsibilities with respect thereto under applicable law or the Authority may terminate its participation in the system of book-entry transfer through DTC at any time by giving notice to DTC. The Authority may retain another securities depository for the Offered Securities or may direct the Trustee to deliver bond certificates in accordance with instructions from DTC or its successor. If the Authority directs the Trustee to deliver such bond certificates, such Offered Securities may thereafter be exchanged for an equal aggregate principal amount of Offered Securities in any other authorized denominations and of the same maturity as set forth in the Bond Indenture, upon surrender thereof at the principal corporate trust office of the Bond Registrar, who will then be responsible for maintaining the registration books of the Authority.

According to DTC, the foregoing information with respect to DTC has been provided to the Industry for informational purposes only and is not intended to serve as a representation, warranty, or contract modification of any kind.

Unless otherwise noted, certain of the information contained in the preceding paragraphs of this subsection "Book-Entry-Only System" has been extracted from information given by DTC. Neither the Authority, the Trustee nor the Underwriter makes any representation as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereto.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE OFFERED SECURITIES, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OF THE OFFERED SECURITIES SHALL MEAN CEDE & CO. AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE OFFERED SECURITIES. PRINCIPAL AND INTEREST PAYMENTS ON THE OFFERED SECURITIES ARE TO BE MADE TO DTC AND ALL SUCH PAYMENTS SHALL BE VALID AND EFFECTIVE TO SATISFY FULLY AND DISCHARGE THE AUTHORITY'S OBLIGATIONS WITH RESPECT TO, AND TO THE EXTENT OF, PRINCIPAL AND INTEREST SO PAID.

NEITHER THE AUTHORITY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO SUCH DTC PARTICIPANTS, INDIRECT DTC PARTICIPANTS, OR THE PERSONS FOR WHOM THEY ACT AS NOMINEES, WITH RESPECT TO THE PAYMENTS TO OR THE PROVIDING OF NOTICE FOR SUCH DTC PARTICIPANTS, INDIRECT DTC PARTICIPANTS, OR THE BENEFICIAL OWNERS OF OFFERED SECURITIES.



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