

**ANNUAL REPORT
OF THE
LONG ISLAND POWER AUTHORITY
AND THE LONG ISLAND LIGHTING COMPANY d/b/a LIPA**

For The 2012 Fiscal Year

As Required By Certain

Continuing Disclosure Certificates

Executed With Respect To The Following Bonds:

**Electric System General Revenue Bonds, Series 1998A
Electric System General Revenue Bonds, Series 2000A
Electric System General Revenue Bonds, Series 2003B
Electric System General Revenue Bonds, Series 2003C
Electric System General Revenue Bonds, Series 2003I-O
Electric System General Revenue Bonds, Series 2004A
Electric System General Revenue Bonds, Series 2006A-B
Electric System General Revenue Bonds, Series 2006C-D
Electric System General Revenue Bonds, Series 2006E
Electric System General Revenue Bonds, Series 2006F
Electric System General Revenue Bonds, Series 2008A
Electric System General Revenue Bonds, Series 2008B
Electric System General Revenue Bonds, Series 2009A
Electric System General Revenue Bonds, Series 2010A
Electric System General Revenue Bonds, Series 2010B
Electric System General Revenue Bonds, Series 2011A
Electric System General Revenue Bonds, Series 2012A-B
Electric System General Revenue Bonds, Series 2012C-D
and**

NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY

**Adjustable Rate Pollution Control Revenue Bonds (Long Island Lighting Company
Project), 1985 Series A and 1985 Series B**

**Electric Facilities Revenue Bonds (Long Island Lighting Company Project), 1993 Series B,
1994 Series A and 1995 Series A**

(See Appendix A for a List of Applicable CUSIP Numbers)

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ANNUAL REPORT
of the
LONG ISLAND POWER AUTHORITY
and the
LONG ISLAND LIGHTING COMPANY d/b/a LIPA
For The 2012 Fiscal Year
As Required By Certain
Continuing Disclosure Certificates

INTRODUCTION

This Annual Report for the year ended December 31, 2012 (together with the Appendices attached hereto, the “Annual Report”) is furnished by the Long Island Power Authority, a corporate municipal instrumentality and political subdivision of the State of New York (the “Authority”) and by its wholly-owned subsidiary, the Long Island Lighting Company (“LILCO”) which does business under the name LIPA (“LIPA”), to provide the information regarding the Authority and LIPA required by the various Continuing Disclosure Certificates described below (the “Continuing Disclosure Certificates”).

This Annual Report is being filed to satisfy the Authority and LIPA’s undertakings under the Continuing Disclosure Certificates executed and delivered by the Authority or LIPA relating to the following bonds:

The Authority’s Electric System General Revenue Bonds, Series 1998A, issued on May 28, 1998.

The Authority’s Electric System General Revenue Bonds, Series 2000A, issued on May 3, 2000.

The Authority’s Electric System General Revenue Bonds, Series 2003B, issued on April 30, 2003.

The Authority’s Electric System General Revenue Bonds, Series 2003C, issued on May 15, 2003.

Certain of the Authority’s Electric System General Revenue Bonds, Series 2003I - Series 2003O, issued on May 29, 2003.

The Authority’s Electric System General Revenue Bonds, Series 2004A, issued on August 12, 2004.

The Authority's Electric System General Revenue Bonds, Series 2006A and Series 2006B, issued on March 21, 2006.

The Authority's Electric System General Revenue Bonds, Series 2006C and Series 2006D, issued on July 26, 2006.

The Authority's Electric System General Revenue Bonds, Series 2006E, issued on September 26, 2006.

The Authority's Electric System General Revenue Bonds, Series 2006F, issued on December 20, 2006.

The Authority's Electric System General Revenue Bonds, Series 2008A, issued on October 16, 2008.

The Authority's Electric System General Revenue Bonds, Series 2008B, issued on November 6, 2008.

The Authority's Electric System General Revenue Bonds, Series 2009A, issued on January 28, 2009.

The Authority's Electric System General Revenue Bonds, Series 2010A and Series 2010B, issued on May 18, 2010.

The Authority's Electric System General Revenue Bonds, Series 2011A, issued on September 28, 2011.

The Authority's Electric System General Revenue Bonds, Series 2012A and Series 2012B, issued on July 16, 2012.

The Authority's Electric System General Revenue Bonds, Series 2012C and Series 2012D, issued on June 13, 2012.

New York State Energy Research and Development Authority's ("NYSERDA") Adjustable Rate Pollution Control Revenue Bonds (Long Island Lighting Company Project), 1985 Series A and 1985 Series B, converted to a fixed rate as of March 1, 1999.

NYSERDA's Electric Facilities Revenue Bonds (Long Island Lighting Company Project), 1993 Series B, 1994 Series A and 1995 Series A, converted to a fixed rate as of March 1, 1999.

Attached to this Annual Report as Appendix A is a listing of the CUSIP numbers of the bonds of the Authority and NYSERDA listed above as to which the Continuing Disclosure Certificates and this Annual Report relate.

Certain of the information contained in this Annual Report may be in addition to that required by the Continuing Disclosure Certificates. Pursuant to the terms of the Continuing

Disclosure Certificates, the Authority and LIPA are under no obligation to update such additional information in the future or include it in any future annual report.

OPERATING RESULTS

The operating results of the Authority and LIPA for the years ended December 31, 2012 and 2011 are contained in the audited basic financial statements included as Appendix B hereto.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2012

Management's Discussion of Financial Condition and Consolidated Results of Operations for the year ended December 31, 2012 is contained in Appendix B hereto and is incorporated by reference herein.

CAPITAL IMPROVEMENT PLAN

Capital expenditures including Nine Mile Point 2 ("NMP2") expenditures for 2012 were approximately \$290 million, and averaged approximately \$292 million over the past five years. Such expenditures included interconnection costs associated with the undersea cable from Sayreville, New Jersey and the new generating stations on Long Island, reliability enhancements, capability expansion, new customer connections, facility replacements and public works. Capital expenditures for 2013 in the approved budget are approximately \$440 million. The increase over prior year results primarily from capital and deferred expenditures related to the transition to the new operating services business model effective January 1, 2014. In addition, the 2013 capital expenditure program provides for a continuation of the historical programs to maintain reliability and quality of electric service, as well as expenditures for capability expansion, new customer connections, facility replacements, reliability enhancements and public work projects that were comparable to historical levels.

LIPA's 18 percent share of capital expenditures for NMP2 during the period 2008 through 2012 averaged approximately \$25 million annually for plant modifications including the power uprate and nuclear fuel purchases, and were \$20 million for 2012.

SYSTEM LOADS AND RESOURCES

Historical Power and Energy Requirements

Electricity usage patterns and seasonal weather conditions in LIPA's service area result in maximum electrical demand during the summer season and relatively low load factors on an annual basis. The table below shows LIPA's peak demand and weather-normalized peak load for the period 2008 through 2012.

<u>Year</u>	<u>Peak Demand (MW)</u>	<u>Weather Normalized (MW)</u>
2008	5,130	5,284
2009	5,034	5,208
2010	5,719	5,303
2011	5,771	5,285
2012	5,333	5,251

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The following table sets forth historical annual peak demands and energy requirements for the period 2008 through 2012.

Historical Loads and Resources

	2008	2009	2010	2011	2012
Annual Peak Demand (Summer) (MW) ¹	5,130	5,034	5,719	5,771	5,333
Capacity (MW) ²					
Nuclear ³	205	206	206	225	224
Purchased Capacity:					
GENCO					
Steam ⁴	2,685	2,707	2,707	2,699	2,354
Other ⁴	1,375	1,371	1,367	1,311	1,313
Other Purchased Capacity ⁵	1,357	1,618	2,055	2,092	2,104
Total Purchased Capacity	5,417	5,696	6,128	6,102	5,771
Total Capacity	5,622	5,902	6,334	6,327	5,995
Annual Reserve Margin:					
MW ⁶	492	868	615	556	662
Percent	9.6	17.2	10.8	9.6	12.4
Energy (MWh)					
Total Energy Requirements ⁷	21,389,895	20,727,286	21,806,828	21,583,426	21,312,015
Generating Resources:					
Nuclear ³	1,536,078	1,785,593	1,590,821	1,707,140	1,470,928
Purchased Energy:					
GENCO					
Steam	6,748,379	4,900,602	5,883,018	5,472,453	5,002,617
Other	261,035	192,397	234,331	189,461	256,264
Other Purchased Energy	12,844,403	13,848,694	14,098,658	14,214,372	14,582,206
Total Purchased Energy	19,853,817	18,941,693	20,216,007	19,876,286	19,841,087
Total Energy	21,389,895	20,727,286	21,806,828	21,583,246	21,312,015

1 Includes peak demand load for Long Island Choice load and Power-for-Jobs. Excludes demand reductions from EnXco solar projects.

2 Summer capacity rating as measured in October of each year. Includes capacity under contract to LIPA.

3 LIPA's 18 percent share of NMP2.

4 Values from National Grid Corporate Services.

5 Includes on- and off-Island resources under contract at time of peak. Resources include capacity associated with Independent Power Producers, firm capacity purchases, Power-for-Jobs, and power supply agreements. Includes capacity from LI based commercial solar applications (BP and EnXco) under contract to LIPA. Excludes short-term bi-lateral and NYISO capacity market auction purchases.

6 Equal to capacity less demand.

7 Includes energy requirements for Power-for-Jobs, Long Island Choice and the Grumman campus. Excludes demand reductions from EnXco solar projects.

Existing Power Supply Resources

Pending the final result of the competitive solicitation described below, LIPA is expected to rely on existing power supply resources, including those described in this section and below under "Certain Additions to Power Supply Resources," to meet the bulk of its capacity and energy requirements. The table shown above sets forth the historical annual contribution of the National Grid Generation LLC ("GENCO") facilities, the NMP2 facility ("Nuclear"), and Independent Power Producers on Long Island and elsewhere. Combined, these resources were able to provide the service area's capacity and energy requirements during the 2008 through 2012 period. The table below provides additional information on the historical operating performance of the GENCO facilities.

Historical GENCO Generation*
(GWH)

Calendar Year

Generating Facility	2008	2009	2010	2011	2012
Steam Turbine:					
E.F. Barrett 1,2	1,115	916	1,081	971	1,001
Far Rockaway 4	138	101	190	344	151
Glenwood 4,5	95	65	152	270	151
Northport 1-4	4,494	3,263	4,030	3,470	3,301
Port Jefferson 3,4	907	556	430	418	389
Total Steam Turbine	6,749	4,901	5,883	5,472	5,003
Combustion Turbine:					
E.F. Barrett 1-6, 8-12 ¹	72	78	68	93	136
Wading River	93	45	65	35	53
East Hampton 1	20	13	13	8	7
Glenwood 1-3	2	1	2	1	4
Holtsville 1-10	59	46	75	42	51
Northport G-1	**	**	**	**	**
Port Jefferson GT	**	**	**	**	**
Shoreham 1-2	1	1	3	1	1
Southampton 1	6	2	3	2	0
Southold 1	-	2	2	1	1
West Babylon 4	2	-	1	4	2
Total Combustion Turbine....	255	188	231	187	255
Internal Combustion:					
East Hampton 2-4	3	2	2	1	1
Montauk 2-4	2	3	2	1	1
Total Internal Combustion....	5	5	4	2	2
Total	7,009	5,094	6,117	5,662	5,260

* Source: National Grid Corporate Services.

** Less than 1.

1 Unit 7 was retired during 2012.

The following table sets forth for each calendar year 2008 through 2012 the actual generation attributable to LIPA's 18% ownership interest in NMP2.

NMP2 Energy Generation

	2008	2009	2010	2011	2012
Energy (GWh)	1,536.1	1,785.6	1,591.0	1,707.1	1,471.0

The two tables below: (i) contain a summary of existing power supply agreements (excluding the Power Supply Agreement with GENCO) and (ii) show for each calendar year 2008 through 2012 the energy output from such agreements.

**Summary of Power Supply Agreements
(Excluding GENCO)**

Unit Name	Capacity (MW)⁽¹⁾	Contract Expiration	Unit Type⁽²⁾	Primary Fuel Type
NYPA Flynn.....	134.3	2020	CC	Natural Gas ⁽³⁾
Suez Nassau Energy Combined Cycle.....	43.7	2016	CC/Cogen	Natural Gas ⁽⁴⁾
Huntington Resource Recovery	24.3	2017	ST	Refuse
Babylon Resource Recovery.....	14.9	2013	ST	Refuse
Hempstead Resource Recovery.....	72.5	2034	ST	Refuse
Islip Resource Recovery	8.8	2035	ST	Refuse
Shoreham Energy	87.7	2017	SC	Kerosene ⁽⁵⁾
National Grid Glenwood Landing.....	79.3	2027	SC	Natural Gas ⁽⁵⁾
National Grid Port Jefferson.....	81.4	2027	SC	Natural Gas ⁽⁵⁾
Bayswater	53.8	2020	SC	Natural Gas ⁽⁵⁾
Jamaica Bay.....	54.3	2018	SC	Kerosene ⁽⁵⁾
Greenport.....	52.9	2018	SC	Kerosene ⁽⁵⁾
Equus.....	47.9	2017	SC	Natural Gas ^(4,5)
NYPA Power-for-Jobs	11.6	2012	N/A	N/A
Gilboa	50.0	2015	PS	Water
Village of Freeport	10.0	2034	SC	Natural Gas
Pinelawn Power.....	76.6	2025	CC	Natural Gas ^(4,5)
Calpine Bethpage 3.....	75.7	2025	CC	Natural Gas ⁽⁵⁾
Bear Swamp Power.....	100.0 ⁽⁶⁾	2021	PS/Hydro	Water
Edgewood Energy.....	86.6	2018	SC	Natural Gas ⁽⁵⁾
Caithness.....	309.6 ⁽⁷⁾	2029	CC	Natural Gas ^(4,5)
Brookfield.....	N/A ⁽⁸⁾	2019	HY	Water
Fitzpatrick.....	124.4	2014	ST	Nuclear
PPL Energy Plus.....	N/A ⁽⁸⁾	2019	IC	Landfill Methane
Marcus Hook.....	685.0 ⁽⁹⁾	2030	CC	Natural Gas
NYPA Hydro Sale for Resale	15.0	2020	HY	Water
Long Island Solar Farm (LISF).....	31.5	2031	PV	Solar
Eastern Long Island Solar Project (ELISP)	11.2 ⁽¹⁰⁾	2033	PV	Solar

1 Summer capacity based upon summer 2012 DMNC test results.

2 CC = Combined Cycle; ST = Steam; Cogen = Cogeneration; IC = Internal Combustion; SC = Simple Cycle; PS = Pumped Storage; HY = Hydro; PV = Photovoltaic.

3 Also capable of burning No. 2 fuel oil.

4 Also capable of burning kerosene.

5 LIPA is responsible for fuel procurement.

6 Reflects Unforced capacity (UCAP) stated in contract beginning June 2010.

7 LIPA agreement to purchase 286 MW of the total capacity.

8 Energy only contract.

9 Capacity only contract. No energy purchase.

10 Projected Capacity. ELSIP reached commercial operation on January 1, 2013.

Energy Output of Power Supply Agreements¹
(GWH)

Calendar Year

<u>Type of Resource</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Independent Power Producers					
NYPA Flynn	1,227.6	1,228.2	958.2	1,061.2	1,229.1
Other Power Supply Agreements	1,124.4	1,724.5	3,069.3	3,175.8	3,565.2
Other ²	1,668.1	1,544.3	1,772.1	1,616.0	1,794.4
Subtotal IPPs	4,020.1	4,497.0	5,799.6	5,853.0	6,582.4
Energy Fitzpatrick (off-Island)	1,100.4	1,237.1	1,067.8	1,225.2	1,219.2
Off-Island Purchases ³	6,000.4	6,424.1	5,633.9	5,627.2	5,290.8
Other Purchases ⁴	1,723.5	1,690.5	1,597.4	1,509.0	1,489.7
Total Purchases	12,844.4	13,848.7	14,098.7	14,214.4	14,582.2

1 Source: National Grid.

2 Includes energy produced by all other on-Island plants.

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

4 Reflects Power-for-Jobs and Long Island Choice programs.

Certain Additions to Power Supply Resources

LIPA has added significant power supply resources over the last decade. LIPA added in excess of 750 MW of newly constructed on-Island resources through agreements to purchase power from these newly constructed on-Island generating stations. In addition, LIPA has entered into an agreement with Neptune Regional Transmission LLC to purchase 660 MW of firm transmission capacity over an undersea high voltage cable that has been installed between Sayreville, New Jersey and Levittown, New York. The cable, which became operational in 2007, permits LIPA to import 660 MW of power and related energy from the Pennsylvania, New Jersey and Maryland markets. LIPA has an agreement with Caithness Long Island LLC (“Caithness”) to acquire 286 MW from a 326 MW combined-cycle plant which began full commercial operational in summer 2009. LIPA has also entered into an agreement with Long Island Solar Farm LLC (a BP Solar International Inc. affiliate) to purchase approximately 31.5 MW of power from an array of 164,312 photovoltaic solar panels located at Brookhaven National Laboratory, which began full commercial operation in November 2011. In addition, LIPA has entered into an agreement with Eastern Long Island Solar Project, LLC (an enXco Development Corporation affiliate) to purchase up to 15.5 MW of power from solar generating facilities under construction on Long Island that became commercially operational January 1, 2013. LIPA’s Electric Resource Plan, which was updated in February 2010, concluded that based on LIPA’s current probability weighted projections of Long Island’s load and existing resources and planned resources, in addition to the successful implementation of its 10-year energy efficiency program, are projected to be sufficient to meet or exceed the Long Island minimum load requirements through 2020. Retirement of existing capacity could accelerate the need for additional capacity to meet the Long Island minimum requirement.

In coordination with LIPA’s evaluations of its options with respect to the Power Supply Agreement with Genco, in 2010, LIPA issued a request for proposals for new generation and/or transmission projects to help it meet projected future resource needs. The request for proposals

elicited 45 unique generation proposals from 16 separate bidders. In October 2012, LIPA announced two finalists: Caithness proposed to develop, operate and own a new 706 MW natural gas power plant in Yaphank; and J-Power USA Development Co. Ltd. proposed to develop, operate and own a new 377 MW natural gas power plant in Shoreham, NY. Both proposers offered to sell LIPA the entire output of the facility under a 20-year agreement beginning in May 2017. LIPA is still evaluating the two final proposals.

RATES AND CHARGES

The statute which created the Authority 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.

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 Public Service Commission (“PSC”) or any other State regulatory body. However, the Authority agreed, in connection with the approval of the LIPA/LILCO Merger by the Public Authorities Control Board (“PACB”) in 1997, 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. However, see “RECENT DEVELOPMENTS” below for additional information - *including legislation recently proposed by the Governor that has passed both houses of the Legislature and been presented to the Governor for signature (the “2013 Legislation”)* - that could impact the process by which LIPA sets electric rates including the introduction of additional oversight.

2012 Legislation

In February 2012 a bill requiring LIPA to undergo an audit of its management and operations was introduced and passed in both houses, and signed into law by Governor Cuomo (the “2012 Legislation”). The 2012 Legislation provides for the Department of Public Service to comprehensively and regularly audit the management and operations of the Authority. The 2012 Legislation further provides that the Department of Public Service shall provide any such audit and any findings and recommendations to the Authority and various designated State officials. The Authority is obligated to implement the findings and recommendations specified in such audit, unless the Authority’s Trustees determine that any particular finding or recommendation is inconsistent with the Authority’s sound fiscal operating practices, any existing contractual or operating obligation or the provision of safe and adequate service. Under the 2012 Legislation, the Authority retains authority to set rates for electric service in its service area and does not require the approval of the PSC or any other State regulatory body in the setting of its rates. However, see “RECENT DEVELOPMENTS” below for additional information, including information about the 2013 Legislation.

Rate Tariffs and Adjustments

LIPA's base 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 street lighting, and seasonally differentiated demand charges for non-residential customer classes (greater than seven kW). 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. In addition to the base delivery service charges, the Authority's charges include a Power Supply Charge (referenced in the Tariff as the FPPCA), a PILOT payments recovery rider, a rider providing for the recovery of the Suffolk Property Tax Settlement, an Energy Efficiency and Renewable Resource Charge to recover the costs of LIPA's customer-side programs and the New York State Assessment Charge to recover the newly-imposed cost of the Temporary State Energy and Utility Conservation Assessment (Public Service Law Section 18-a). Effective March 1, 2011, the Board of Trustees approved a 0.5% increase to the Energy Efficiency and Renewable Resource Charge. Effective March 1, 2011, the Board of Trustees approved an increase to the base rates for delivery service. The increase in the delivery service charge caused an average customer bill to increase approximately 1.9% to 2.2% overall for most rate classes. This was the first time since LIPA acquired the transmission and distribution system in 1998 and implemented the Tariff that LIPA implemented an increase in its base rates for delivery service. Effective April 1, 2012, the Board of Trustees approved an increase to the base rates for delivery service, which caused an increase to the average residential customer's bill of approximately 1.8%.

Over the past few years, LIPA has regularly modified the FPPCA in response to changes in fuel and purchased power prices. In 2012, the FPPCA tariff was modified to allow for 100% recovery of LIPA's power supply costs and to transition from a quarterly update process to a monthly basis. Prior to this modification, should LIPA's fuel and purchased power prices change such that the Authority would exceed or fail to meet a Board approved financial target, the FPPCA would be reduced or increased accordingly. In no event, however, did the Authority recover an amount that exceeded its fuel and purchased power costs incurred. With the new modification, fuel and purchased power cost recovery will no longer be set to achieve a targeted reserve of \$75 million.

PILOTs

The Act also 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 or through the FPPCA for certain PILOTs related to power generation stations under power supply agreements.

BILLING AND COLLECTIONS

At December 31, 2012, the Authority served approximately 1.1 million customers in its service area. For the 12-month periods ended December 31, 2008, December 31, 2009, December 31, 2010, December 31, 2011 and December 31, 2012, the 12-month write-off rates for uncollectible accounts were 0.51%, 0.77%, 0.71 %, 0.68% and 0.57%, respectively.

LITIGATION

LIPA is 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, including asbestos. 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, 2012 and 2011, Note 14 for a description of certain litigation in which LIPA is involved.

RECENT DEVELOPMENTS

Organizational Structure

In mid-2009, the Trustees voted to undertake a strategic organizational review, which resulted in the approval of a plan to restructure the way LIPA contracts for services to operate its electric utility business, which services are generally provided currently under a Management Services Agreement ("MSA"). Beginning in 2014, LIPA will adopt a business model, which includes a dedicated business unit providing services exclusively to LIPA. The new business model is designed to enhance the quality of customer service, provide long-term workforce stability and allow LIPA to more effectively manage costs. The decision was based on a year-long independent and comprehensive study of LIPA's strategic organizational options conducted by Brattle Group/M.J. Beck. The adoption of the enhanced business model led to a further decision by the Trustees to select a service provider as part of a competitive procurement to contract for the operation, customer service, maintenance, repair and expansion of LIPA's electric transmission and distribution business beginning on January 1, 2014. On December 15, 2011, the Board of Trustees approved the selection of PSEG-Lockheed to provide operations services for a period of ten years commencing January 1, 2014 and transition services beginning January 1, 2012. Pursuant to that selection, LIPA and PSEG executed a Transition Services Agreement ("TSA") and an Operations Services Agreement ("OSA"). Both the TSA and OSA received the approval of the New York State Comptroller on June 27, 2012.

The 2013 Legislation described below authorizes the restructuring of the relationship between LIPA and PSEG, which will require changes to the OSA.

Superstorm Sandy

In October 2012, Superstorm Sandy caused catastrophic damage to virtually all of the Authority's service area. Long Island's south shore experienced extensive flooding from unprecedented storm surges. The storm and flooding resulted in significant damage to the Authority's transmission and distribution system resulting in widespread power outages, mandatory evacuations and the destruction of a significant number of homes and businesses in the service area. The Authority's entire service area was declared a federal major disaster area.

The Authority's preliminary estimate of restoration costs, which include labor, material, equipment, travel and incidental expenses associated with assistance from utilities across the nation, totaled approximately \$806 million which has been accrued but not paid as of December 31, 2012. The Authority expects to receive reimbursement from FEMA for at least 75% of eligible costs related to the restoration work. The Authority has recorded the FEMA estimated recovery of \$605 million as grant income. In addition, the estimated Superstorm Sandy costs described above exclude the anticipated capital costs to reconstruct many substations damaged by flooding, which the Authority expects to be approximately \$100 million and further believes will be largely covered by insurance.

In rare circumstances when damage to a State exceeds a federally mandated per capita level, the State may petition FEMA to provide 90% funding. The Authority believes the damage caused by Superstorm Sandy will exceed the federal threshold and as such, the Authority may be able to recover up to 90% of its eligible storm costs once the administrative process necessary for such funding is complete. Until such thresholds are met, the necessary approvals are obtained and collection is reasonably assured, the Authority's results continue to reflect an estimated 75% FEMA reimbursement of eligible storm costs. The Authority has retained professional consultants to assist in the FEMA process. In addition, the Authority's Board has authorized the establishment of a regulatory asset for the recovery from its customers for the \$80 million estimated unreimbursed Superstorm Sandy costs, which is expected to be collected over a 10-year period beginning January 2014. In May LIPA received its first reimbursement from FEMA related to Superstorm Sandy for \$254 million. LIPA also received an advance from its insurance carrier for \$26 million as an advance against the final claim for sub-station related damages. LIPA is unable to predict at this time the amount and timing of the remaining FEMA reimbursements and insurance recoveries.

Liquidity

Through a combination of cash-on-hand, reimbursements from FEMA, available commercial paper capacity, and a recently established Senior Credit Facility, LIPA believes it will have sufficient liquidity to meet its near-term financial needs, including storm restoration costs and debt service obligations. LIPA recently closed on a \$500 million working capital line of credit from a syndicate of banks, led by TD Bank, NA. In addition, LIPA has received all necessary approvals to issue up to \$500 million of medium-term notes, if necessary, to finance a portion of the repair and restoration costs of Hurricane Sandy until reimbursement is available from FEMA and other sources. Also, LIPA has received approval from its Board and from the PACB to issue debt to refund \$200 million of outstanding commercial paper, which, if implemented, would increase the unused capacity under the LIPA's commercial paper program from \$100 million to \$300 million.

The Moreland Commission

As a result of Superstorm Sandy, pursuant to an Executive Order adopted by Governor Cuomo, a Moreland Commission was established to review all New York utilities, including LIPA, and their responses to recent emergency weather events. The Commission is mandated by such Executive Order to undertake a thorough review of all actions taken by power companies relating to these emergencies and make recommendations to reform and modernize oversight, regulation and management of New York's power delivery services. The final report was recently issued and our understanding is that it can be found at www.governor.ny.gov/assets/documents/MACfinalreportjune22.pdf. That report expressed concerns regarding certain aspects of the Authority's operations, including a consultancy arrangement and certain financial practices. The reference to that report is included herein for informational purposes only and the content of that report represents the views of the Commission and not those of the Authority.

The 2013 Legislation

Consistent with the May 13, 2013 proposal by Governor Cuomo, on June 21, 2013, the Assembly (A 8073) and Senate (S 5844) passed a series of amendments to the Public Service Law and the Public Authorities Law, which will substantially alter the role, responsibilities and organization of LIPA. The legislation is awaiting the Governor's signature and is intended to: (a) restructure the relationship between LIPA and PSEG, as the T&D System's operation and maintenance service provider, such that PSEG will assume control of all utility operations, thereby reducing LIPA's role to one of meeting its statutory, fiduciary, financial and related obligations; (b) establish a new Long Island office of the Department of Public Service ("DPS") with broad responsibility to oversee and make recommendations with regard to LIPA's rates, operations and programs and the core utility operations of PSEG; and (c) authorize the sale of securitized bonds by a new special purpose governmental entity established by the 2013 Legislation, which will be used to refinance a portion of LIPA's outstanding debt. The preceding sentence is not intended to be a comprehensive summary of the legislation and readers are encouraged to review the legislation for complete detail of its provisions.


OTHER

The Authority and LIPA's offices are located at 333 Earle Ovington Blvd., Uniondale, New York 11553, phone (516) 222-7700, facsimile: (516) 222-9137 Attn: Chief Financial Officer.

Neither the Authority nor LIPA has failed, in any material respect, to timely make any required filing under the Continuing Disclosure Certificates.

This Annual Report 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.

Long Island Power Authority
and
Long Island Lighting Company d/b/a LIPA

By: 
Name: Michael J. Taunton
Title: Chief Financial Officer

DATE: June 28, 2013

List of CUSIP⁺ Numbers

<u>Series</u>	<u>CUSIP</u>	<u>Maturity/ Mandatory Purchase</u>	<u>Coupon or Yield</u>	<u>Serial/Term</u>
Electric System General Revenue Bonds				
Capital Appreciation Bonds				
1998A	542690BX9	12/1/2013	5.150%	CABs
1998A	542690BY7	12/1/2014	5.200%	CABs
1998A	542690BZ4	12/1/2015	5.250%	CABs
1998A	542690CA8	12/1/2016	5.250%	CABs
1998A	542690CB6	12/1/2017	5.280%	CABs
1998A	542690CC4	12/1/2018	5.280%	CABs
1998A	542690CD2	12/1/2019	5.280%	CABs
1998A	542690CE0	12/1/2020	5.300%	CABs
1998A	542690CF7	12/1/2021	5.300%	CABs
1998A	542690CG5	12/1/2022	5.300%	CABs
1998A	542690CH3	12/1/2023	5.300%	CABs
1998A	542690CJ9	12/1/2024	5.300%	CABs
1998A	542690CK6	12/1/2025	5.300%	CABs
1998A	542690CL4	12/1/2026	5.300%	CABs
1998A	542690CM2	12/1/2027	5.300%	CABs
1998A	542690CN0	12/1/2028	5.300%	CABs
Capital Appreciation Bonds				
2000A	542690NL2	6/1/2013	5.540%	CABs
2000A	542690NM0	6/1/2014	5.600%	CABs
2000A	542690NN8	6/1/2015	5.670%	CABs
2000A	542690NP3	6/1/2016	5.720%	CABs
2000A	542690NQ1	6/1/2017	5.770%	CABs
2000A	542690NR9	6/1/2018	5.810%	CABs
2000A	542690NS7	6/1/2019	5.830%	CABs
2000A	542690NT5	6/1/2020	5.860%	CABs
2000A	542690NU2	6/1/2021	5.880%	CABs
2000A	542690NV0	6/1/2022	5.900%	CABs
2000A	542690NW8	6/1/2023	5.910%	CABs
2000A	542690NX6	6/1/2024	5.920%	CABs
2000A	542690NY4	6/1/2025	5.930%	CABs
2000A	542690NZ1	6/1/2026	5.940%	CABs
2000A	542690PA4	6/1/2027	5.950%	CABs
2000A	542690PB2	6/1/2028	5.950%	CABs
2000A	542690PC0	6/1/2029	5.950%	CABs

Series	CUSIP	Maturity/ Mandatory Purchase	Coupon or Yield	Serial/Term
Current Interest Bonds				
2003B	542690TW2	6/1/2013	5.250%	Serial
2003B	542690TX0	12/1/2013	5.250%	Serial
2003B	542690TY8	6/1/2014	5.250%	Serial
2003B	542690TZ5	12/1/2014	5.250%	Serial
Current Interest Bonds				
2003C	542690UG5	9/1/2013	4.250%	Serial
2003C	542690UZ3	9/1/2027	4.700%	Serial
2003C	542690VB5	9/1/2028	4.750%	Serial
2003C	542690VC3	9/1/2028	5.000%	Term
2003C	542690UY6	9/1/2029	5.250%	Term
2003C	542690VD1	9/1/2033	5.000%	Term
2003I	542690L34	12/1/2029	Variable	Term
2003L	542690L91	12/1/2029	Variable	Term
2003M	542690L83	12/1/2029	Variable	Term
2003O	542690L42	12/1/2029	Variable	Term
Current Interest Bonds				
2004A	542690WP3	9/1/2013	3.800%	Serial
2004A	542690WQ1	9/1/2014	3.875%	Serial
2004A	542690WR9	9/1/2015	4.000%	Serial
2004A	542690WS7	9/1/2016	4.125%	Serial
2004A	542690WT5	9/1/2017	4.250%	Serial
2004A	542690WU2	9/1/2018	4.250%	Serial
2004A	542690WV0	9/1/2019	4.375%	Serial
2004A	542690WW8	9/1/2020	4.500%	Serial
2004A	542690WX6	9/1/2021	4.500%	Serial
2004A	542690WY4	9/1/2022	4.625%	Serial
2004A	542690WZ1	9/1/2023	4.750%	Serial
2004A	542690XA5	9/1/2024	4.750%	Serial
2004A	542690XB3	9/1/2025	4.875%	Serial
2004A	542690XC1	9/1/2029	5.000%	Term
2004A	542690XD9	9/1/2029	5.100%	Term
2004A	542690XE7	9/1/2032	5.100%	Term
2004A	542690XF4	9/1/2034	5.000%	Term
Current Interest Bonds				
2006A	542690XP2	12/1/2016	4.000%	Serial
2006A	542690XQ0	12/1/2016	5.000%	Serial
2006A	542690XR8	12/1/2016	4.250%	Serial
2006A	542690XS6	12/1/2019	5.000%	Serial
2006A	542690XT4	12/1/2020	4.125%	Serial

Series	CUSIP	Maturity/ Mandatory Purchase	Coupon or Yield	Serial/Term
2006A	542690XU1	12/1/2020	5.250%	Serial
2006A	542690XV9	12/1/2023	5.000%	Serial
2006A	542690XW7	12/1/2024	4.500%	Serial
2006A	542690XX5	12/1/2024	5.000%	Serial
2006A	542690XY3	12/1/2025	5.000%	Serial
2006A	542690XZ0	12/1/2026	4.250%	Serial
2006A	542690YA4	12/1/2026	5.000%	Serial
Current Interest Bonds				
2006B	542690YB2	12/1/2035	4.500%	Serial
2006B	542690YC0	12/1/2035	5.000%	Term
Current Interest Bonds				
2006C	542690ZA3	9/1/2035	5.000%	Term
Current Interest Bonds				
2006D	542690ZK1	9/1/2013	4.000%	Serial
2006D	542690ZL9	9/1/2014	5.000%	Serial
2006D	542690ZM7	9/1/2014	4.125%	Serial
2006D	542690ZN5	9/1/2015	Variable	Serial
2006D	542690ZP0	9/1/2017	5.000%	Serial
2006D	542690ZQ8	9/1/2020	5.000%	Serial
2006D	542690ZR6	9/1/2021	5.000%	Serial
2006D	542690ZS4	9/1/2022	4.500%	Serial
2006D	542690ZT2	9/1/2023	5.000%	Serial
2006D	542690ZU9	9/1/2025	5.000%	Serial
Current Interest Bonds				
2006E	542690A51	12/1/2017	5.000%	Serial
2006E	542690A44	12/1/2017	5.000%	Serial
2006E	542690A69	12/1/2018	5.000%	Serial
2006E	542690A85	12/1/2018	4.000%	Serial
2006E	542690A77	12/1/2018	5.000%	Serial
2006E	542690A93	12/1/2020	5.000%	Serial
2006E	542690B27	12/1/2021	5.000%	Serial
2006E	542690B35	12/1/2021	5.000%	Serial
2006E	542690B50	12/1/2022	5.000%	Serial
2006E	542690B68	12/1/2022	4.125%	Serial
2006E	542690B43	12/1/2022	5.000%	Serial
Current Interest Bonds				
2006F	542690C59	5/1/2013	5.000%	Serial
2006F	542690C67	5/1/2014	4.000%	Serial
2006F	542690C75	5/1/2015	4.000%	Serial

Series	CUSIP	Maturity/ Mandatory Purchase	Coupon or Yield	Serial/Term
2006F	542690C83	5/1/2015	5.000%	Serial
2006F	542690C91	5/1/2016	4.000%	Serial
2006F	542690D25	5/1/2016	5.000%	Serial
2006F	542690D33	5/1/2017	5.000%	Serial
2006F	542690D41	5/1/2018	5.000%	Serial
2006F	542690D58	5/1/2019	5.000%	Serial
2006F	542690D66	5/1/2020	4.000%	Serial
2006F	542690D74	5/1/2021	4.000%	Serial
2006F	542690D90	5/1/2028	4.250%	Serial
2006F	542690D82	5/1/2028	4.500%	Serial
2006F	542690E24	5/1/2033	4.250%	Term
Current Interest Bonds				
2008A	542690N32	5/1/2033	5.500%	Term
2008A	542690N40	5/1/2033	6.000%	Term
Current Interest Bonds				
2008B	542690Q54	4/1/2019	5.250%	Serial
2008B	542690Q62	4/1/2020	5.375%	Serial
2008B	542690Q70	4/1/2021	5.500%	Serial
2008B	542690Q88	4/1/2022	5.500%	Serial
2008B	542690Q96	4/1/2023	5.625%	Serial
2008B	542690R20	4/1/2024	5.625%	Serial
2008B	542690R38	4/1/2025	5.750%	Serial
2008B	542690R46	4/1/2033	5.750%	Term
Current Interest Bonds				
2009A	542690S52	4/1/2014	3.000%	Serial
2009A	542690S60	4/1/2015	5.000%	Serial
2009A	542690S78	4/1/2016	3.500%	Serial
2009A	542690S86	4/1/2017	5.000%	Serial
2009A	542690S94	4/1/2018	5.000%	Serial
2009A	542690T28	4/1/2019	5.000%	Serial
2009A	542690T36	4/1/2020	4.500%	Serial
2009A	542690T44	4/1/2020	5.250%	Serial
2009A	542690T51	4/1/2021	5.250%	Serial
2009A	542690T69	4/1/2022	5.500%	Serial
2009A	542690T77	4/1/2023	5.000%	Serial
2009A	542690T85	4/1/2024	5.500%	Serial
2009A	542690T93	4/1/2030	5.700%	Serial
2009A	542690U34	4/1/2039	5.750%	Serial
2009A	542690U26	4/1/2033	6.250%	Term

Series	CUSIP	Maturity/ Mandatory Purchase	Coupon or Yield	Serial/Term
Current Interest Bonds				
2010A	542690V41	5/1/2014	3.000%	Serial
2010A	542690V66	5/1/2014	4.000%	Serial
2010A	542690V82	5/1/2014	5.000%	Serial
2010A	542690V58	5/1/2015	2.500%	Serial
2010A	542690V74	5/1/2015	3.000%	Serial
2010A	542690V90	5/1/2015	4.000%	Serial
2010A	542690W24	5/1/2015	5.000%	Serial
(Federally Taxable - Issuer Subsidy - Build America Bonds) Current Interest Bonds				
2010B	542690W32	5/1/2020	4.850%	Serial
2010B	542690W40	5/1/2021	5.100%	Serial
2010B	542690W57	5/1/2022	5.250%	Serial
2010B	542690W65	5/1/2024	5.450%	Serial
2010B	542690W73	5/1/2025	5.600%	Serial
2010B	542690W81	5/1/2026	5.700%	Serial
2010B	542690W99	5/1/2041	5.850%	Serial
Current Interest Bonds				
2011A	542690X31	5/1/2016	5.000%	Serial
2011A	542690X49	5/1/2017	4.000%	Serial
2011A	542690X98	5/1/2017	5.000%	Serial
2011A	542690X56	5/1/2018	4.000%	Serial
2011A	542690Y22	5/1/2018	5.000%	Serial
2011A	542690X64	5/1/2019	5.000%	Serial
2011A	542690X72	5/1/2020	5.000%	Serial
2011A	542690X80	5/1/2021	5.000%	Serial
2011A	542690Y30	5/1/2036	5.000%	Serial
2011A	542690Y48	5/1/2038	5.000%	Term
Current Interest Bonds				
2012A	542690Z70	9/1/2037	5.000%	Term
2012A	542690Z62	9/1/2042	5.000%	Term
Current Interest Bonds				
2012B	542690Z96	9/1/2014	3.000%	Serial
2012B	5426902A9	9/1/2015	4.000%	Serial
2012B	5426902B7	9/1/2016	5.000%	Serial
2012B	5426902C5	9/1/2021	5.000%	Serial

Series	CUSIP	Maturity/ Mandatory Purchase	Coupon or Yield	Serial/Term
2012B	5426902D3	9/1/2022	5.000%	Serial
2012B	5426902E1	9/1/2023	5.000%	Serial
2012B	5426902F8	9/1/2024	5.000%	Serial
2012B	5426902G6	9/1/2025	5.000%	Serial
2012B	5426902H4	9/1/2026	5.000%	Serial
2012B	5426902J0	9/1/2027	5.000%	Serial
2012B	5426902K7	9/1/2029	5.000%	Serial
Current Interest Bonds				
2012C	542690Z47	5/1/2033	Variable	Term
Current Interest Bonds				
2012D	542690Z21	12/1/2029	Variable	Term
NYSERDA Bonds				
P	1985A	649845ES9/ET7	3/1/2016	5.150%*
P	1985B	649845CX0	3/1/2016	5.150%*
P	1993B	649841BU6/DD2	11/1/2023	5.300%*
P	1994A	649841BW2/DE0	10/1/2024	5.300%*
P	1995A	649841BZ5	8/1/2025	5.300%*

Note: P indicates Promissory Note Obligation by KeySpan

* indicates adjustable rate converted to fixed

+ 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 Authority's bonds. 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 as indicated in this Appendix A.

APPENDIX B

Audited Basic Financial Statements



LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Basic Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Basic Financial Statements
December 31, 2012 and 2011

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KPMG LLP
Suite 200
1305 Walt Whitman Road
Melville, NY 11747-4302

Independent Auditors' Report

The Board of Trustees
Long Island Power Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the Long Island Power Authority (the Authority), a component unit of the State of New York, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the Authority as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Report on Other Legal and Regulatory Requirements

In accordance with Government Auditing Standards, we have also issued a report dated March 25, 2013, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope and of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that Management's Discussion and Analysis, as listed in the table of contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

New York, New York
March 25, 2013

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Management's Discussion and Analysis
(unaudited)
December 31, 2012 and 2011

Overview of the Financial Statements

This report consists of three parts: management's discussion and analysis (unaudited), the basic financial statements, and the notes to the financial statements.

The financial statements provide summary information about the overall financial condition of the Long Island Power Authority (Authority). The notes provide explanation and more details about the contents of the financial statements.

The Authority is considered a special-purpose government entity engaged in business-type activities and follows financial reporting for enterprise funds. The Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

Management's Discussion and Analysis (Unaudited)

The management's discussion and analysis of the Authority's financial performance provides an overview of the Authority's financial information for the years ended December 31, 2012 and 2011. The discussion and analysis should be read in conjunction with the financial statements and accompanying notes, which follow this section. The Authority's basic financial statements are presented as an enterprise fund following the accrual basis of accounting. Under this basis, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred.

The Authority is subject to the provisions of GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB No. 62 addresses accounting rules for regulated operations. This statement recognizes the economic impact of regulation, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Authority records these future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Management's Discussion and Analysis
(unaudited)
December 31, 2012 and 2011

Nature of Operations

The Authority, as owner of the transmission and distribution system located in the New York State Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways (Service Area), is responsible for supplying electricity to customers within the Service Area. Since 1998, the Authority has contracted with KeySpan Energy Corporation (KeySpan), a wholly owned subsidiary of National Grid plc, to provide the majority of services necessary to serve the Authority's customers under certain operating agreements.

Under the Management Services Agreement (MSA), which expires on December 31, 2013, KeySpan provides operations and management services related to the transmission and distribution system. The Authority conducted a competitive procurement seeking a vendor to provide the services currently provided under the MSA. In December 2011, the Board of Trustees (Board) approved the selection of Public Service Enterprise Group (PSEG) as the new service provider to operate the Authority's transmission and distribution system for a scheduled term of ten years beginning January 1, 2014, which has received all the appropriate regulatory approvals. Transition to the new service provider is on schedule.

Under the Power Supply Agreement (PSA), KeySpan provides capacity and energy from their oil and gas fired generating plants located on Long Island (herein referred to as GENCO). Through the PSA the Authority has a right of first refusal to purchase, on substantially the same terms as offered, all (but not less than all) GENCO generating facilities which GENCO may decide to sell to a foreign or foreign-controlled entity during the term of the PSA (Right of First Refusal). The PSA has a term that expires in May 2013. During 2012, the Authority and National Grid entered into a new PSA providing for the purchase of generation (including capacity and related energy) from these fossil fired generating plants for a maximum term of 15 years commencing in May 2013. Required regulatory approvals for the new agreement are expected to be secured over the next several months.

Under the Energy Management Agreement (EMA) and the Fuel Management and Bidding Services Agreement, KeySpan provides fuel management services for the generating facilities located on Long Island including those owned by National Grid and others under contract with the Authority. The existing services provided under these Agreements with KeySpan expire in May 2013. In April 2012, the Authority issued a request for proposal (RFP) for Fuel Management Services currently provided by KeySpan under the EMA, as well as for the non-KeySpan units currently being provided under the Fuel Management and Bidding Services Agreement. As a result of the RFP, the Authority selected Con Edison Energy, Inc. (CEE) to provide fuel management services for both the KeySpan GENCO generating facilities and the non-KeySpan units for which the Authority is responsible for providing fuel. The contract with CEE is subject to final approval from the New York State Comptroller and the Attorney General.

Certain other services, namely "mid-office" and "back-office" operations related to commodity hedging activities are managed by two other providers through contracts that commenced on January 1, 2010 for a five-year period. These contracts are subject to an extension for a period of five years at the Authority's option.

Power Supply

In addition to the PSA, the Authority has entered into numerous other agreements for capacity and energy necessary to continue to satisfy the energy demand of our customers, while increasing the diversity of its fuel mix alternatives.

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Management's Discussion and Analysis
(unaudited)
December 31, 2012 and 2011

For additional information on power purchase agreements and its related accounting treatments, see Notes 5 and 13 to the Basic Financial Statements.

Below is summary level information on the Authority's financial position:

Summary of Statements of Net Position
(Amounts in thousands)

	December 31		
	2012	2011	2010
Assets:			
Current assets:			
Cash, cash equivalents and investments	\$ 334,830	447,569	479,026
Other current assets	965,890	937,169	837,616
Regulatory assets	775,732	713,663	756,125
Noncurrent assets:			
Utility plant, net	6,595,582	6,624,802	6,431,896
Promissory notes receivable	155,422	155,422	155,422
Nonutility property and other investments	91,742	85,534	80,703
Unrealized charges and long-term receivables	875,604	330,591	179,816
Acquisition adjustment, net	2,264,616	2,375,991	2,487,366
Deferred outflows of resources	113,471	134,619	196,168
Total assets and deferred outflows of resources	<u>\$ 12,172,889</u>	<u>11,805,360</u>	<u>11,604,138</u>
Liabilities and net position:			
Regulatory liability	\$ 62,339	137,693	277,308
Other current liabilities	1,987,421	1,367,921	1,213,524
Noncurrent liabilities:			
Long-term debt	6,473,019	6,379,609	6,363,244
Capital lease obligations	2,726,089	2,883,321	2,834,416
Other noncurrent liabilities	526,477	562,067	405,453
Unearned credits	66,870	78,779	133,024
Total liabilities	<u>11,842,215</u>	<u>11,409,390</u>	<u>11,226,969</u>
Net position:			
Net investment in capital assets	(38,144)	(96,610)	(87,016)
Unrestricted	368,818	492,580	464,185
Total net position	<u>330,674</u>	<u>395,970</u>	<u>377,169</u>
Total liabilities and net position	<u>\$ 12,172,889</u>	<u>11,805,360</u>	<u>11,604,138</u>

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Management's Discussion and Analysis
(unaudited)
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Summary of Revenues, Expenses, and Changes in Net Position
(Amounts in thousands)

	Year ended December 31		
	2012	2011	2010
Electric revenue	\$ 3,546,152	3,684,596	3,853,052
Operating expenses:			
Operations – fuel and purchased power	1,553,769	1,743,533	1,879,839
Operations and maintenance	948,660	923,863	907,941
Storm Restoration	785,656	225,385	215,493
General and administrative	44,713	42,537	41,852
Depreciation and amortization	272,017	267,845	251,117
Payments in lieu of taxes	321,132	301,284	281,609
Total operating expenses	<u>3,925,947</u>	<u>3,504,447</u>	<u>3,577,851</u>
Operating (loss) income	(379,795)	180,149	275,201
Other income, net	37,351	35,389	46,445
Grant income - FEMA	604,500	119,658	56,996
Grant income - other	6,466	14,998	9,298
Interest charges	<u>(333,818)</u>	<u>(331,393)</u>	<u>(330,491)</u>
Change in net position	(65,296)	18,801	57,449
Net position – beginning of year	<u>395,970</u>	<u>377,169</u>	<u>319,720</u>
Net position – end of year	<u>\$ 330,674</u>	<u>395,970</u>	<u>377,169</u>

Change in Net Position

The change in net position for the year ended December 31, 2012 totaled a loss of \$65 million. The significant negative variance from 2011 of \$84 million was the result of the extraordinary restoration efforts associated with Superstorm Sandy and its unfavorable impact on sales and revenue. Due to the catastrophic damage caused by Superstorm Sandy, Long Island was declared a federal major disaster area allowing the Authority to receive reimbursement from the Federal Emergency Management Agency (FEMA) for at least 75% of eligible restoration costs. When damage to a State exceeds a federally mandated per capita threshold, the State can petition FEMA to provide 90% funding. The Authority believes the damage caused by Superstorm Sandy will exceed the federal threshold and as such, the Authority may be able to recover up to 90% of its eligible storm costs once the administrative process necessary for such funding is complete. The Authority's results continue to reflect the 75% funding level until thresholds are met, necessary approvals are obtained and collection is reasonably assured. However, as the Authority is hopeful that all requirements to qualify for the 90% funding will be met, the Board has approved a resolution for the portion of Superstorm Sandy costs that it believes are potentially non-recoverable from FEMA totaling \$80 million. As such, the change in net position includes the estimated restoration costs totaling approximately \$806 million; the recognition of the Board approved regulatory asset offsetting these costs by \$80 million; and, grant income of \$605 million representing the standard FEMA reimbursement level of 75%.

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The Authority has received FEMA aid previously in connection with costs incurred with natural disasters, most recently with regard to Tropical Storm Irene in 2011. The Authority submits claims only for storm costs which are believed to be eligible for reimbursement and the timing of such reimbursements cannot be predicted.

The 2012 loss is compared to the earnings for the years ended December 31, 2011 and 2010 which totaled approximately \$19 million, and \$57 million, respectively.

Revenue

Revenue for the twelve months ended December 31, 2012 decreased approximately \$138 million when compared to 2011 primarily due to a reduction in the power supply charge, resulting from lower commodity costs, totaling \$228 million (\$197 million due to lower rates and \$31 million due to lower sales); lower sales impacting delivery revenues by \$30 million; lower miscellaneous revenues of \$1 million; partially offset by higher delivery rates, which went into effect March 2012, increasing revenue by \$111 million and increased revenues to support the energy efficiency program of \$10 million.

Revenue for the twelve months ended December 31, 2011 decreased approximately \$168 million when compared to 2010. Approximately \$62 million of the variance was due to a one-time adjustment in 2010 resulting from a revised methodology for unbilled receivables. In addition, the Authority realized lower sales resulting in lower revenue of \$20 million and lower recoveries of power supply costs resulting from the reduction in the power supply rate which negatively impacted revenues by \$147 million. This decrease was partially offset by increased (i) delivery charge rates positively impacting revenues by \$39 million, (ii) Energy Efficiency Cost Recovery rates, which positively impacted revenues by \$14 million (net of deferrals), (iii) late payment charges of \$6 million; and, (iv) miscellaneous revenues of \$2 million.

Fuel and Purchased Power Costs

The Authority's tariff includes a power supply cost recovery provision – the Fuel and Purchased Power Cost Adjustment (FPPCA) that provides for the amount and timing of fuel and purchased power cost recoveries.

For the year ended December 31, 2012, fuel and purchased power costs decreased \$190 million compared to the year ended December 31, 2011. The Authority experienced lower commodity costs of \$197 million, and lower sales volumes impacting fuel costs by \$31 million. These decreases were offset by the lack of customer bill credits which were fully amortized in 2011; therefore, no such credits were amortized in 2012. During 2011, the customer bill credit amortization totaled \$38 million.

For the year ended December 31, 2011, fuel and purchased power costs decreased \$136 million compared to 2010. The Authority experienced lower commodity costs of \$132 million, lower sales volumes impacting fuel costs, compared to the year ended December 31, 2010, by \$11 million, lower amortization of prior year fuel deferrals totaling \$1 million, partially offset by lower amortization of customer bill credits of \$8 million.

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Operations and Maintenance Expense (O&M)

Operations and maintenance (O&M) expense for the year ended December 31, 2012, increased \$25 million compared to the year ended December 31, 2011. The Authority experienced higher energy efficiency and renewable costs of \$27 million and higher Management Services Agreement (MSA) costs of \$5 million. These increases were partially offset with lower bad debt expense of \$5 million and lower Power Supply Agreement (PSA) costs of \$2 million.

O&M expense for the year ended December 31, 2011, increased \$16 million compared to the year ended December 31, 2010, due to higher scheduled PSA costs of \$9 million, higher MSA costs of \$4 million, higher NMP2 costs of \$4 million, higher energy efficiency and renewable costs of \$1 million. These increases were partially offset by lower other costs of \$2 million.

Storm Restoration

For the year ended December 31, 2012, storm restoration expense increased \$560 million compared to the year ended December 31, 2011. This is primarily attributable to Superstorm Sandy which hit Long Island in October 2012, causing catastrophic damage to predominantly all of the Authority's service territory. Long Island's south shore experienced extensive flooding from unprecedented storm surges. The storm and flooding caused significant damage to the Authority's electric transmission and distribution system resulting in widespread power outages, mandatory evacuations and the destruction of homes and businesses. The restoration, which included assistance from utilities across the nation, is estimated to cost approximately \$806 million. As the Authority expects to receive a minimum of 75% from FEMA (as discussed below in grant income-FEMA), and as much as a 90% FEMA reimbursement, the Authority's Board has authorized the establishment of a regulatory asset totaling \$80 million for the estimated unreimbursed Superstorm Sandy costs, partially offsetting the \$806 million. Additionally 2012, the Authority experienced several other significant storms totaling approximately \$60 million.

The estimated Superstorm Sandy charges exclude the anticipated costs to reconstruct many substations damaged by flooding, which the Authority believes will be largely covered by insurance.

For the year ended December 31, 2011, storm restoration expense had an increase of \$10 million compared to the year ended December 31, 2010, due primarily to Tropical Storm Irene.

General and Administrative Expenses (G&A)

General and administrative expenses for the year ended December 31, 2012, increased by \$2 million compared to the year ended December 31, 2011, due to higher pension costs attributable to an updated actuarial study, which reflected a lower discount rate in establishing the liability.

General and administrative expenses for the year ended December 31, 2011 to 2010, remained relatively similar.

Depreciation and Amortization

For the year ended December 31, 2012, depreciation and amortization increased approximately \$4 million due to higher utility plant balances.

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For the year ended December 31, 2011, depreciation and amortization increased approximately \$17 million, due to the \$10 million one-time adjustment recorded in 2010 to the acquisition adjustment associated with the unbilled methodology revision. The remaining \$7 million increase was due to higher utility plant balances.

Payments in Lieu of Taxes

For the year ended December 31, 2012, payments in lieu of taxes (PILOTs) increased approximately \$20 million compared to the year ended December 31, 2011, due primarily to higher property taxes, set by various government organizations, on the transmission and distribution assets.

For the year ended December 31, 2011, payments in lieu of taxes (PILOTs) increased approximately \$20 million compared to the year ended December 31, 2010, due to higher property taxes of \$24 million on the transmission and distribution assets partially offset by lower revenue-based taxes of \$4 million.

Other Income, Net

For the year ended December 31, 2012, other income increased approximately \$2 million compared to 2011 due to higher earnings on the Authority's Nine Mile Point 2 (NMP2) trust account.

For the year ended December 31, 2011, other income decreased approximately \$11 million compared to 2010 as a result of: (i) the recognition of \$6 million of income related to previously deferred receipts that were deemed nonrefundable in 2010; (ii) lower earnings on the Authority's NMP2 trust account of \$3 million and (iii) \$2 million of non-operating expenses related to the Natural Resources Benefit contribution to fund the preservation of ecological properties to enhance the benefits of the Long Island Solar Farm Project at Brookhaven National Lab.

Grant Income - FEMA

Grant income increased approximately \$485 million due to the estimated FEMA reimbursements related to Superstorm Sandy. Long Island was declared an Emergency Disaster Area, as a result of this storm, making the Authority eligible for federal aid. The Authority expects the FEMA reimbursement to be at least the standard 75% reimbursement level estimated to be \$605 million. Due to the extraordinary nature of this event, the Authority believes New York State may be eligible to recover up to 90% of its eligible storm costs. However, until FEMA imposed financial thresholds are met, necessary approvals are obtained and collection is reasonably assured, the Authority's results continue to reflect the standard 75% funding level. Management believes it is probable that FEMA will remit such amounts based upon prior experience with other natural disasters.

Grant income increased approximately \$63 million compared to 2010 due primarily to the expected FEMA reimbursements related to Tropical Storm Irene. Long Island was declared an Emergency Disaster Area, as a result of this storm, making the Authority eligible for federal aid. The Authority expects a total reimbursement of \$116 million for Tropical Storm Irene. Through the date of the issuance of these financial statements approximately \$93 million has been received from FEMA related to this claim and management believes it is probable that the remaining balances will be remitted to the Authority.

Grant Income - other

Grant income—other decreased approximately \$9 million from 2011 due to lower grants received under the American Recovery and Rehabilitation Act of 2009.

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Grant income-other increased by approximately \$5 million from 2010 primarily due to an energy efficiency and renewable grant from New York State Energy Research Development Authority (NYSERDA).

Interest Charges and Credits

For the year ended December 31, 2012, total interest charges increased \$2 million compared to 2011 due primarily to higher letter of credit fees associated with the Authority's variable rate debt.

For the year ended December 31, 2011, total interest charges increased by \$1 million compared to 2010 due to higher interest rates associated with the Authority's variable rate debt.

Cash, Cash Equivalents, and Investments and Liquidity

The Authority's cash, cash equivalents, and investments totaled approximately \$335 million, \$448 million, and \$479 million at December 31, 2012, 2011, and 2010, respectively. The decrease from 2011 to 2012 is primarily due to lower revenues, resulting from the negative impacts of Superstorm Sandy, and the timing of payments related to Tropical Storm Irene costs (2011 storm event). Subsequent to December 31, 2012, the Authority received \$53 million and the Authority is anticipating the receipt of an additional \$23 million from FEMA for the reimbursable costs for Tropical Storm Irene. The Authority also expects receipt of reimbursement of eligible restoration costs related to Superstorm Sandy. Those costs, which include labor, materials, travel and equipment and incidental expenses associated with assistance from utilities across the nation, totaled approximately \$806 million has been accrued but not paid as of December 31, 2012. Since the Authority cannot predict the timing of any such FEMA reimbursements, it will finance the repayment of these costs using a combination of cash and cash equivalents held at December 31, 2012, commercial paper notes and an anticipated line of credit.

The Authority has also requested an advance from its insurer related to the restoration of its substations damaged by flooding during Superstorm Sandy. The Authority may seek additional advances throughout the year until the final settlement is reached with the insurer. The Authority anticipates finalization of the insurance claim by year end.

Furthermore, the Authority has the authorization to issue up to \$300 million of commercial paper notes, \$200 million of which were outstanding at December 31, 2012, 2011 and 2010. The Authority has received approval from its Board and the Public Authorities Control Board (PACB) to issue bonds to refund the \$200 million commercial paper notes outstanding, which if implemented, would increase the capacity under the commercial paper notes program to the authorization level of \$300 million. The Board and PACB have also authorized the Authority to issue \$500 million of medium-term notes, if necessary, to finance a portion of the Superstorm Sandy restoration costs until FEMA and insurance reimbursements are received. Additionally on March 25, 2013, the Authority secured a three year senior revolving credit facility that allows borrowing for up to \$500 million according to the terms and conditions contained in the credit agreement. Given the above, the Authority believes it will have sufficient liquidity throughout 2013 to meet its planned operating, maintenance and capital programs.

The decrease from 2010 to 2011 is primarily due to lower revenues and timing of payments related to Tropical Storm Irene costs.

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Capital Assets

The Authority continued its investment in transmission and distribution (T&D) upgrades to manage reliability and to enhance capacity needed to meet anticipated customer demands. For the years ended December 31, 2012 and 2011, capital improvements to the T&D system totaled approximately \$231 million and \$233 million, respectively. These improvements included interconnection equipment, the replacement or upgrade of transformer banks and circuit breakers, new substations, enhanced transmission lines and upgraded command and control equipment. The Authority also invested, in 2012 and 2011, approximately \$19 million and \$26 million, respectively, in NMP2 (discussed in Note 8 to the Basic Financial Statements). Also in 2011, the Authority had approximately \$7 million for information technology system improvements.

Regulatory Assets

Regulatory assets increased approximately \$62 million during the year ended December 31, 2012. The increase is the result of: (i) the recognition of a regulatory asset totaling \$80 million for the Superstorm Sandy costs that have been approved by the Board, to be recovered from its customers over a ten-year period beginning January 1, 2014, (ii) the 2012 deferred excess fuel and purchased power costs totaling \$43 million, (ii) the carrying charges of \$29 million on the credits related to the Shoreham Property Tax Settlement Agreement; and (iii) the deferral of costs totaling \$11 million related to the transition to the new business model upon expiration of the Management Services Agreement at the end of 2013. The Authority will recover the deferred transition costs over a 10-year period starting in 2014. These increases were partially offset by (i) the continued recovery of the 2003 deferred excess fuel and purchased power costs totaling approximately \$36 million annually, scheduled to be recovered over a ten-year period which began January 1, 2004, in accordance with the Authority's tariff; (ii) the scheduled recovery of approximately \$36 million related to the Shoreham Property Tax Settlement Agreement through a surcharge on billings for electric service to customers residing in Suffolk County (the Shoreham surcharge), which began in 2003 (as discussed in greater detail in Note 3 to the Basic Financial Statements); (iii) the scheduled recovery of prior year deferred fuel and purchased power related costs of approximately \$22 million and (iv) the amortization of other certain deferred costs totaling \$7 million.

Regulatory assets decreased approximately \$42 million during the year ended December 31, 2011. The decrease is the result of: (i) the continued recovery of the 2003 deferred excess fuel and purchased power costs totaling approximately \$37 million annually; (ii) the deferral of the New York State special assessment totaling \$7 million; (iii) the scheduled recovery of approximately \$38 million related to the Shoreham Property Tax Settlement Agreement; and (iv) the amortization of certain deferred costs totaling \$5 million. These decreases were partially offset by carrying charges of \$30 million on the credits related to the Shoreham Property Tax Settlement Agreement and the deferral of certain fuel and purchased power related costs totaling \$15 million.

Regulatory Liabilities

For the year ended December 31, 2012, the regulatory liabilities decreased by approximately \$75 million resulting primarily from the return to customers of (i) the excess fuel and purchased power costs recoveries totaling \$25 million; (ii) approximately \$36 million related to the deferral resulting from the revised unbilled receivable estimate; and (iii) the excess collection of the 2010 and 2011 efficiency and renewable charge totaling \$31 million. These decreases were partially offset by the excess collection of the 2012 efficiency and renewable charge totaling \$17 million.

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For the year ended December 31, 2011, the regulatory liabilities decreased by approximately \$140 million resulting primarily from the return to customers (i) the 2010 excess fuel and purchased power costs totaling \$136 million; and, (ii) approximately \$57 million of the deferral resulting from the revised unbilled receivable estimate. These decreases were partially offset by the excess recovery of 2011 fuel and purchased power supply costs totaling \$25 million which was returned to customers through reductions in the FPPCA in 2012; and, the excess collection of the 2011 efficiency and renewable charge totaling \$28 million.

Debt

The Authority's debt, including current maturities, is comprised of the following instruments (amounts in thousands):

	Balance at December 31		
	2012	2011	2010
General Revenue Bonds	\$ 6,166,540	6,013,987	5,945,934
Subordinated Revenue Bonds	350,000	525,000	551,450
Commercial Paper Notes	200,000	200,000	200,000
NYSERDA Notes	155,420	155,420	155,420
	\$ 6,871,960	6,894,407	6,852,804

During 2012, debt increased approximately \$22 million resulting from: (i) the issuance of Electric System General Revenue Bonds Series 2012A totaling approximately \$250 million (plus premium of approximately \$18 million) which will be used to finance the Authority's on-going capital improvements program; (ii) the issuance of Electric System General Revenue Bonds Series 2012B totaling approximately \$252 million (plus premium of approximately \$35 million) which were used to refund \$274 million of variable rate debt; (iii) the issuance of Electric System General Revenue Bonds Series 2012C and Series 2012D totaling \$324 million which were used to refund \$324 million of variable rate debt; and, (iv) the accretion of the capital appreciation bonds totaling approximately \$30 million. This is partially offset by scheduled maturities of \$280 million.

During 2011, debt increased approximately \$42 million resulting from: (i) the issuance of Electric System General Revenue Bonds Series 2011A totaling approximately \$250 million (plus premium of approximately \$12 million) which was used to finance the Authority's on-going capital improvements program; and, (ii) the accretion of the capital appreciation bonds totaling approximately \$30 million. This is partially offset by scheduled maturities of \$238 million.

For a full discussion on the Authority's debt activities during 2012 and 2011, see Note 10 to the Basic Financial Statements.

Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to attempt to mitigate such exposure, the Authority formed an Executive Risk Management Committee to strengthen executive management oversight for the risk mitigation activities of the Authority. In addition, the Authority retains an external consultant specializing in risk management, energy markets and energy trading to enhance the Authority's understanding of these areas.

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The energy risk management program is intended to identify exposures to movements in fuel and purchased power prices, quantify the impact of these exposures on the Authority's financial position, liquidity and the fuel and purchased power costs and attempts to mitigate the exposures in line with the Authority's identified levels of risk tolerance. The Authority actively manages the program in both upward and downward trending markets and adjusts its positions as necessary in an attempt to mitigate the impact of potentially unfavorable market movements. At December 31, 2012, 2011 and 2010 the Authority had posted approximately \$1.1 million, \$540,000, and \$365,000, respectively, of collateral to its counterparties in connection with its energy commodity hedge positions. No collateral was held by or posted by the Authority with respect to its interest rate derivatives.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) expanded the Commodity Futures Trading Commission's (CFTC) jurisdiction to regulate swaps under the Commodity Exchange Act. The CFTC has been implementing its authority under the Dodd-Frank Act in an expansive manner, and although the Authority has implemented several compliance measures, the Authority will still need to evaluate future CFTC rules and regulations to determine if there would be any potential impacts to the Authority's risk management strategies and practices.

In accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, the Authority records its hedging and investment derivatives at fair value and records deferred inflows and outflows for changes in fair values on hedging derivatives and defers, as unrealized gains and losses, changes in fair value for investing derivatives consistent with its rate making practices. For a further discussion on these matters, see Note 5 to the Basic Financial Statements.

Fuel and purchased power transactions – For the year ended December 31, 2012, the Authority had realized losses of \$94 million and recognized \$5 million of option premium amortization which increased fuel and purchased power costs by \$99 million. The Authority also recorded deferred outflows (unrealized loss) and unrealized charges on commodity derivatives of approximately \$113 million, reflecting the negative mark-to-market on the Authority's fuel derivative positions as of December 31, 2012.

For the year ended December 31, 2011, the Authority had realized losses of \$89 million and recognized \$2 million of option premium amortization which increased fuel and purchased power costs by \$91 million. The Authority also recorded deferred outflows (unrealized loss) and unrealized charges on commodity derivatives of approximately \$141 million, reflecting the negative mark-to-market on the Authority's fuel derivative positions as of December 31, 2011.

Interest rate transactions – At December 31, 2012 and 2011, the Authority recorded deferred outflows of \$25 million and \$56 million, respectively, related to its interest rate hedging derivatives. The Authority also recorded net unrealized fair value losses on its investment derivatives of approximately \$198 million (of which approximately \$31 million is a component of deferred loss on debt refunding) and \$194 million, respectively. Any gains or losses resulting from changes in the mark-to-market valuations on investment derivatives are deferred, and will be recognized when realized consistent with how the Authority recovers any such amounts in rates charged to customers.

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Investment Ratings

Below are the Authority's securities as rated by Moody's Investors Service (Moody's), Standard and Poor's Ratings Services (S&P), and Fitch Ratings (Fitch):

	Investment ratings		
	Moody's⁽¹⁾	S&P⁽¹⁾	Fitch⁽¹⁾
Senior Lien debt	A3	A-	A

⁽¹⁾ Negative outlook

Certain Senior and all Subordinated Lien debt and the Commercial Paper notes are supported by either a Letter of Credit (LOC) or are insured against default. Such debt carries the higher of the ratings of the credit support provider (LOC bank or insurance company), or that of the Authority.

Contacting the Long Island Power Authority

This financial report is designed to provide our bondholders, customers, and other interested parties with a general overview of the Authority's finances and to demonstrate its accountability for the funds it receives. If you have any questions about this report or need additional information, contact the Authority at 333 Earle Ovington Blvd., Suite 403, Uniondale, New York 11553, or visit our website at www.lipower.org.

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Statements of Net Position

December 31, 2012 and 2011

(Amounts in thousands)

Assets and Deferred Outflow of Resources	2012	2011
Current assets:		
Cash and cash equivalents	\$ 334,830	437,570
Investments	—	9,999
Counterparty collateral – posted by the authority	1,100	540
Accounts receivable (less allowance for doubtful accounts of \$32,519, at December 31, 2012 and 2011)	645,975	527,871
Other receivable	138,268	202,866
Fuel inventory	148,436	165,280
Material and supplies inventory	8,234	8,220
Unrealized charges	12,227	28,922
Regulatory assets due within one year:		
Fuel and purchased power costs recoverable	83,936	59,253
Shoreham property tax settlement	40,692	39,918
New York State assessment	17,646	12,079
Power Supply Management transition costs	3,183	3,183
Southampton visual benefit assessment	888	950
Prepayments and other current assets	11,650	3,473
	1,447,065	1,500,124
Noncurrent assets:		
Utility plant and property and equipment, net	6,595,582	6,624,802
Promissory Notes Receivable-KeySpan Energy	155,422	155,422
Nonutility property and other investments	91,742	85,534
Other long – term receivables	639,072	44,642
Unrealized charges	236,532	285,946
Regulatory assets:		
Shoreham settlement	487,636	495,071
Storm restoration - Superstorm Sandy	80,000	—
Fuel and purchased power costs	38,460	77,802
New York State assessment	—	9,260
Transition costs – Power Supply Management	3,184	6,367
Transition costs – Management Services Agreement	10,547	—
Southampton visual benefit assessment	9,560	9,780
Acquisition Adjustment (net of accumulated amortization)	2,264,616	2,375,991
Total noncurrent assets	10,612,353	10,170,617
Deferred Outflows of Resources:		
Accumulated decrease in fair value of commodity derivatives	88,341	78,441
Accumulated decrease in fair value of financial derivatives	25,130	56,178
Total deferred outflows of resources	113,471	134,619
Total assets and deferred outflows of resources	\$ 12,172,889	11,805,360

See accompanying notes to basic financial statements.

Liabilities and Net Position	2012	2011
Current liabilities:		
Short-term debt	\$ 200,000	200,000
Current maturities of long-term debt	175,625	278,025
Current portion of capital lease obligation	157,232	147,656
Accounts payable and accrued expenses	432,930	493,028
Regulatory liabilities:		
Fuel and purchased power costs refundable	37,764	62,713
Energy efficiency cost recovery variances	24,575	39,267
Commodity derivative instruments	55,682	75,064
Accrued payments in lieu of taxes	41,102	43,526
Accrued interest	55,666	55,103
Customer deposits	36,841	34,282
Accrued storm costs	832,343	41,237
Total current liabilities	<u>2,049,760</u>	<u>1,469,901</u>
Noncurrent liabilities:		
Long-term debt	6,473,019	6,379,609
Borrowings	100,901	105,315
Commodity derivative instruments	57,591	65,822
Financial derivative instruments	261,237	290,200
Regulatory liability - fuel and purchased power costs refundable	-	35,713
Capital lease obligations	2,726,089	2,883,321
Asset retirement obligation	84,850	79,457
Unrealized credits	66,870	78,779
Claims and damages	21,898	21,273
Total noncurrent liabilities	<u>9,792,455</u>	<u>9,939,489</u>
Net position:		
Net investment in capital assets	(38,144)	(96,610)
Unrestricted	368,818	492,580
Total net position	<u>330,674</u>	<u>395,970</u>
Total liabilities and net position	<u>\$ 12,172,889</u>	<u>11,805,360</u>

See accompanying notes to basic financial statements.

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Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2012 and 2011

(Amounts in thousands)

	2012	2011
Operating revenues – electric sales	\$ 3,546,152	3,684,596
Operating expenses:		
Operations – fuel and purchased power	1,553,769	1,743,533
Operations and maintenance	948,660	923,863
Storm restoration	785,656	225,385
General and administrative	44,713	42,537
Depreciation and amortization	272,017	267,845
Payments in lieu of taxes	321,132	301,284
Total operating expenses	3,925,947	3,504,447
Operating (loss) income	(379,795)	180,149
Nonoperating revenues and expenses:		
Other income, net:		
Investing income	6,917	4,645
Grant income - FEMA	604,500	119,658
Grant income - other	6,466	14,998
Carrying charges on regulatory assets	30,215	30,829
Other	219	(85)
Total nonoperating revenues and expenses:	648,317	170,045
Interest charges and (credits):		
Interest on long-term debt, net	327,500	328,080
Other interest	15,657	10,901
Allowance for borrowed funds used during construction	(9,339)	(7,588)
Total interest charges	333,818	331,393
Total nonoperating revenues and expenses	314,499	(161,348)
Change in net position	(65,296)	18,801
Total net position, beginning of year	395,970	377,169
Total net position, end of year	\$ 330,674	395,970

See accompanying notes to basic financial statements.

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Statements of Cash Flows

Years ended December 31, 2012 and 2011

(Amounts in thousands)

	2012	2011
Cash flows from operating activities:		
Received from customers for system sales, net of refunds	\$ 3,381,131	3,634,133
Other operating revenues received	44,349	59,130
Paid to suppliers and employees:		
Operations and maintenance	(1,063,728)	(1,093,663)
Fuel and purchased power	(1,469,973)	(1,711,081)
Payments in lieu of taxes	(408,684)	(401,676)
Collateral on fuel derivative transactions, net	(560)	(175)
Net cash provided by operating activities	482,535	486,668
Cash flows from investing activities:		
Sales of investment securities	9,999	223,808
Purchase of investment securities	-	(117,875)
Fair value adjustment – short term securities	-	16
Realized gains on short term securities	-	(242)
Earnings received on investments	392	597
Other	(486)	3,503
Net cash provided by investing activities	9,905	109,807
Cash flows from noncapital financing related activities:		
Grant proceeds	52,658	29,717
Net cash provided by noncapital related activities	52,658	29,717
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(330,469)	(265,738)
Proceeds from promissory note	8,075	8,075
Proceeds from the issuance of bonds, net of discount/premium	867,716	261,693
Bond issuance costs	(2,530)	(2,137)
Interest paid, net	(312,605)	(315,734)
Redemption of long-term debt	(878,025)	(238,100)
Net cash used in capital and related financing activities	(647,838)	(551,941)
Net (decrease) increase in cash and cash equivalents	(102,740)	74,251
Cash and cash equivalents at beginning of year	437,570	363,319
Cash and cash equivalents at end of year	\$ 334,830	437,570
Reconciliation to net cash provided by operating activities:		
Operating (loss) income	\$ (379,795)	180,149
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Depreciation and amortization	272,017	267,845
Nuclear fuel burned	9,140	8,452
Shoreham surcharges	36,238	38,063
Accrued storm costs and claims and damages	869,038	226,677
Accretion of asset retirement obligation	4,188	3,826
Amortization of settlement benefits to ratepayers	-	(39,475)
Other, net	(8,058)	(12,852)
Changes in operating assets and liabilities:		
Accounts receivable, net	(89,534)	42,669
Regulatory asset – storm restoration	(80,000)	-
Regulatory asset – New York State assessment	3,693	6,449
Fuel and material and supplies inventory	16,830	1,562
Fuel and purchased power costs adjustments	(46,003)	(140,781)
Counterparty collateral	(560)	(175)
Claims, damages and storm restoration	(77,307)	(240,917)
Accounts payable, accrued expenses and other	(47,352)	145,176
Net cash provided by operating activities	\$ 482,535	486,668

See accompanying notes to basic financial statements.

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(1) Basis of Presentation

The Long Island Power Authority (Authority) was established as a corporate municipal instrumentality of the State of New York (State), constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the LIPA Act). As such, it is a component unit of the State and is included in the State's annual financial statements.

The Authority's reporting entity is comprised of itself and its operating subsidiary, the Long Island Lighting Company (LILCO), a wholly owned subsidiary of the Authority doing business as LIPA. LIPA has one share of \$1 par value common stock authorized, issued and outstanding, which is held by the Authority.

The Authority holds 100% of the common stock of LIPA, controls the operations of LIPA, and the governing bodies of both LIPA and the Authority are the same. LIPA services are provided to entirely benefit the Authority, and as such under Governmental Accounting Standard Board Statement (GASB) No. 14, *The Financial Reporting Entity*, LIPA is considered a blended component unit of the Authority. The assets, liabilities and results of operations are consolidated with the operation of the Authority for financial reporting purposes.

The Authority and its blended component unit, LIPA, are referred to collectively, as the "Authority" in the financial statements. All significant transactions between the Authority and LIPA have been eliminated.

(2) Nature of Operations

The Authority, as owner of the transmission and distribution system located in the New York State Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways (Service Area), is responsible for supplying electricity to customers within the Service Area. The Authority has contracted with KeySpan Energy Corporation (KeySpan), a wholly owned subsidiary of National Grid plc, to provide the majority of services necessary to service the Authority's customers. The Authority pays KeySpan directly and KeySpan, in turn, pays the salaries of its employees and fees of its contractors and suppliers. In 2012 and 2011, the Authority paid to KeySpan approximately \$2 billion each year under operating agreements, which includes all fees under such agreements, reimbursement for various taxes and payments in lieu of taxes (PILOTs), certain fuel and purchased power costs, capital projects, energy efficiency services, research and development and various other expenditures authorized by the Authority. In addition, the Authority contracts with two other service providers to manage certain fuel related services.

Below is a summary of the Authority's Operating Agreements:

MSA. Under the Management Services Agreement (MSA), KeySpan provides operations and management services related to the transmission and distribution system. In 2006, the Authority amended the MSA and certain other Operating Agreements. The Amended and Restated MSA has a term that expires on December 31, 2013. In anticipation of the expiration of the Amended and Restated MSA on December 31, 2013, the Authority conducted a competitive procurement seeking a vendor to provide the services currently provided under the MSA. In December 2011, the Board of Trustees (Board) approved the selection of Public Service Enterprise Group (PSEG), along with their partner, Lockheed Martin

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(Lockheed), as the new service provider to take over the operation of the transmission and distribution system beginning January 1, 2014 under a new Long Island based company (PSEG LI) that will focus exclusively on services to the Authority. In January 2012, the Authority and PSEG LI executed an Operations Services Agreement (OSA) for a scheduled term of ten years beginning January 1, 2014. In addition, the Authority and PSEG LI have executed a Transition Services Agreement (TSA) for a term of approximately two years that requires PSEG LI to perform a variety of specified activities in order to position itself to assume responsibility to provide operation services under the OSA on January 1, 2014. The scope of services under the OSA is substantially similar to that of the existing MSA with National Grid. PSEG-Lockheed will provide operations services under the OSA through a PSEG, wholly-owned subsidiary, fully dedicated to LIPA's operations. Under the OSA, LIPA will have more direct control over the budget and work scope and will have greater transparency into the costs of performing such services. Under the OSA, PSEG-Lockheed will be paid a management fee. In addition, all costs of operating and maintaining the Authority's T&D System incurred by PSEG-Lockheed will be passed through to and paid by the Authority. The OSA contains performance metrics similar to those under the existing MSA. The new agreements with PSEG have received all required regulatory approvals.

PSA. Under the Power Supply Agreement (PSA), KeySpan provides capacity and energy from the oil and gas fired generating plants of KeySpan (GENCO). Under the PSA the Authority has a right of first refusal to purchase, on substantially the same terms as offered, all (but not less than all) GENCO generating facilities which GENCO may decide to sell to a foreign or foreign-controlled entity during the term of the PSA (Right of First Refusal). The PSA has a term that expires on May 28, 2013. On October 2, 2012, the Authority and National Grid entered into a new PSA providing for the purchase of up to 3,700 MW of generation (including capacity and related energy) from the oil and gas fired generating plants for a maximum term of 15 years commencing in May 2013. Required regulatory approvals for the new agreement are expected to be secured over the next several months

EMA. Under the Energy Management Agreement and the Fuel Management and Bidding Services Agreement, KeySpan provides fuel management services for the generating facilities located on Long Island including those owned by National Grid and others under contract with the Authority. The existing services provided under these Agreements with KeySpan expire in May 2013. In April 2012, the Authority issued a request for proposal (RFP) for Fuel Management Services currently provided by KeySpan under the EMA, as well as for the non-KeySpan units currently being provided under the Fuel Management and Bidding Services Agreement. As a result of the RFP, the Authority selected Con Edison Energy, Inc. (CEE) to provide fuel management services for both the KeySpan GENCO generating facilities and the non-KeySpan units for which the Authority is responsible for providing fuel. The contract with CEE is subject to final approval from the New York State Comptroller and the Attorney General.

Certain other services, namely "mid-office" and "back-office" operations related to commodity hedging activities are managed by two other providers through contracts that commenced on January 1, 2010 for a five-year period. These contracts are subject to an extension for a period of five years at the Authority's option.

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(3) Summary of Significant Accounting Policies

(a) General

The Authority complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). The operations of the Authority are presented as an enterprise fund following the accrual basis of accounting in order to recognize the flow of economic resources. Under this basis, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred.

(b) Accounting for the Effects of Rate Regulation

The Authority is subject to the provisions of GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB No. 62 addresses accounting rules for regulated operations. 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 Authority records these future economic benefits and obligations as regulatory assets or 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 GASB No. 62, it must meet the following three criteria: (i) 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; (ii) the regulated rates must be designed to recover the specific enterprise's costs of providing the regulated services; and (iii) 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 Authority'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 Authority believes that GASB No. 62 continues to apply.

The Authority regularly assesses whether regulatory assets and liabilities are probable of recovery or refund. If recovery or refund is not approved by the Authority's Board, which sets rates charged to customers, or if it becomes no longer probable that these amounts will be realized or refunded, they would need to be written-off and recognized in the current period results of operations. The acquisition adjustment totaling approximately \$2.3 billion would also be evaluated for impairment.

(c) 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

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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 to be used for specific purposes, including rate stabilization, debt service, and capital expenditures. Investments' carrying values are reported at fair market value. For a further discussion, see Note 9 to the Basic Financial Statements.

(d) Counterparty Collateral

The Authority and its counterparties require collateral posting for mark-to-market valuations that exceed established credit limits. At December 31, 2012 and 2011, the Authority was required to post approximately \$1.1 million and \$540,000, respectively, of collateral to various counterparties, which is recorded as a current asset.

(e) Utility Plant and Property and Equipment

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 borrowed 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, meters and wire) are accounted for on an average unit cost basis by year of installation. For a further discussion, see note 7.

Property and equipment represents leasehold improvements, office equipment and furniture and fixtures of the Authority.

(f) Fuel Inventory

Under the terms of the EMA and various Power Purchase Agreements, the Authority owns the fuel oil used in the generation of electricity at the facilities under contract to the Authority. Fuel inventory represents the value of low sulfur and other liquid fuels that the Authority 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.

(g) Material and Supplies Inventory

This represents the Authority's share of material and supplies inventory needed to support the operation of the Nine Mile Point 2 (NMP2) nuclear power station.

(h) Promissory Note Receivable

As part of the KeySpan merger in 1998, KeySpan issued promissory notes to the Authority of approximately \$1.048 billion. As of December 31, 2012 and 2011, approximately \$155 million remained outstanding. The fair market value of the note at December 31, 2012 and 2011 is approximately \$156 million. The interest rates and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed

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by the Authority in the merger. KeySpan is required to make principal and interest payments to the Authority thirty days prior to the corresponding payment due dates.

(i) *Nonutility Property and Other Investments*

The Authority's nonutility property and other investments consist primarily of the NMP2 Decommissioning Trust Funds (the Trusts). At December 31, 2012 and 2011, the value of the Trusts was approximately \$92 million and \$85 million, respectively.

(j) *Other Receivables and Long-Term Receivables*

The current portion of other receivables includes approximately \$76 million for the Tropical Storm Irene (2011 storm event) claims submitted to the Federal Emergency Management Agency (FEMA) of which approximately \$53 million was received subsequent to December 31, 2012. Long Island was declared an Emergency Disaster Area, in August 2011, making the Authority eligible for federal aid for this event. Management believes it is probable that FEMA will remit the remaining amounts and expects receipt in 2013.

The long term portion of other receivables includes approximately \$605 million representing 75% of the total estimated restoration costs associated with Superstorm Sandy, which occurred in October 2012. These estimates have been submitted to FEMA for initial review and based on prior experience with other federal disaster aid claims; management believes it is probable FEMA will remit this amount. The remaining balance of the long term portion of other receivables represents the net present value of a receivable related to the reimbursable costs to construct the interconnection facilities related to the Neptune cable, which is to be paid to the Authority over a period of 20 years.

(k) *Deferred Outflow of Resources*

This represents the accumulated changes in the fair value of hedging derivative instruments. Under hedge accounting, the changes in the fair value of a hedging derivative instrument, in asset or liability positions, are reported as a deferred inflow of resources or deferred outflow of resources, respectively, on the Statements of Net Position.

The change in fair value of investment derivative instruments are reported as unamortized charges, as the Authority's Board has authorized the deferral of these unrealized gains and losses, and all such gains and losses are deferred until realized, which corresponds to the period they are recovered in rates.

(l) *Unrealized Charges*

Unrealized charges consists primarily of (i) the balance of the investment derivative instruments; and, (ii) the unamortized balance of costs incurred to issue long-term debt, which are amortized to interest expense over the life of the debt issuance to which they relate.

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(m) Regulatory Assets

Shoreham Property Tax Settlement (Settlement)

In January 2000, the Authority reached an agreement with 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 (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 was required to issue \$457.5 million of rebates and credits to customers over the five-year period which began May 29, 1998. In order to fund such rebates and credits, the Authority used the proceeds from the issuance in May 1998 of its Capital Appreciation Bonds, Series 1998A Electric System General Revenue Bonds totaling approximately \$146 million and the issuance in May 2000 of approximately \$325 million of Electric System General Revenue Bonds, Series 2000A.

As provided under the Settlement, beginning in June 2003, Suffolk County customers' bills include a surcharge (the Suffolk Surcharge) to be collected over the succeeding approximate 25 year period to repay the debt service and issuance costs on the bonds issued by the Authority to fund the Settlement as well as its cost of pre-funding certain rebates and credits.

As future rates will be established at a level sufficient to recover all such costs identified above, the Authority recorded a regulatory asset. The balance of the Shoreham property tax settlement regulatory asset as of December 31, 2012 and 2011 was approximately \$528 million and \$535 million, respectively. The balance represents rebates and credits issued to customers, costs of administering the program plus annual debt service costs on the bonds identified above, less surcharges collected since 2003.

Fuel and Purchased Power Costs Recoverable

The Authority's tariff includes a fuel recovery provision – the Fuel and Purchased Power Cost Adjustment (FPPCA) that provides for the recovery of fuel and purchased power costs in the period incurred. In 2012, the FPPCA tariff was modified to allow for 100% recovery of LIPA's power supply costs and to transition from a quarterly update process to a monthly basis. Prior to this modification, should LIPA's fuel and purchased power prices change such that the Authority would exceed or fail to meet a Board approved financial target, the FPPCA would be reduced or increased accordingly. In no event, however, did the Authority recover an amount that exceeded its fuel and purchased power costs incurred. With the new modification, fuel and purchased power cost recovery will no longer be set to achieve a targeted reserve of \$75 million. For the year ended December 31, 2012, actual fuel and purchased power costs exceeded the amounts recovered in the power supply charge. As a result, a regulatory asset totaling \$43 million was recorded and as prescribed by the monthly collection method, the 2013 tariff reflects a recovery factor for this under-recovery.

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Also remaining as a regulatory asset is the 2003 deferred excess fuel and purchased power costs. In order to transition to a current period recovery method (within the same year), the Authority deferred approximately \$365 million of unrecovered fuel and purchased power costs to be recovered over a 10-year period beginning January 1, 2004. As of December 31, 2012 and 2011, the uncollected balance totaled approximately \$37 million and \$73 million, respectively.

Also recorded as recoverable fuel and purchased power costs are: (i) amounts incurred related to various energy projects, whose amortization is charged to fuel and purchased power costs over the period of benefit (the life of the power purchase agreement) totaling approximately \$41 million and \$44 million as of December 31, 2012 and 2011, respectively; and (ii) excess credits related to prior year excess fuel and purchased power costs refunded totaling approximately \$1 million and \$19 million as of December 31, 2012 and 2011, respectively.

Superstorm Sandy

Superstorm Sandy estimated costs totaled \$806 million. The Authority expects to receive a minimum FEMA reimbursement of 75% of allowable costs but believes that due to the extraordinary costs of this event that New York State may be eligible to seek as much as a 90% FEMA reimbursement (for a further discussion see note 4). Accordingly, the Board has approved recovery from customers \$80 million of estimated storm costs that it believes are not recoverable from FEMA. The regulatory asset of \$80 million will be recovered over a 10-year period beginning January 1, 2014. Deferring recovery until 2014 allows the Authority to ensure that the amount collected from customers is consistent with the actual amount of FEMA reimbursement to be received, which will be finalized in the upcoming months. It should be noted that the amount of the regulatory asset may be adjusted in the event that the actual reimbursement from FEMA is different from what is expected at this time.

New York State Temporary Energy and Utility Conservation Assessment

As a result of an amendment to the Public Service Law effective April 1, 2009, LIPA is required to collect from all customers a special assessment that is paid directly to the State for a five year period that began in 2009. As the Authority's rates did not include the recovery of this assessment until approved by the Authority's Board effective January 1, 2010, the 2009 assessment has been deferred and is collected ratably from customers over four years.

Transition Costs - Power Supply Management

The Authority deferred costs related to transition to two new service providers due to the expiration of the EMA. These costs have been classified as a regulatory asset as the Authority's Board has approved collection of these costs to be recovered over a five year period coincident with the contracts which commenced on January 1, 2010 and expire December 31, 2015.

Transition Costs – Management Services Agreement

Deferred costs related to the transition to PSEG LI as LIPA's new management service provider. The OSA is for a scheduled term of ten years beginning January 1, 2014. In addition, the Authority and PSEG LI have executed a TSA for a term of approximately two years that requires PSEG LI to

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perform a variety of specified activities in order to position itself to assume responsibility to provide operation services under the OSA on January 1, 2014. The costs of transitioning to the new service provider are being classified as a regulatory asset as the Authority's Board has approved collection of these costs to be recovered over a ten year period coincident with the contracts beginning on January 1, 2014 and expiring December 31, 2024.

Southampton Visual Benefit Assessment

The Authority has recorded the incremental costs incurred to bury a portion of a transmission cable routed through the Town of Southampton (Town) that will be recovered from certain customers of the Town over a period of 20 years that began in 2009.

(n) Acquisition Adjustment

The acquisition adjustment, an intangible asset, 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 through 2033.

(o) Capitalized Lease Obligations

Capitalized lease obligations represent the net present value of various contracts for the capacity and/or energy of certain generation and transmission facilities. Upon satisfying the capitalization criteria, the net present value of the contract payments is included in both Utility Plant and Capital Lease Obligations.

The Authority recognizes in fuel and purchased power expense an amount equal to the contract payment of the capitalized leases, as allowed through the ratemaking process. The value of the asset and the obligation is reduced each month so that the statement of net position properly reflects the remaining net present value of the asset and obligation at each month end.

For a further discussion on the capitalization of capacity and/or energy contracts, see note 13.

(p) Unrealized Credits

Unrealized credits primarily represent amounts received from KeySpan/National Grid as a result of certain renegotiated agreements. These credits and savings have been amortized through a reduction to expense and provided as a benefit to the customer. Also included in unrealized credits is the Authority's unfunded other post-employment benefit obligation.

(q) Borrowings

Borrowings represent the unamortized balance of cash premiums received at the time of entering into certain financial derivative instruments. The Authority is amortizing such premiums over the life of the instrument in accordance with GASB No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB No. 53).

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(r) Commodity and Financial Derivative Instruments

Represents the amount that the Authority believes it would be required to pay in order to terminate these derivative instruments as of December 31, 2012 and 2011, which approximates fair value.

(s) Accrued Storm Costs

Accrued storm costs consist primarily of unpaid storm restoration costs related to Superstorm Sandy which at December 31, 2012 are estimated to be \$806 million. Also included are estimated costs related to other storms incurred during 2012 but not paid as of December 31, 2012 totaling \$26 million.

(t) Claims and Damages

Losses arising from claims 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.

(u) Revenues

Operating revenues are comprised of cycle billings for electric service rendered to customers, based on meter reads, and the accrual of revenues for electric service rendered to customers not billed at month-end. The Authority accrues unbilled revenues by estimating unbilled consumption at the customer meter. For the years ended December 31, 2012, the Authority received approximately 52% of its revenues from residential sales, 44% from sales to commercial and industrial customers, and the balance from sales to public authorities and municipalities.

All other revenue is reported as non-operating revenue when service is rendered. Fuel and purchased power supply cost recoveries collected in excess of that incurred are deferred until the FPPCA rate is adjusted.

(v) Depreciation and Amortization

The provisions for depreciation for utility plant result from the application of straight-line rates by groups of depreciable properties in service assets. The rates are determined by age-life studies performed on depreciable properties. The average composite depreciation rate is 2.96% and 2.88% for December 31, 2012 and 2011, respectively.

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.

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The following estimated useful lives and capitalization thresholds are used for utility property:

<u>Category</u>	<u>Useful life</u>
Generation – nuclear	39 – 46 years
Transmission and distribution	20 – 48 years
Common	4 – 41 years
Nuclear fuel in process and in reactor	6 years
Generation assets under capital lease	10 – 25 years

(w) *Payments-in-Lieu-of-Taxes*

The Authority makes payments-in-lieu-of-taxes (PILOTS) for certain 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. In addition, the Authority has entered into various PILOT arrangements for property it owns, upon which merchant generation and transmission is built.

(x) *Allowance for Borrowed Funds Used during Construction*

The allowance for borrowed funds used during construction (AFUDC) is the net cost of borrowed funds used for construction purposes. AFUDC is not an item of current cash income. AFUDC is computed monthly on a portion of construction work in progress, and is shown as a net reduction in interest expense. The AFUDC rates were 5.189% and 5.01% for the years ended December 31, 2012 and 2011, respectively.

(y) *Income Taxes*

The Authority is a political subdivision of the State of New York and, therefore, is exempt from Federal, state, and local income taxes.

(z) *Regulatory Liability – Fuel and Purchased Power Costs Refundable*

Regulatory liabilities represent amounts that are expected to be refunded to customers through the ratemaking process. In accordance with the FPPCA, the Authority must return any FPPCA revenues it recovers in excess of the fuel and purchased power costs it incurs. Any such over recoveries are recognized as regulatory liabilities. For 2011, a regulatory liability resulting from such over recoveries totaled \$25 million. Such amounts were reflected as reductions in the 2012 FPPCA rate and were returned to customers in 2012.

In 2010, as a result of the change in the unbilled revenue estimate, a regulatory liability for approximately \$129 million was recorded that represents deferred revenue to be refunded to customers. The Authority returned approximately \$36 million in 2012 and \$57 million in 2011, and will return the remaining excess recovery of \$36 million to customers in 2013.

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(aa) Asset Retirement Obligation

The Authority follows FASB ASC 410, *Asset Retirement and Environment Obligations* (ARO). An ARO exists when there is an 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. The Authority, as an 18% owner of NMP2 has a legal obligation associated with its retirement. This initial obligation is offset by the capitalization of the asset which is included in "Utility plant and property and equipment". As of December 31, 2012 and 2011, the NMP2 ARO totaled approximately \$78 million and \$73 million, respectively. The Authority maintains a Trust for the decommissioning of NMP2. The decommissioning funds are reported at their fair market value and any unrealized gains or losses are recognized as a component of the ARO in accordance with the Authority's ratemaking process and have no impact to the Authority's net position. For a further discussion on the Authority's NMP2 decommissioning obligations and related funding see note 8.

Additionally, FASB ASC 410, *Asset Retirement and Environment Obligations* defines the term conditional ARO as a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. As of December 31, 2012 and 2011, the ARO for the Authority's transmission and distribution utility assets totaled approximately \$7 million.

A summary of the ARO activity of the Authority for the years ended December 31, 2012 and 2011 is included below (amount in thousands):

	2012	2011
Asset retirement obligation:		
Beginning balance	\$ 79,457	73,675
Changes in fair market value of decommissioning fund	931	1,695
Accumulated depreciation	274	261
Accretion expense	4,188	3,826
Balance at December 31	\$ 84,850	79,457

(bb) Long-Lived Assets

Long-lived assets and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that there is a significant unexpected decline in the service utility of a capital asset. Impairment, if any, would be measured using one of three approaches that best reflects the decline in service utility.

(cc) Use of Estimates

The accompanying financial statements were prepared in conformity with U.S. generally accepted accounting principles 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

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of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(dd) Recent Accounting Pronouncements

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB No. 63). GASB No. 63 requires a change in certain descriptions on the statement of financial position. As such, deferred outflows of resources shall be reported in a separate section following assets, and deferred inflows of resources be reported in a separate section following liabilities. The Authority's statements reflect such changes for the periods presented.

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. GASB No. 65 reclassifies and recognizes certain items currently reported as assets and liabilities as one of four financial statement elements: (i) deferred outflows of resources, (ii) outflows of resources, (iii) deferred inflows of resources and (iv) inflows of resources. The provisions of this statement become effective for periods beginning after December 15, 2012. The Authority does not believe this statement will have a material impact on its financial statements.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25* and Statement No. 68, *Financial Reporting for Pension Plans-an amendment of GASB Statement No. 27*. GASB No. 67 and No. 68 changes how governments calculate and report the costs and obligations associated with pensions and improve the decision-usefulness of reported pension information and increase the transparency, consistency, and comparability of pension information. Statement No. 67 will take effect for periods beginning after June 15, 2013. Statement No. 68 will take effect for periods beginning after June 15, 2014. The Authority does not believe these statements will have a material impact on its financial statements.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.

(4) Superstorm Sandy

In October 2012, Superstorm Sandy caused catastrophic damage to predominantly all of the Authority's service territory. Long Island's south shore experienced extensive flooding from unprecedented storm surges. The storm and flooding resulted in significant damage to the Authority's electric transmission and distribution system resulting in widespread power outages, mandatory evacuations and the destruction of homes and businesses. The Authority's entire service territory was declared a federal major disaster area. The Authority's preliminary estimate of restoration costs, which includes labor, material, equipment, travel and incidental expenses associated with assistance from utilities across the nation, totaled approximately \$806 million which has been accrued but not paid as of December 31, 2012. The Authority expects to receive reimbursement from FEMA for at least 75% of eligible costs related to the

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restoration work. The Authority has recorded the FEMA estimated recovery of \$605 million as grant income.

In rare circumstances when damage to a State exceeds a federally mandated per capita level, the State may petition FEMA to provide 90% funding. The Authority believes the damage caused by Superstorm Sandy will exceed the federal threshold and as such, the Authority may be able to recover up to 90% of its eligible storm costs once the administrative process necessary for such funding is complete. Until such thresholds are met, the necessary approvals are obtained and collection is reasonably assured, the Authority's results continue to reflect an estimated 75% FEMA reimbursement of eligible storm costs. In addition, the Authority's Board has authorized the establishment of a regulatory asset for the recovery from its customers for the \$80 million estimated unreimbursed Superstorm Sandy costs.

Superstorm Sandy also significantly disrupted the Authority's ability to routinely read customer meters from late October, when the storm occurred, through December 31, 2012. As a result, significantly more customer bills had to be estimated than normal. The Authority believes reasonable estimates have been made and any adjustments to actual amounts of usage will not be material.

As a result of Superstorm Sandy, the Moreland Commission (Commission) was established to review all New York utilities, including LIPA, and their responses to recent emergency weather events. The Commission is mandated to undertake a thorough review of all actions taken by power companies relating to these emergencies and make recommendations to reform and modernize oversight, regulation and management of New York's power delivery services. On January 7, 2013, the Commission issued their Interim Report (Interim Report) which discusses the Commission's preliminary findings. The primary recommendation in the Interim Report is privatization of LIPA. Full ownership and operation of the transmission and distribution system by LIPA as a municipally owned utility is presented as another identified alternative by the Commission. The final report of the Commission is expected to be issued later in 2013.

The New York State Attorney General has also initiated a review of some New York utilities, including LIPA, with respect to Superstorm Sandy preparation and response. Findings related to this review are not yet available.

The Authority has taken steps to provide for liquidity needs given the material amount of storm costs incurred. The Authority has received approval from its Board and the Public Authorities Control Board (PACB) to issue bonds to refund the \$200 million commercial paper notes outstanding, which if implemented would increase the capacity under the commercial paper notes program to the authorization level of \$300 million. The Board and PACB have also authorized the Authority to issue \$500 million of medium-term notes, if necessary, to finance a portion of the Superstorm Sandy restoration costs until FEMA and insurance reimbursements are received. Additionally, on March 25, 2013 the Authority secured a three year senior revolving credit facility that allows borrowing up to \$500 million according to the terms and conditions contained in the credit agreement. Given the above, the Authority believes it has adequate sources of liquidity to meet its planned operating, maintenance, capital programs and storm costs incurred.

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LIPA's management and the Board continue to monitor the financial and operational impacts associated with Superstorm Sandy's aftermath and other NY State initiatives, including the Moreland Commission, that have resulted following this storm. The State of New York is considering alternatives for the Authority that might change the Authority's ownership and/or governance. This might involve a sale or restructuring of the Authority. The ultimate outcome of any such changes cannot be predicted at this time.

(5) Derivative Instruments

The Authority uses derivative instruments to attempt to manage the cash flow impact of interest rate changes and market price fluctuations for the purchase of fuel oil, natural gas and electricity on its customers, net position and cash flows. The Authority does not use derivative instruments for trading or speculative purposes. These contracts are evaluated pursuant to GASB No. 53 to determine whether they meet the definition of derivative instruments, and if so, whether they effectively hedge the expected cash flows associated with interest rate and commodity price risk exposures. The fair values of the Authority's derivatives as defined by GASB No. 53 are reported on the Statement of Net Position as either Commodity Derivative Instruments or Financial Derivative Instruments.

The Authority applies hedge accounting for derivative instruments that are deemed effective under GASB No. 53. Under hedge accounting, changes in the fair value of such hedging derivative instrument is a component of deferred inflow or deferred outflow on the Statement of Net Position until the contract is settled or hedge accounting is terminated. The Authority's derivative instruments that do not meet the definition of a hedging derivative instrument are referred to as investment derivative instruments. Changes in the fair value of investment derivative instruments are deferred until settled or terminated in accordance with the Authority's ratemaking process.

All settlement payments or receipts for hedging derivative instruments are recorded as either fuel and purchased power expense or interest expense for interest rate derivatives on the Statements of Revenues, Expenses and Changes in Net Position in the period settled. All settlement payments or receipts related to investment derivative instruments are recorded as interest expense or as fuel and purchased power expense in the Statements of Revenues, Expenses and Changes in Net Position in the period incurred.

A portion of the Authority's fuel and purchased power derivative contracts are exchange-traded contracts with readily available quoted market prices. Another portion is non exchange-traded contracts valued using prices provided by external sources, primarily price quotations available through brokers or over-the-counter, on-line exchanges. The remainder of the fuel and purchased power as well as the financial derivative products represents contracts for which external sources or observable market quotes are not available. These contracts are valued based on various valuation techniques including but not limited to models internal to the Authority's energy risk management consultant based on extrapolation of observable market data with similar characteristics. Contracts valued with prices provided by models and other valuation techniques make up a significant portion of the total fair value of such derivative contracts. The Authority's policy is to not discount the fair value of each contract using an interest rate which represents default risk associated with a particular counterparty.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) expanded the Commodity Futures Trading Commission's (CFTC) jurisdiction to regulate swaps under the Commodity Exchange Act. The CFTC has been implementing its authority under the Dodd-Frank Act in an expansive manner, and although the Authority has implemented several compliance measures, the Authority will still need to evaluate future CFTC rules and regulations to determine if there would be any potential impacts to the Authority's risk management strategies and practices.

The Authority's derivative instruments at December 31, 2012 are as follows (in thousands):

<u>Derivative instrument description</u>	<u>Fair value December 31, 2012</u>	<u>Net change in fair value</u>	<u>Fair value December 31, 2011</u>	<u>Type of hedge</u>	<u>Financial statement classification for changes in fair value</u>
Hedging derivative instruments:					
Financial derivatives:					
Interest Rate Swap 1	\$ (40,209)	(142)	(40,067)	Cash flow	Deferred outflow
Interest Rate Swap 2	(26,932)	(101)	(26,831)	Cash flow	Deferred outflow
Interest Rate Swap 7	(4,258)	2,839	(7,097)	Cash flow	Deferred outflow
Total	<u>\$ (71,399)</u>	<u>2,596</u>	<u>(73,995)</u>		
Commodity derivatives:					
Natural Gas Swaps	\$ (94,499)	26,539	(121,038)	Cash flow	Deferred outflow
Residual Oil Swaps	2,595	(7,073)	9,668	Cash flow	Deferred outflow
Purchased Power Swaps	3,564	(32,840)	36,404	Cash flow	Deferred outflow
Natural Gas Basis Swaps	(1)	3,422	(3,423)	Cash flow	Deferred outflow
Natural Gas Options	—	52	(52)	Cash flow	Deferred outflow
Total	<u>\$ (88,341)</u>	<u>(9,900)</u>	<u>(78,441)</u>		
Investment derivative instruments:					
Financial derivatives:					
Interest Rate Swap 3	\$ (169,698)	3,123	(172,821)	N/A	Deferred charges
Interest Rate Swap 4	(10,070)	11,622	(21,692)	N/A	Deferred charges
Interest Rate Swap 5	(5,035)	5,811	(10,846)	N/A	Deferred charges
Interest Rate Swap 6	(5,035)	5,811	(10,846)	N/A	Deferred charges
Total	<u>\$ (189,838)</u>	<u>26,367</u>	<u>(216,205)</u>		
Commodity derivatives:					
Natural Gas Options	\$ (2,369)	(1,794)	(575)	N/A	Deferred charges
Natural Gas Swaps	(22,563)	39,307	(61,870)	N/A	Deferred charges
Total	<u>\$ (24,932)</u>	<u>37,513</u>	<u>(62,445)</u>		

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The terms of the Authority's commodity derivative instruments that were outstanding at December 31, 2012 and 2011 are summarized in the tables below:

	Notional amount (amounts in thousands)	Beginning date	Ending date	Authority pays per unit	Authority receives
2012:					
Natural Gas Swaps	208,870 Dths	1/1/2013	10/1/2015	\$ 2.75 to 6.85	Natural Gas at Henry Hub
Residual Oil Swaps	103 Bbls	1/1/2013	8/1/2014	73.50 to 99.45	Residual Fuel Oil at NY Harbor
Purchased Power Swaps	7,597 Mwths	1/1/2013	8/1/2015	31.17 to 81.40	Power at PJM East
Natural Gas Basis Swaps	5,493 Dths	1/1/2013	3/1/2013	.44 to 3.735	Gas Basis between Henry Hub & Transco Z6, NY

	Notional amount (amounts in thousands)	Beginning date	Ending date	Authority pays per unit	Authority receives
2011:					
Natural Gas Swaps	117,025 Dths	1/1/2012	12/1/2014	\$ 4.25 to 8.49	Natural Gas at Henry Hub
Residual Oil Swaps	382 Bbls	1/1/2012	8/1/2014	65.75 to 103.5	Residual Fuel Oil at NY Harbor
Purchased Power Swaps	6,087 Mwths	1/1/2012	11/1/2014	37.88 to 81.40	Power at PJM East
Natural Gas Basis Swaps	3,083 Dths	1/1/2012	3/1/2012	0.94 to 4.86	Gas Basis between Henry Hub & Transco Z6, NY

The terms of the Authority's financial derivative instruments that were outstanding at December 31, 2012 are summarized in the tables below (amounts in thousands):

Financial derivative	Type	Effective date	Termination date	Authority pays	Authority receives	Original notional	Upfront cash payment
Interest rate:							
Swap 1	Synthetic Fixed	11/12/1998	4/1/2025	4.178%	SIFMA	\$ 150,000	\$ —
Swap 2	Synthetic Fixed	11/12/1998	4/1/2025	4.208	SIFMA	100,000	—
Swap 3	Synthetic Fixed	6/1/2003	12/1/2029	5.120	69.47% of 1-month LIBOR	587,225	106,400
Swap 4	Basis Swap	7/1/2004	8/15/2033	SIFMA	70.50% of 1-month LIBOR	502,090	17,500
Swap 5	Basis Swap	7/1/2004	8/15/2033	SIFMA	70.50% of 1-month LIBOR	251,045	8,750
Swap 6	Basis Swap	7/1/2004	8/15/2033	SIFMA	70.50% of 1-month LIBOR	251,045	8,750
Swap 7	Synthetic Fixed	7/11/2006	9/1/2015	4.110%	CPI + 0.765%	110,715	—

Swap termination: In accordance with GASB No. 53, at the time of a termination event related to a current refunding of hedged debt, the balance of the amounts in deferred outflows are to be included in the net

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carrying amount of the refunded debt for the purpose of calculating the deferred loss on refunding. In 2012, portions of the debt associated with Swap 1 and 2 had a current refunding resulting in a reassignment for the interest rate swaps to a new underlying notional debt with similar terms. As a result, approximately \$32 million of the deferred outflow at the refunding dates was apportioned to the deferred loss on refunding. Subsequent to this refunding, the Authority novated Swap 1 which caused an event of termination in accordance with guidance provided under GASB No. 53 as the terms of the swap were modified. As a result, approximately \$21 million of the deferred outflow related to Swap 1 was reclassified to unamortized charges.

In 2011, portions of the debt associated with Swap 1, 2 and 3 had a current refunding resulting in a reassignment of the interest rate swaps to a new underlying notional debt with identical terms. This refunding and reassignment effectively terminated the original hedges. As a result, approximately \$45 million of the deferred outflow at the refunding dates was apportioned to the deferred loss on refunding.

The Authority is exposed to the following risks related to derivative instruments as defined by GASB No. 53:

Termination Risk: Termination risk is the risk that a derivative could be terminated by a counterparty prior to its scheduled maturity due to a contractual event with the Authority owing a termination payment and no longer meeting the objective of the hedge. As long as the Authority fulfills its obligations under the contracts and does not default under the agreements, the counterparties do not have the right to terminate these agreements. The Authority believes that termination risk is low because the counterparties may terminate the agreements only upon the occurrence of specific events such as, payment defaults, other defaults which remain uncured for 30 days after notice, bankruptcy or insolvency of the Authority (or similar events), or a downgrade of the Authority's and its insurers', if any, credit rating below investment grade. If, at the time of termination, the mark-to-market of the derivative was a liability of the Authority, the Authority could be required to pay that amount to the counterparty. Termination risk associated with all of the Authority's derivatives is limited to the fair value.

Basis Risk: The Authority is exposed to basis risk on certain of its pay-fixed interest rate swaps because the variable-rate payments received by the Authority (SIFMA, 69.47% of LIBOR) on these hedging derivative instruments are based upon indexes other than the actual interest rates the Authority pays on its hedged variable rate debt. The terms of the related hedging fixed rate swap transactions are summarized in the charts above.

The Authority is exposed to other basis risk on a portion of its commodity swaps when the commodity swap payment received is based upon a reference price in a market (i.e. natural gas priced at Henry Hub) that differs from the market in which the hedged item is expected to be bought (natural gas priced at New York gate). If the correlation between these market prices should fail, the Authority may incur costs as a result of the hedging derivative instrument's inability to offset the price of the related commodity.

Rollover risk: The Authority is exposed to rollover risk on its Swap 1 as Series 2003 3A bonds mature in 2030 while Swap 1 terminates in April 2025. With respect to Swap 2, Series 2012C bonds mature in May

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2033, while the swap terminates in April 2025. The inconsistency between the maturity dates and the swap termination date leaves the Authority exposed to interest rate volatility during that period.

Collateral Posting: Under certain conditions, the Authority may be required to post collateral related to its interest rate derivative instruments. Under the terms of its interest rate derivative agreements, collateral may be required if the Authority's credit ratings and, in the case of insured swaps, the credit ratings of any related interest rate swap insurer, fall below minimum levels as provided in each swap agreement, and the Authority fails to provide alternative credit enhancements. Collateral for its financial derivatives, if required, would approximate fair value. The Authority has never been required to posted collateral under its interest rate derivative instruments.

The Authority has collateral requirements for all of its commodity derivatives. Collateral is required to be posted with the counterparty when the negative fair value of the commodity derivative instrument exceeds the unsecured line of credit established with each counterparty as listed in the counterparty table below. In the event of collateral being posted, the value will equal the difference between the fair value and the amount of the unsecured line of credit. At December 31, 2012 and 2011, the Authority had posted collateral with counterparties of approximately \$1.1 million and \$0.5 million, respectively.

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Credit Risk: The risk that the counterparty (or its guarantor) will default on its obligations under the agreement. Currently, counterparty risk for the Authority is limited as the termination values of the transactions are generally negative. Additionally, the Authority has sought to limit counterparty risk by contracting only with highly rated counterparties or requiring guarantees of the counterparty's obligations. Below is a table with the credit-ratings of the Authority's counterparties as of December 31, 2012 (amounts in millions):

<u>Counterparty</u>	<u>Moody's</u>	<u>S&P</u>	<u>unsecured line of credit</u>
Interest rate derivative instruments:			
Bear Stearns Capital Markets Inc.	A2	A	\$ -
Citibank, N.A. New York	A3	A	-
Merrill Lynch Capital Services	Baa2	A-	-
UBS AG, Stamford Branch	A2	A	-
Societe Generale	A2	A	-
Morgan Stanley Capital Group Inc.	Baa1	A-	-
Wells Fargo	Aa3	AA-	-
Commodity derivative instruments:			
Barclays Bank PLC	A2	A+	25
BP Corporation North America Inc.	Baa1	A	15
Credit Suisse Int'l	A1	A+	30
Deutsche Bank AG	A2	A+	50
J. Aron & Company	A3	A-	40
JPMorgan Chase Bank, N.A.	Aa3	A	35
Macquarie Energy LLC	A2	A	20
Merrill Lynch Commodities, Inc.	Baa2	A-	20
Morgan Stanley Capital Group Inc.	Baa1	A-	40
Next Era Power Marketing	Baa1	A-	10
Societe Generale	A2	A	25

(6) Rate Matters

The LIPA 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; PILOTS; renewals, replacements and capital additions; and the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable. In addition, the Authority must establish or maintain reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

In addition to the delivery rate, the Authority's tariff also includes: (i) the FPPCA, to allow for adjustments to customers' bills to reflect changes in the cost of fuel and purchased power and related costs; (ii) a PILOTS recovery rider, which allows for rate adjustments to accommodate changes in PILOTS; (iii) a rider providing for the recovery of costs associated with the Shoreham Property Tax Settlement; (iv) a rider

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for the Authority's energy efficiency and renewable program; and (v) a rider providing for the collection of the Temporary State Assessment imposed by the New York State Legislature.

Authority to Set Rates

Under current State law, the Board of Trustees of 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, in connection with the approval of the LIPA/LILCO Merger by the PACB in 1997, the Authority agreed that it would comply with the condition imposed by the PACB and 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.

Legislation was unanimously passed by the New York State Legislature in June 2008, seeking to amend the LIPA Act and the State Public Service Law to require the approval by the PSC of an increase in LIPA's average customer rates exceeding 2.5% over a 12-month period or to extend or reestablish any portion of a temporary rate increase exceeding 2.5%. Were such legislation to have become law, the Authority would have had to notify the PSC of any proposed rate increase, extension or re-establishment exceeding 2.5% of average rates over a 12-month period. Approval of any such request by the PSC would have required a full evidentiary hearing by the PSC. The proposed legislation was vetoed September 4, 2008 and therefore has not been enacted into law. A revised version of the 2008 bill was introduced in both the Assembly and Senate in 2009. The Assembly passed the bill on June 16, 2009, however, the Senate did not take any further action in 2009 and the legislative session ended without the bill being passed. A further revised bill was introduced in both the Assembly and Senate in 2010 and on March 10, 2010, the Assembly passed the bill. Again in 2011, the rate regulation bill was introduced and on April 4, 2011, it passed in the Senate and on June 16, 2011, it passed in the Assembly. Subsequently, a new bill requiring LIPA to undergo an audit of its management and operations was introduced and passed in both houses, and signed into law. Once signed into law, the rate regulation bill was repealed. It is not expected that a rate regulation bill will be proposed during this session based on remarks made by the bill sponsors; however, the Authority cannot predict with certainty that other similar legislation will not be introduced and acted upon in the future.

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(7) Utility Plant and Property and Equipment

The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2012 (amounts in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 17,566	—	—	17,566
Retirement work in progress	31,509	22,923	21,439	32,993
Construction in progress	255,513	279,492	267,112	267,893
	<u>304,588</u>	<u>302,415</u>	<u>288,551</u>	<u>318,452</u>
Total capital assets not being depreciated				
Capital assets, being depreciated:				
Generation – nuclear	705,899	43,727	15,119	734,507
Transmission and distribution	3,650,660	203,986	10,511	3,844,135
Common	43,527	2,802	320	46,009
Nuclear fuel in process and in reactor	122,657	1,810	836	123,631
Office equipment, furniture, and leasehold improvements	16,549	1,426	531	17,444
Generation and transmission assets under capital lease	3,751,349	—	—	3,751,349
	<u>8,290,641</u>	<u>253,751</u>	<u>27,317</u>	<u>8,517,075</u>
Total capital assets being depreciated				
Less accumulated depreciation for:				
Generation – nuclear	286,395	22,112	15,119	293,388
Transmission and distribution	852,395	133,366	31,898	953,863
Common	20,728	2,550	387	22,891
Nuclear fuel in process and in reactor	82,691	9,140	—	91,831
Office equipment, furniture, and leasehold improvements	7,846	2,648	550	9,944
Generation assets under capital lease	720,372	147,656	—	868,028
	<u>1,970,427</u>	<u>317,472</u>	<u>47,954</u>	<u>2,239,945</u>
Total accumulated depreciation				
Net value of capital assets, being depreciated	<u>6,320,214</u>	<u>(63,721)</u>	<u>(20,637)</u>	<u>6,277,130</u>
Net value of all capital assets	<u>\$ 6,624,802</u>	<u>238,694</u>	<u>267,914</u>	<u>6,595,582</u>

In 2012, depreciation expense related to capital assets was approximately \$161 million.

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The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2011 (amounts in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 17,566	—	—	17,566
Retirement work in progress	35,053	16,944	20,488	31,509
Construction in progress	168,412	269,685	182,584	255,513
Total capital assets not being depreciated	<u>221,031</u>	<u>286,629</u>	<u>203,072</u>	<u>304,588</u>
Capital assets, being depreciated:				
Generation – nuclear	704,310	1,723	134	705,899
Transmission and distribution	3,506,610	159,509	15,459	3,650,660
Common	39,802	4,516	791	43,527
Nuclear fuel in process and in reactor	96,325	26,332	—	122,657
Office equipment, furniture, and leasehold improvements	11,817	4,881	149	16,549
Generation and transmission assets under capital lease	3,555,024	196,325	—	3,751,349
Total capital assets being depreciated	<u>7,913,888</u>	<u>393,286</u>	<u>16,533</u>	<u>8,290,641</u>
Less accumulated depreciation for:				
Generation – nuclear	264,812	21,696	113	286,395
Transmission and distribution	757,146	128,081	32,832	852,395
Common	16,446	4,328	46	20,728
Nuclear fuel in process and in reactor	74,239	8,452	—	82,691
Office equipment, furniture, and leasehold improvements	5,482	3,052	688	7,846
Generation assets under capital lease	584,898	135,474	—	720,372
Total accumulated depreciation	<u>1,703,023</u>	<u>301,083</u>	<u>33,679</u>	<u>1,970,427</u>
Net value of capital assets, being depreciated	<u>6,210,865</u>	<u>92,203</u>	<u>(17,146)</u>	<u>6,320,214</u>
Net value of all capital assets	<u>\$ 6,431,896</u>	<u>378,832</u>	<u>185,926</u>	<u>6,624,802</u>

In 2011, depreciation expense related to capital assets was approximately \$157 million.

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(8) Nine Mile Point Nuclear Power Station, Unit 2 (NMP2)

The Authority has an undivided 18% interest in NMP2, located upstate New York, and operated by Constellation Energy Nuclear Group, LLC (Constellation) a division of Constellation Energy Group, Inc. (CEG).

In March 2012, Exelon Corporation acquired Constellation. LIPA anticipates no material differences in NMP2 operation due to this change of ownership. For purposes of this footnote, the majority owner of NMP2 will be referred to as Constellation.

NMP2 operated at an annual mean capacity through June 2012 of approximately 1148 MW. Modifications completed during the 2012 refueling outage resulted in an increase of 150 MW to NMP2's power rating and as of July 2012 was approximately 1298 MW. The Authority's share of the new rated capability of NMP2 is approximately 234 megawatts (MW). The net utility plant investment, excluding nuclear fuel, was approximately \$441 million and \$420 million as of December 31, 2012 and 2011, respectively. Generation from NMP2 and operating expenses incurred by NMP2 are shared by the Authority at its 18% ownership interest. The Authority 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.

The Authority has an operating agreement with Constellation for NMP2 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. The Authority 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, the Authority maintains on-site nuclear oversight representation to provide additional support to protect the Authority's interests.

The Nuclear Regulatory Commission (NRC) granted a license extension for the NMP2 facility extending the license through October 2046.

(a) Nuclear Plant Decommissioning

Provisions for decommissioning costs for NMP2 are based on the most current site-specific study prepared by Constellation in 2010. The Authority's share of the total decommissioning costs for both the contaminated and noncontaminated portions is \$78 million as of December 31, 2012 and is included in the Statement of Net Position as a component of the ARO. The value reflects the lengthening of the expected dormancy period prior to the commencement of decommissioning activities as a result of the license extension, partially offset by additional costs associated with the expected delay by the U.S. Department of Energy (DOE) in providing a permanent centralized repository for spent nuclear fuel and the reduction in the credit-adjusted risk-free interest rate. The Authority maintains a nuclear decommissioning trust fund (NDT) for its share of the decommissioning costs of NMP2, which as of December 31, 2012 and 2011 had an approximate value of \$92 million and \$85 million, respectively. Based on deposits and assumed investment returns related to these funds, the Authority believes that the value of these trusts will be sufficient to meet the Authority's expected decommissioning obligations.

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(b) *NMP2 Radioactive Waste*

Constellation has contracted with the 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 not forecasted the start of operations of its high level radioactive waste repository. As of May 2012, NMP2 spent fuel storage pool can no longer accept a total fuel off-load. In order to regain this capability and to provide for future spent fuel storage, a dry fuel storage facility was constructed for NMP2 spent fuel at the site. This storage facility license was approved by the NRC for 20 years and may be subsequently re-licensed in up to 40 year increments. The cost of the current facility, which is designed to service both Nine Mile Point 1 and NMP2, is expected to be \$58 million, with LIPA's share being approximately \$6 million. This facility will provide sufficient storage capacity with provisions for expansion, when needed, through the end of commercial operation in 2046. Spent fuel transfers from NMP2 spent fuel storage pool to the storage facility is scheduled for the third quarter of 2013. Spent fuel will remain in this storage facility at the site until such time as an ultimate repository is provided by the DOE. The Authority reimburses Constellation for its 18% share of the disposal costs of spent fuel 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.

(c) *Nuclear Plant Insurance*

Constellation procures public liability and property insurance for NMP2 and the Authority reimburses Constellation for its 18% share of those costs.

The Terrorism Risk Insurance Act (TRIA) of 2002 was extended by the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007. Under the TRIA, property and casualty insurance companies are required to offer insurance for losses resulting from certified acts of terrorism. Certified acts of terrorism are determined by the U.S. Secretary of the Treasury, in concurrence with the Secretary of State and Attorney General, and primarily are based upon the occurrence of significant acts of terrorism as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion. The nuclear property and accidental outage insurance programs, as discussed later in this section provide coverage for certified acts of terrorism.

Property losses resulting from noncertified acts of terrorism are covered as a common occurrence, meaning that if noncertified terrorist acts occur against one or more commercial nuclear power plants insured by the insurers of NMP2 within a 12-month period, such acts would be treated as one event and the owners of 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 \$375 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 104 presently licensed nuclear reactors in the United States

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to a retrospective assessment of up to \$117.5 million for each nuclear incident, payable at a rate not to exceed \$17.5 million per year. The Authority's interest in NMP2 could expose it to a maximum potential loss of \$21.2 million per incident, through assessments of up to \$3.2 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. The policy provides a single industry aggregate limit of \$200 million for occurrences of radiation injury claims against all those insured by this policy prior to January 1, 2003; \$300 million for occurrences of radiation injury claims against all those insured by this policy between January 1, 2003 and January 1, 2010; and \$375 million for occurrences of radiation injury claims against all those insured by this policy after January 1, 2010.

Constellation has also procured \$500 million of primary nuclear property insurance and additional protection (including decontamination costs) of \$1.25 billion of stand-alone excess property insurance and a \$1.0 billion shared excess policy for NMP2 through the Nuclear Electric Insurance Limited (NEIL). Each member of NEIL, including the Authority, is also subject to retrospective premium adjustments in the event of losses at other member facilities. For its share of NMP2, the Authority could be assessed up to approximately \$3.3 million per loss.

The Authority 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 \$630,000 per week for the first 52 weeks, reduced to \$504,000 per week for an additional 110 weeks for the purchase of replacement power, with a maximum limit of \$88.2 million over a three-year period.

(d) Other

In March 2012, the NRC issued additional safety enhancement requirement orders as a result of the disaster at the Fukushima Daiichi facility. These orders are applicable to operating U.S. reactors, as well as all construction permits and combined license holders. The orders require safety enhancements to mitigate the response to natural events resulting in the loss of system power at plants, reliable hardened containment vents and enhancing spent fuel pool instrumentation. Implementation of all safety enhancements is required by the end of the second quarter in 2016. The NRC has also requested each reactor reevaluate the seismic and flooding hazards at their site using present-day methods and information, conduct walk downs of their facilities to ensure protection against the hazards in their current design basis, and reevaluate their emergency communications systems and staffing levels. Constellation is preparing a response to these new regulations in accordance with NRC rules and indicates that they will comply with all NRC requirements within the allotted time-frame. The Authority believes that the costs of such safety enhancements, if any, will not have a material impact on the Authority's operations or cash flows.

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(9) Cash, and Cash Equivalents and Investments

(a) Authority

The Authority's investments are managed by an external investment manager and consist of three accounts; the Operating Fund, the Rate Stabilization Fund and the Construction Fund. The Operating Fund is managed to meet the liquidity needs of the Authority, the Rate Stabilization Fund is managed to maximize the return on investment and the Construction Fund is used to fund capital expenditures from the proceeds of the bonds. The Authority must maintain in the Rate Stabilization Fund an amount determined by the Authority from time to time in accordance with the Authority's bond resolution. In accordance with its agreements with the banks issuing letters of credit to secure the Authority's bonds, the Authority has agreed that such amount will not be less than \$150 million. Additionally, the Authority is required to maintain compensating balances of \$1.2 million.

The Authority's investment policy places limits on investments by issuer and by security type and addresses various risks described below. The Board of Trustees of the Authority may also specifically authorize, as it deems appropriate, other investments that are consistent with the Authority's investment objective. The Authority reviews its investment policy on an annual basis to ensure continued effectiveness.

Credit Risk: The Authority's permissible investments and related minimum credit ratings include U.S. Treasury and Federal Agency obligations (AA- or Aa3), repurchase agreements (A-1), commercial paper (A1 or P-1), corporate notes (AA- or Aa3), master notes (AA- or Aa3) and asset backed securities (AAA), certificates of deposit (AA- or Aa3), money-market mutual funds (AAAm or AAAM-G), investment contracts (AA- or Aa3), municipal obligations (AA- or Aa3), and variable rate notes (based on the specific asset type noted above). The Authority's investment policy prohibits investments involving complex derivatives, reverse repurchase agreements, auction rate securities and short selling and arbitrage related investment activity.

Concentration of Credit Risk: To address concentration of credit risk, the Authority's investment policies have established limits such that no more than 5% of the investment portfolio may be invested in the securities of any one issuer except as follows: (i) U.S. Treasury Obligations up to 100%; (ii) each Federal agency up to 10%; (iii) repurchase agreements up to 10% or \$50 million; (iv) money-market mutual funds up to 75% maximum; and, (v) investment contracts up to 10%.

Custodial Credit Risk: The Authority believes that custodial credit risk related to its investments is minimal, as it is the Authority's policy and practice, as stipulated in its Investment Guidelines, that investments be held by a third-party custodian who may not otherwise be a counter-party to the transactions, and that all securities are free and clear of any lien and held in a separate account, in the name of the Authority.

Custodial credit risk for cash deposits (including demand deposits, time deposits and certificates of deposit issued by a commercial bank) is the risk that in the event of a bank failure, the Authority's deposits may not be returned, either in part or in whole. The Authority's policy to address this risk requires that all demand deposits, time deposits and certificates of deposits issued by a commercial bank not having a long-term credit rating of Aa3/AA- or higher, be fully collateralized above the

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Federal Deposit Insurance Corporation coverage. Commercial banks with long-term credit ratings of Aa3/AA- or higher do not require collateralization unless otherwise required by the Authority's Chief Financial Officer.

As of December 31, 2012 and 2011, the Authority had deposits of \$9 million and \$11 million, respectively, of which approximately \$1 million and \$9 million, respectively, were not collateralized or were uninsured. Uncollateralized balances were primarily the result of amounts temporarily held pending investment or disbursement. Collateral on the remaining deposits was held in an account for the Authority at 102% of the available deposit balance.

Interest Rate Risk: The Authority's investment policy states that investments have maturities of 12 months or less, generally. Investment maturities may exceed 12 months provided that the maturity does not exceed the expected disbursement date of those funds, the total average portfolio maturity is one year or less and no individual maturity exceeds three years, with the exception of U.S. government obligations and investment contracts. As of December 31, 2012 and 2011, all of the Authority's investments had maturities of less than 12 months.

As of December 31, 2012, and 2011, the Authority had the following investments and maturities (amounts in thousands):

Deposit/investment type	2012 Fair value	Percent of portfolio	2012	
			Investment maturities	
			Less than 3 months	3 months to 1 year
Short-term discount notes:				
Commercial paper	\$ 92,452	27%	92,452	—
Federal agencies	5,492	2%	5,492	—
Money-market mutual funds	228,026	68%	228,026	—
Cash and collateralized deposits	8,860	3%	8,860	—
Total	\$ 334,830	100%	\$ 334,830	—

Deposit/investment type	2011 Fair value	Percent of portfolio	2011	
			Investment maturities	
			Less than 3 months	3 months to 1 year
Short-term discount notes:				
Commercial paper	\$ 161,686	36%	\$ 151,687	9,999
Federal agencies	12,850	3%	12,850	—
Money-market mutual funds	261,790	58%	261,790	—
Cash and collateralized deposits	11,243	3%	11,243	—
Total	\$ 447,569	100%	\$ 437,570	9,999

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(b) LIPA

LIPA maintains a separate investment policy applicable to the long-term investments in the Nuclear Decommissioning Trusts (NDT) which is held to meet LIPA's obligation with respect to the eventual decommission of LIPA's 18% interest in the NMP2 nuclear facility. LIPA guidelines detail permissible investments and portfolio restrictions. LIPA reviews its investment policy at least annually to ensure that the value in the trusts in 2046, (the year in which decommissioning activities are scheduled to begin) will be sufficient to meet its decommissioning obligations.

Credit Risk

LIPA's guidelines attempt to minimize risk by limiting permissible investments to include: obligations of the U.S. government and its agencies; corporate or other obligations with an A or better rating; mortgage obligations rated AA or higher; commercial paper with a rating of A1 or P1; certificates of deposit; Eurodollar certificates of deposit and bankers acceptances of domestic banks with A+ rating or better, short-term money market investment accounts that conform to the aforementioned permissible investments; and with respect to the LIPA's long-term NDT investment portfolio only, equity investments limited to portfolio funds of securities designed to replicate the overall market measured by the S&P 500 Index, and futures contracts on the S&P 500 Index. Within the NDT investment portfolio, the use of equity investments as a permissible investment is limited to a target exposure of 35% with a quarterly rebalancing within plus or minus 5%. The fixed income portion of the NDT investment portfolio must maintain an average credit rating of AA or better with no more than 30% of the portfolio invested in notes and bonds rated A and no more than 20% of the portfolio invested in municipal securities.

Concentration of Credit Risk: To address this risk, LIPA's investment policies have established limits such that no more than 5% of the portfolio may be invested in the securities of any one issuer with the exception of U.S. government and its agencies securities. In addition, no more than 25% of the portfolio may be invested in securities of issuers in the same industry.

Custodial Credit Risk: LIPA does not have a policy relative to custodial credit risk of its deposits, however, as a practical matter, LIPA defers to the policies of the Authority, as discussed above.

Interest Rate Risk: Due to the long-term nature of the NDT asset, interest rate risk is managed to track the Barclays Capital U.S. government/Credit Bond Index. The portfolio's duration is required to fall within a range of 20% below the duration of the index and 10% above the duration of the index.

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As of December 31, 2012 and 2011, LIPA had the following investments (amounts in thousands):

<u>Investment type</u>	<u>2012 Fair value</u>	<u>Percent of portfolio</u>
U.S. government and its agencies obligations	\$ 55,524	61%
Money-market mutual funds	1,572	1%
Commingled equity fund	34,515	38%
Total	\$ <u>91,611</u>	<u>100%</u>

<u>Investment type</u>	<u>2011 Fair value</u>	<u>Percent of portfolio</u>
Corporate notes and bonds	\$ 18,555	22%
Mortgage obligations	692	1%
U.S. government and its agencies obligations	35,141	41%
Money-market mutual funds	138	0%
Commingled equity fund	30,877	36%
Total	\$ <u>85,403</u>	<u>100%</u>

The overall duration of the three individual accounts averaged 5.6 and 5.9 years at December 31, 2012 and 2011, respectively, and is within the limits described by LIPA's investment guidelines.

(10) Long-Term and Short-Term Debt

The Authority financed the cost of acquiring the T&D system and the refinancing of certain of LILCO's outstanding debt by issuing 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.

All of the Authority's 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.

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The Authority's bond and note indebtedness and other long-term liabilities as of December 31, 2012 are comprised of the following obligations (amounts in thousands):

	<u>Beginning balance</u>	<u>Accretion/ additions</u>	<u>Maturities</u>	<u>Refundings</u>	<u>Ending balance</u>	<u>Due within one year</u>
Authority debt:						
Electric system general revenue bonds:						
Series 1998A	\$ 143,055	7,557 (a)	12,970	—	137,642	12,970
Series 2000A	392,962	22,021 (a)	31,705	—	383,278	32,155
Series 2001A	165,175	—	—	165,175	—	—
Series 2003B	237,465	—	87,710	—	149,755	92,375
Series 2003C	256,000	—	—	108,825	147,175	8,875
Series 2003 D	73,625	—	—	—	73,625	—
Series 2003 H-J	167,600	—	—	102,000	65,600	—
Series 2003 L-O	134,000	—	—	47,000	87,000	—
Series 2004A	200,000	—	—	—	200,000	4,215
Series 2006A	839,245	—	—	—	839,245	—
Series 2006B	96,955	—	—	—	96,955	—
Series 2006C	198,020	—	—	—	198,020	—
Series 2006D	325,570	—	47,680	—	277,890	1,940
Series 2006E	507,600	—	—	—	507,600	—
Series 2006F	433,170	—	97,960	—	335,210	23,095
Series 2008A	605,055	—	—	—	605,055	—
Series 2008B	149,340	—	—	—	149,340	—
Series 2009A	435,825	—	—	—	435,825	—
Series 2010A	193,325	—	—	—	193,325	—
Series 2010B	210,000	—	—	—	210,000	—
Series 2011A	250,000	—	—	—	250,000	—
Series 2012A	—	250,000	—	—	250,000	—
Series 2012B	—	252,000	2,000	—	250,000	—
Series 2012C	—	175,000	—	—	175,000	—
Series 2012D	—	149,000	—	—	149,000	—
Subtotal	<u>6,013,987</u>	<u>855,578</u>	<u>280,025</u>	<u>423,000</u>	<u>6,166,540</u>	<u>175,625</u>
Electric system subordinate revenue bonds:						
Series 1-3	525,000	—	—	175,000	350,000	—
Subtotal	<u>525,000</u>	<u>—</u>	<u>—</u>	<u>175,000</u>	<u>350,000</u>	<u>—</u>
LIPA debt:						
NYSERDA notes	155,420	—	—	—	155,420	—
Net unamortized discounts/premiums and deferred amortization	(36,773)	57,707	—	44,250	(23,316)	—
Total bonds and notes, net of unamortized discounts/premium \$	<u>6,657,634</u>	<u>913,285</u>	<u>280,025</u>	<u>642,250</u>	<u>6,648,644</u>	<u>175,625</u>

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	<u>Beginning balance</u>	<u>Accretion/ additions</u>	<u>Maturities</u>	<u>Refundings</u>	<u>Ending balance</u>	<u>Due within one year</u>
Other long-term liabilities:						
Unrealized credits	\$ 78,779	5,651	17,560	—	66,870	—
Borrowings	105,315	—	4,414	—	100,901	—
Claims and damages	21,273	1,300	675	—	21,898	—
Capital lease obligations	<u>3,030,977</u>	<u>—</u>	<u>147,656</u>	<u>—</u>	<u>2,883,321</u>	<u>157,232</u>
Total other long-term liabilities	<u>\$ 3,236,344</u>	<u>6,951</u>	<u>170,305</u>	<u>—</u>	<u>3,072,990</u>	<u>157,232</u>

(a) Represents accretion of capital appreciation bonds

The Authority's bond and note indebtedness and other long-term liabilities as of December 31, 2011 are comprised of the following obligations (amounts in thousands):

	<u>Beginning balance</u>	<u>Accretion/ additions</u>	<u>Maturities</u>	<u>Refundings</u>	<u>Ending balance</u>	<u>Due within one year</u>
Authority debt:						
Electric system general revenue bonds:						
Series 1998A	\$ 217,630	7,225 (a)	81,800	—	143,055	12,970
Series 1998B	3,745	—	3,745	—	—	—
Series 2000A	401,774	22,448 (a)	31,260	—	392,962	31,705
Series 2001A	165,175	—	—	—	165,175	—
Series 2003B	250,265	—	12,800	—	237,465	87,710
Series 2003C	256,000	—	—	—	256,000	—
Series 2003 D	73,625	—	—	—	73,625	—
Series 2003 H-J	167,600	—	—	—	167,600	—
Series 2003 L-O	134,000	—	—	—	134,000	—
Series 2004A	200,000	—	—	—	200,000	—
Series 2006A	839,245	—	—	—	839,245	—
Series 2006B	96,955	—	—	—	96,955	—
Series 2006C	198,020	—	—	—	198,020	—
Series 2006D	326,260	—	690	—	325,570	47,680
Series 2006E	507,600	—	—	—	507,600	—
Series 2006F	514,495	—	81,325	—	433,170	97,960
Series 2008A	605,055	—	—	—	605,055	—
Series 2008B	149,340	—	—	—	149,340	—
Series 2009A	435,825	—	—	—	435,825	—
Series 2010A	193,325	—	—	—	193,325	—
Series 2010B	210,000	—	—	—	210,000	—
Series 2011A	<u>—</u>	<u>250,000</u>	<u>—</u>	<u>—</u>	<u>250,000</u>	<u>—</u>
Subtotal	<u>5,945,934</u>	<u>279,673</u>	<u>211,620</u>	<u>—</u>	<u>6,013,987</u>	<u>278,025</u>
Electric system subordinate revenue bonds:						
Series 1-3	525,000	—	—	—	525,000	—
Series 8	<u>26,480</u>	<u>—</u>	<u>26,480</u>	<u>—</u>	<u>—</u>	<u>—</u>
Subtotal	<u>551,480</u>	<u>—</u>	<u>26,480</u>	<u>—</u>	<u>525,000</u>	<u>—</u>

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	<u>Beginning balance</u>	<u>Accretion/ additions</u>	<u>Maturities</u>	<u>Refundings</u>	<u>Ending balance</u>	<u>Due within one year</u>
LIPA debt:						
NYSERDA notes	\$ 155,420	—	—	—	155,420	—
Net unamortized discounts/premiums and deferred amortization	<u>(51,490)</u>	<u>11,693</u>	<u>(3,024)</u>	<u>—</u>	<u>(36,773)</u>	<u>—</u>
Total bonds and notes, net of unamortized discounts/premium	<u>\$ 6,601,344</u>	<u>291,366</u>	<u>235,076</u>	<u>—</u>	<u>6,657,634</u>	<u>278,025</u>
Other long-term liabilities:						
Unrealized credits	\$ 133,024	12,161	66,406	—	78,779	—
Borrowings	110,297	—	4,982	—	105,315	—
Claims and damages	21,648	1,302	1,677	—	21,273	—
Capital lease obligations	<u>2,970,126</u>	<u>196,563</u>	<u>135,712</u>	<u>—</u>	<u>3,030,977</u>	<u>147,656</u>
Total other long-term liabilities	<u>\$ 3,235,095</u>	<u>210,026</u>	<u>208,777</u>	<u>—</u>	<u>3,236,344</u>	<u>147,656</u>

(a) Represents accretion of capital appreciation bonds

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Below is the Authority's schedule of capitalization for the years ended December 31, 2012 and 2011, (amounts in thousands):

<u>Electric system</u>	<u>Maturity</u>	<u>Interest rate</u>	<u>Series</u>	<u>2012</u>	<u>2011</u>
Electric system general revenue bonds:					
Capital appreciation bonds	December 1, 2013 to 2028	5.050% to 5.300% a	1998 A	\$ 137,642	143,055
Capital appreciation bonds	June 1, 2013 to 2029	5.540% to 5.950% a	2000 A	383,278	392,962
Serial bonds	September 1, 2013 to 2014	4.600% to 4.700% a,	2001 A	—	745
Term bonds	September 1, 2027 to 2029	5.000% to 5.125% a, c	2001 A	—	164,430
Serial bonds	June 1, 2013 to 2014	5.250%	a 2003 B	149,755	237,465
Serial bonds	September 1, 2013 to 2028	4.25% to 5.00%	a, c 2003 C	12,165	70,480
Term bonds	September 1, 2027 to 2033	5.00% to 5.25%	a, c 2003 C	135,010	185,520
Term bonds	December 1, 2029	0.15% to 30%	b, c 2003 D-O	226,225	375,225
Serial bonds	September 1, 2013 to 2025	3.80% to 4.875%	a, c 2004 A	33,900	33,900
Term bonds	September 1, 2029 to 2034	5.00% to 5.10%	a 2004 A	166,100	166,100
Serial bonds	December 1, 2016 to 2026	4.00% to 5.25%	a, c 2006A	839,245	839,245
Serial bonds	December 1, 2035	4.500%	a, c 2006B	4,240	4,240
Term bonds	December 1, 2035	5.000%	a 2006B	92,715	92,715
Term bonds	September 1, 2035	5.000%	a 2006C	198,020	198,020
Serial bonds	September 1, 2013 to 2025	4.00% to 5.00%	a, c 2006D	277,890	325,570
Serial bonds	December 1, 2017 to 2022	4.00% to 5.00%	a, c 2006E	507,600	507,600
Serial bonds	May 1, 2013 to 2028	4.00% to 5.00%	a, c 2006F	222,630	320,590
Term bonds	May 1, 2033	4.250%	a 2006F	112,580	112,580
Term bonds	May 1, 2033	5.50% to 6.00%	a 2008A	605,055	605,055
Serial bonds	April 1, 2019 to 2033	5.25% to 5.75%	a 2008B	149,340	149,340
Term bonds	April 1, 2031 to 2033	6.250%	a 2009A	435,825	435,825
Serial bonds	May 1, 2014 to 2015	2.50% to 5.00%	a 2010A	193,325	193,325
Term bonds	May 1, 2020 to 2041	4.85% to 5.85%	a,d 2010B	210,000	210,000
Serial bonds	May 1, 2016 to 2036	4.00% to 5.00%	a 2011A	113,360	113,360
Term bonds	May 1, 2038	5.000%	a 2011A	136,640	136,640
Term bonds	September 1, 2042	5.000%	a 2012A	250,000	—
Serial bonds	September 1, 2014 to 2029	3.00% to 5.00%	a 2012B	250,000	—
Term bonds	May 1, 2033	0.120%	b, c 2012C	175,000	—
Term bonds	May 1, 2033	0.120%	b, c 2012D	149,000	—
Electric system subordinated revenue bonds:					
	May 1, 2033	0.25% to 0.30%	b, c Series 1A,2A	200,000	275,000
	May 1, 2033	0.05% to 0.15%	b, c Series 1B, 2B	150,000	250,000
Total general and subordinated revenue bonds				<u>6,516,540</u>	<u>6,538,987</u>
Commercial paper notes		0.220%	b CP-1	150,000	150,000
		0.160%	b CP-3	50,000	50,000
				<u>200,000</u>	<u>200,000</u>
NYSERDA Financing notes:					
Pollution control revenue bonds	March 1, 2016	5.150%	a 1985 A,B	108,020	108,020
Electric facilities revenue bonds	November 1, 2023	5.300%	a 1993 B	29,600	29,600
	October 1, 2024	5.300%	a 1994 A	2,600	2,600
	August 1, 2025	5.300%	a 1995 A	15,200	15,200
Total NYSERDA financing notes				155,420	155,420
Unamortized premium/discount and deferred amortization				<u>(23,316)</u>	<u>(36,773)</u>
Total long-term debt				6,848,644	6,857,634
Less current maturities and short-term debt				<u>375,625</u>	<u>478,025</u>
Long-term debt				6,473,019	6,379,609
Net position				330,674	395,970
Total capitalization				<u>\$ 6,803,693</u>	<u>6,775,579</u>

a Fixed rate.

b Variable rate (rate presented is as of December 31, 2012).

c Certain bonds of this series are subject to interest rate exchange agreements – see note 5.

d Taxable Build America Bonds subject to 35% federal subsidy, rate shown is pre-subsidy level.

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The debt service requirements for the Authority's bonds (excluding commercial paper notes) as of December 31, 2012, are as follows (amounts in thousands):

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Net swap payments</u>	<u>Total</u>
2013	\$ 175,625	290,063	25,237	490,925
2014	279,745	291,416	16,167	587,328
2015	288,850	285,098	11,632	585,580
2016	311,185	277,817	7,446	596,448
2017	215,380	267,874	7,097	490,351
2018 – 2022	1,343,940	1,202,106	34,078	2,580,124
2023 – 2027	1,346,065	923,488	41,469	2,311,022
2028 – 2032	1,589,280	616,126	15,064	2,220,470
2033 – 2037	887,265	223,649	—	1,110,914
2038 – 2042	532,535	57,126	—	589,661
	<u>6,969,870</u>	<u>4,434,763</u>	<u>158,190</u>	<u>11,562,823</u>
Unamortized discounts/premiums	(23,316)	—	—	(23,316)
Unaccreted interest on capital appreciation bonds	<u>(297,910)</u>	<u>—</u>	<u>—</u>	<u>(297,910)</u>
Total	<u>\$ 6,648,644</u>	<u>4,434,763</u>	<u>158,190</u>	<u>11,241,597</u>

Future debt service on the variable rate bonds and floating rate portion of any floating-to-fixed rate swaps use an assumed rate of 2.00% for 2013; 3.00% for 2014, 3.50% and 4.00% for 2015, and thereafter, respectively. For bonds subject to floating-to-fixed rate swap agreements, the "net swap payments" represent the fixed swap rate payment net of the assumed future variable rate swap receipts for each agreement.

(a) ***Electric System General Revenue Bonds***

2012

The Authority issued \$250 million of its Electric System General Revenue Bonds, Series 2012A. The proceeds of these fixed rate bonds, including the original issue premium of \$18 million, were used to fund LIPA's capital programs and to pay bond issuance costs. The 2012A bonds have an average life of 28 years and an all-in cost of 4.57%.

The Authority issued \$252 million of its Electric System General Revenue Bonds, Series 2012B. The proceeds of these fixed rate bonds, including the original issue premium of \$35 million, were used to redeem \$274 million of outstanding variable rate securities in a current refunding and to pay bond issuance costs. The refunding produced an approximate \$30 million net present value savings. The 2012B bonds have an average life of 14 years and an all-in cost of 3.80%.

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The Authority issued \$324 million of its Electric System General Revenue Bonds, Series 2012C and Series 2012D. The proceeds of these variable rate bonds were used to refund certain of the Authority's outstanding variable rate securities. The 2012C and 2012D bonds have an average life of 18 years. Each of these bonds will be supported by payments made under its own irrevocable Letter of Credit. Each Letter of Credit will expire on June 12, 2015, unless extended prior to its expiration date in connection with the issuance of these bonds.

2011

In September 2011, the Authority issued \$250 million of its Electric System General Revenue Bonds, Series 2011A. The proceeds of these fixed rate bonds, including the original issue premium of \$12 million, were used to fund LIPA's capital programs and to pay bond issuance costs. The 2011A bonds have an average life of 21.9 years and an all-in cost of 4.70%.

(b) Interest Rate Swap Agreements

The Authority has entered into several interest rate swap agreements with various counterparties to modify the effective interest rate on outstanding debt. For a further discussion, see note 5.

(c) Commercial Paper Notes

The Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 through CP-3 (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. 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. In connection with the issuance of the Notes, the Authority has entered into three Letter of Credit and Reimbursement Agreements totaling \$300 million in principal amount. These Letter of Credit and Reimbursement Agreements are for a period of three years with a stated expiration date of January 27, 2015.

The Authority's short-term indebtedness as of December 31, 2012 and 2011 is comprised of the following obligations (amounts in thousands):

	2012			
	Beginning balance	Issuances	Retirements	Ending balance
Short-term debt – CP-1	\$ 150,000	900,000	(900,000)	150,000
Short-term debt – CP-3	50,000	336,723	(336,723)	50,000
	<u>\$ 200,000</u>	<u>1,236,723</u>	<u>(1,236,723)</u>	<u>200,000</u>

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		2011			
		<u>Beginning balance</u>	<u>Issuances</u>	<u>Retirements</u>	<u>Ending balance</u>
Short-term debt – CP-1	\$	100,000	750,000	(700,000)	150,000
Short-term debt – CP-3		100,000	625,558	(675,558)	50,000
		<u>\$ 200,000</u>	<u>1,375,558</u>	<u>(1,375,558)</u>	<u>200,000</u>

(11) 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 Legislature. 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 January 1, 2010 benefits for new members vest after ten years of accredited service, all others generally vested after five years.

Members of the System with less than 10 years of service or 10 years of membership contribute 3% of their gross salaries and the Authority pays the balance of the annual contributions for these employees. After 10 years of service or membership, members of the System no longer contribute 3% of their gross salaries and the Authority pays the entire amount of the annual contributions of these employees. Effective January 1, 2010, all new members contribute 3% of their gross salaries for their entire career.

Under this plan, the Authority's required contributions and payments made to the System were approximately \$1.9 million, \$1.6 million, and \$1.1 million, for the years ended December 31, 2012, 2011, and 2010, 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 benefits for Authority employees are not separately computed. 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, 110 State Street, Albany, New York 12244.

(12) Postemployment Healthcare Plan

(a) Plan Description

The Authority is a participating employer in the New York State Health Insurance Program (NYSHIP) which is administered by the State of New York as an agent multiple employer defined benefit plan. Under the plan, the Authority provides certain health care for eligible retired employees and their dependents. Article XI of the New York State Civil Service Law assigns the authority to

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NYSHIP to establish and amend the benefit provisions of the plans and to establish maximum obligations of the plan members to contribute to the plan. The Authority's Board is authorized to establish the contribution rates of its employees and retirees below those set by Civil Service Law. Participation in the NYSHIP program provides for employees and/or their dependents to continue eligibility for these benefits in retirement if the employee had at least one year of full-time service with the Authority, satisfied the requirements for retiring as a member of the New York State and Local Retirement System and is enrolled in NYSHIP. Eligible retirees contribute 10% of the cost of single coverage and 25% of the cost of dependent coverage for health insurance benefits. Participants include approximately 96 employees and retired and/or spouses of retired employees who were eligible to receive these benefits at December 31, 2012. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State of New York.

The Authority accounts for its other post employment benefit (OPEB) obligations, in accordance with GASB Statement No. 45, *Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions*. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Examples include assumptions about employment mortality and the healthcare cost trend. Amounts determined regarding the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The Authority's annual OPEB cost for the plan is calculated based on the Annual Required Contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB No. 45. GASB No. 45 does not require that an employer actually fund its ARC, but allows for the financing of these benefits on a pay-as-you-go basis. Since the Authority expensed the entire prior service cost in 2007, the ARC in future periods represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year, actuarial assumptions and plan changes, and interest on the unfunded actuarial liability. Amounts "required" but not actually set aside to pay for these benefits are accumulated as part of the Net OPEB Obligation (which was \$25 million at December 31, 2012), and as the Authority has not funded the "required" amount, future valuations may produce larger ARCs. For December 31, 2012 and 2011, the current period ARC was approximately \$4.7 million and \$2.4 million, respectively, as detailed in (d).

(b) Funding

The contribution requirements (funding) of the Authority's Net OPEB obligation are at the discretion of management and the Board of Trustees. The Net OPEB obligation is paid on a pay-as-you-go basis. The Authority has not funded a qualified trust or its equivalent.

(c) Actuarial Methods and Assumption

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. For the 2012 and 2011 actuarial

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valuation, the projected unit credit actuarial cost method was used. For the 2012 and 2011, the actuarial assumptions included an investment rate of return (net of administrative expenses) of 2.00% and 3.75%, respectively, and an annual healthcare cost trend rate of 10% (net of administrative expenses) including inflation, declining 1% each year to an ultimate trend rate of 5%. Both rates include a 3% inflation assumption.

(d) OPEB Status and Funding Progress

The OPEB obligation, which is included in deferred credits, and the funded status of the plan as of December 31, 2012 and 2011 is as follows (amounts in thousands):

	2012	2011
Annual OPEB cost:		
Annual required contribution (ARC):		
Normal cost	\$ 3,028	1,557
Amortization payment	20,874	17,694
Interest to the end of the year	475	718
Total	24,377	19,969
ARC adjustment	(20,061)	(18,249)
Interest on net OPEB obligation	400	667
Annual OPEB cost	\$ 4,716	2,387
Net OPEB obligation:		
Net OPEB obligation at beginning of fiscal year	\$ 19,977	17,825
Annual required contribution:		
Annual OPEB cost	4,716	2,387
Employer contribution:		
Payments for retirees during year to a trust	(163)	(235)
Net OPEB obligation at end of fiscal year	\$ 24,530	19,977

	2012	2011	2010
Actuarial valuation date:			
Actuarial value of assets	\$ —	—	—
Accrued actuarial liability (AAL)	32,875	18,688	16,680
Unfunded AAL	32,875	18,688	16,680
Funded ratio	—%	—%	—%
Covered payroll	\$ 11,714	11,401	10,980
UAAL as percentage covered payroll	280.6%	163.9%	151.9%

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(13) Commitments and Contingencies

(a) *Power Supply Agreement (PSA)*

The PSA provides for the sales to the Authority by KeySpan of all of the capacity, energy and, ancillary service output from the oil and gas-fired generating plants on Long Island formerly owned by LILCO. Such sales of capacity and energy are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission (FERC). The rates may be modified 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 return on net capital additions, which require approval by the Authority; and (iii) reasonably incurred expenses that are outside of the control of KeySpan. The PSA rates were reset in 2009, in accordance with the PSA agreement and as approved by FERC, and will continue through May 27, 2013 at which time the PSA is set to expire. The Authority and KeySpan have entered into an Amended & Restated PSA which is scheduled to take effect on May 28, 2013, subject to approval by the Office of the State Comptroller and FERC. The annual capacity charge in 2012 and 2011 was approximately \$452 million and \$441 million, respectively. The variable charge remains constant at \$0.90/Mwh of electric power generated by the plants.

The PSA provides incentives and penalties for up to \$4 million annually to maintain the output capability of the facilities, as measured by annual industry-standard tests of operating capability, and to maintain/or make capital improvements which benefit plant availability. The performance incentives were approximately \$4.0 million and \$3.7 million in 2012 and 2011, respectively.

(b) *Purchased Power and Transmission Agreements Assumed from LILCO*

As a result of the merger with LILCO, the Authority became party to power purchase agreements (PPAs) with Independent Power Producers (IPPs) and the New York Power Authority (NYPA) for electric generating capacity. Certain of these agreements have been renegotiated by the Authority or modified to comply with market rules instituted by the New York Independent System Operator (NYISO).

Under the terms of a 1989 agreement with NYPA, which will expire in 2015, the Authority purchases power from a pumped storage plant in upstate New York at tariff rates established by NYPA. Under the terms of a 1994 agreement with NYPA, the Authority purchases the electric capacity and energy produced at the NYPA facility located within the service territory at Holtsville, New York. In 2012, LIPA exercised its right to terminate the agreement in April 2014.

The Authority also became party to contracts with NYPA and Con Edison for firm transmission (wheeling) capacity in connection with the pumped storage PPA, as well as a contract with NYPA associated with a transmission cable that was constructed, in part, for the benefit of the Authority. With the inception of the NYISO on November 18, 1999, these transmission contracts were provided with “grandfathered rights” status. The Authority was provided with the opportunity to convert its grandfathered rights for Existing Transmission Agreements (ETAs) into Transmission Congestion Contracts (TCCs). Although the Authority has converted its ETA’s into TCCs, the Authority will continue to pay all transmission charges per the ETAs. In return, the Authority receives revenues

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from congestion charges collected by the NYISO. All such charges and revenue are considered components of or reductions to fuel and purchased power costs.

With respect to PPAs entered into with the IPPs, the Authority is obligated to purchase all the energy they make available to the Authority. However, LIPA has no obligation to the IPPs if they fail to deliver energy.

As provided by the Authority's tariff, the costs of all of the facilities noted above except for those subject to the PSA will be includable in the calculation of Fuel and Purchased Power Cost. As such, these costs are expected to be recoverable through the FPPCA.

The following table represents the Authority's commitments under the PPAs and transmission contracts assumed from LILCO, as renegotiated or modified (amounts in thousands):

	<u>PPA</u>	<u>Firm transmission</u>	<u>IPPs*</u>	<u>Total</u>
Years ended:				
2013	\$ 40,251	24,690	52,600	117,541
2014	40,173	26,010	52,600	118,783
2015	40,460	25,760	56,700	122,920
2016	40,884	25,430	14,800	81,114
2017	41,209	22,350	—	63,559
2018 through 2022	105,747	72,600	—	178,347
2023 through 2027	—	19,510	—	19,510
2028 through 2032	—	20,190	—	20,190
2033 through 2036	—	22,300	—	22,300
Subtotal	308,724	258,840	176,700	744,264
Less imputed interest	57,264	74,040	17,800	149,104
Total	\$ 251,460	184,800	158,900	595,160

* Assumes full performance by NYPA and the IPPs.

(c) Additional Power Purchase and Transmission Agreements

The Authority has entered into power purchase agreements (PPAs) with several private companies to develop and operate generating units at sites throughout Long Island. Generally, the PPAs provide for the Authority to purchase 100% of the capacity (and associated energy as needed), for the term of each contract, which vary in duration up to 30 years from contract initiation date.

The Authority has entered into several agreements to purchase renewable energy from on and off-Island sources. Certain of these power producing facilities have been accounted for as capitalized lease obligations. Facilities that do not meet the criteria for capitalization, under GASB No. 62, are being accounted for as operating leases.

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The following table represents the minimum payments under these various capacity and/or energy contracts (amounts in thousands):

	Capital leases	Operating leases
Minimum lease/rental payments:		
2013	\$ 307,104	150,679
2014	309,011	153,432
2015	310,882	156,434
2016	312,944	158,954
2017	302,529	161,261
2018 through 2022	1,271,687	615,435
2023 through 2027	1,068,187	374,251
2028 through 2032	289,538	217,888
2033 through 2035	—	2,649
Total	4,171,882	1,990,983
Less imputed interest	1,288,561	595,635
Net present value	\$ 2,883,321	1,395,348

(d) Office Lease

The Authority's office lease agreement terminated on April 30, 2011 and a new lease commenced on May 1, 2011.

The Authority's new office lease agreement includes scheduled base rent increases and rent "holidays" over the term of the lease. The total amount of the base rent payments is charged to expense on the straight-line method over the term of the lease. The Authority recorded a deferred credit to reflect the excess of rent expense over cash payments since inception of the lease.

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The termination date of the new lease agreement is April 30, 2024. The future minimum payments under the lease are as follows for the years ended (amounts in thousands):

Minimum lease/rental payments:		
2013	\$	658
2014		1,051
2015		1,528
2016		1,577
2017		1,629
2018 through 2022		8,973
2023 through 2024		4,697
Total		20,113
Less imputed interest		1,784
Net present value	\$	18,329

(e) Insurance Programs

The Authority's insurance program is comprised of a combination of policies from major insurance companies, self-insurance and contractual transfer of liability, including naming the Authority as an additional insured and indemnification.

The Authority has purchased Workers' Compensation insurance from the New York State Insurance Fund to provide coverage for claims arising from employee injuries. Liability related to construction projects and similar risks is transferred through contractual indemnification and compliance with Authority insurance requirements. The Authority also has various insurance coverage on its interest in NMP2 as disclosed in detail in note 8.

The Authority has commercially available excess general liability and property insurance for claims above the self-insurance provisions. For general liability, including automobile liability, the Authority is self-insured up to \$3 million. For transmission assets, such as substations, the Authority is self-insured up to \$7.5 million and distribution assets are self-insured up to \$1.5 million. Transformers are self-insured up to \$2.0 million.

The Authority has no excess general property insurance for damage to its poles and wires and is self-insured.

(f) Other

Following the issuance of a competitive solicitation for utility management services of LIPA's transmission and distribution system (T&D System), in December 2011, the LIPA Trustees approved the selection of PSEG to succeed National Grid Electric Services, LLC (NGES) as the Service Provider to operate, maintain, and make capital improvements to the T&D System when LIPA's current Management Service Agreement (MSA) with National Grid expires on December 31, 2013. The new agreements with PSEG have received all required regulatory approvals.

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As a result the impending expiration of the MSA, LIPA has been reviewing its rights and responsibilities under its various contracts related to both transitioning to a new management contract and new service provider. In this regard, the agreements between LIPA and National Grid provide, among other things, that upon termination of the MSA, if a third party succeeds NGES as the service provider, then the successor shall assume the rights and obligations of NGES regarding certain employee benefit plan liabilities and that NGES and LIPA shall enter into agreements to separate the new service provider obligations from those which NGES shall retain. The agreement further states that if the successor service provider fails to discharge these obligations, then NGES may pursue its rights first against the new service provider and secondarily against LIPA. The new agreement with PSEG would not require PSEG to pay employee benefit plan costs; rather, LIPA would fund the costs for employees providing service to LIPA.

LIPA is reviewing the agreement to determine which, if any, employee plan obligations need to be separated at the end of the MSA. Although LIPA has consistently funded the annual plan costs throughout the MSA term, NGES has asserted that LIPA is responsible for significant pension and other employee plan benefit obligations that are currently substantially underfunded or unfunded (such as OPEBs). The nature and extent of LIPA's potential obligation for such unfunded costs is being carefully assessed at this time given the various legal and financial factors involved, and may result in the need for LIPA to record a liability after the expiration of the MSA.

(14) Legal Proceedings

(a) *Superstorm Sandy*

Four class actions were filed against LIPA and National Grid related to Superstorm Sandy which contains common allegations of wrongdoing and/or gross negligence relating to LIPA's and National Grid's preparedness for and response to the storm. All of these actions seek monetary damages, fees and other relief. LIPA has also received more than 100 notices of claim related to property losses incurred by certain residents in the Breezy Point and Belle Harbor portions of its Queens service territory as a result of Superstorm Sandy. The claims allege that the failure to de-energize the electrical system in advance of the tidal surges experienced resulted in house fires that caused various types of property damage, ranging from all or partial loss of customers' homes. LIPA cannot predict with certainty whether or when these claims will be put into suit, although claimants have one year to do so. Management is evaluating these storm-related claims which seek material amounts in damages. The Authority cannot predict with certainty the outcome of these matters, but does not believe at this time that they will have a significant impact on operating results or the financial condition of the Authority.

(b) *Environmental*

In connection with the Merger, KeySpan and the Authority entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and the Authority on the basis of whether they relate to assets transferred to KeySpan or retained by the Authority as part of the Merger. In addition, to

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clarify and supplement these agreements, KeySpan and the Authority 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 the Authority after the Merger (the Retained Business) and to the business and operations to be conducted by KeySpan after the Merger (the Transferred Business).

National Grid, who subsequently purchased KeySpan in 2007, is now responsible for all liabilities arising from all manufactured gas plant operations on Long Island (MGP Sites), including those currently or formerly operated by National Grid or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, National Grid is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the nonnuclear generating business may be recoverable by National Grid as part of the capacity charge under the PSA. The Authority is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities other than those related to MGP sites 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 to LIPA and National Grid, as provided for in the Merger.

LIPA and National Grid entered into an Amended and Restated Power Supply Agreement, (A&R PSA) which will commence on May 28, 2013, subject to receipt of regulatory approvals. The A&R PSA addresses the terms by which LIPA will continue to purchase electricity from certain National Grid facilities. Generally, National Grid's liabilities under this contract are limited to losses due to gross negligence or willful misconduct or violations of environmental laws not consistent with prudent utility practices.

On December 28, 2011, LIPA and PSEG LI entered into an Operation Services Agreement (OSA) related to LIPA's transmission and distribution system whereby PSEG would begin providing operation services on or after January 1, 2014. Several clauses bear on the allocation of liability between the two parties. Generally, PSEG is required to provide services in accordance with prudent utility practices, must operate in compliance with law, must monitor new regulations, and must properly handle hazardous wastes. PSEG's liabilities associated with these services are limited to losses attributed to negligence, omission or willful misconduct. Further, PSEG's liability to third-party claims is generally limited to amounts above \$2.5 million in the aggregate in one year up to a maximum aggregate amount of \$2.5 million in any contract year. PSEG is not responsible for any liabilities that occur prior to December 31, 2013.

(c) ***Environmental Matters Retained by the Authority***

Superfund Sites – Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, also commonly referred to as Superfund), 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.

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Port Washington Landfill – LILCO is a Potentially Responsible Party (PRP) at this 54-acre municipal solid waste landfill located in the Town of North Hempstead. The landfill operated from 1973 to 1983. Since January 2001, LILCO and 11 other parties have been signing tolling agreements with the New York State Attorney General to extend the statute of limitations under CERCLA. The current tolling agreement expires on April 13, 2013. Six of the 11 tolling agreement PRPs, including LILCO, have formed a Joint Defense Group (JDG) that acts as one with respect to dealing with the Attorney General. The Attorney General is seeking to recover Environmental Quality Bond Act funds advanced to the Town of North Hempstead so it could properly close out the site with oversight by the New York State Department of Environmental Conservation (DEC). The landfill has been remediated and this matter is only concerned with cost recovery. The JDG is in negotiations with the Attorney General to resolve this matter. The Authority does not believe that its share of any settlement agreement will have a material adverse effect on its financial position, cash flows or results of operations.

Metal Bank –this is a ten-acre site with PCB contamination on the Delaware River that EPA had sued and settled with a number of utility companies, including LIPA, in 2005 for allegedly sending used transformers to the site. The National Oceanic and Atmospheric Administration (NOAA) has notified the PRP group that it (NOAA) will be initiating discussions about natural resource damages for marine resources. After NOAA performs a preliminary assessment study to determine whether injury to natural resources has occurred, and if so, the severity, NOAA will quantify that injury, and then consider possible restoration projects, such as replanting wetlands and restoring fish. At this preliminary stage LIPA is unable to estimate potential liability, but believes that it would be immaterial to its position.

(d) *Asbestos Proceedings*

Litigation is pending in State Court against the Authority, LILCO, KeySpan and various other defendants, involving thousands of plaintiffs seeking damages for personal injuries or wrongful death allegedly caused by exposure to asbestos. The cases for which the Authority may have financial responsibility involve employees of various contractors and subcontractors engaged in the construction or renovation of one or more of LILCO's six major power plants. These cases include extraordinarily large damage claims, which have historically proven to be excessive. The actual aggregate amount paid to plaintiffs alleging exposure to asbestos at LILCO power plants over the years has not been material to the Authority. Due to the nature of how these cases are litigated, it is difficult to determine how many of the remaining cases that have been filed (or of those that will be filed in the future) involve plaintiffs who were exposed to asbestos at any of the LILCO power plants. Based upon experience, it is likely that the Authority will have financial responsibility in a significantly smaller percentage of cases than are currently pending (or which will be filed in the future) involving plaintiffs who allege exposure to asbestos at any of the LILCO power plants.

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

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(e) ***Other Claims***

The Authority is subject to legal proceedings and claims that arise in the ordinary course of business. These include various environmental related claims, primarily to clean air and water standards. The Authority would expect to capitalize and recover in rates any capital additions necessary to comply with these standards. Other than those capital additions, any potential environmental related settlements are not expected to materially impact the Authority's operating results or financial position.



KPMG LLP
Suite 200
1305 Walt Whitman Road
Melville, NY 11747-4302

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
Long Island Power Authority

We have audited, in accordance with the 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, the financial statements of the Long Island Power Authority (the Authority) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated March 25, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

New York, New York
March 25, 2013