

Long Island Power Authority and Subsidiaries

**Consolidated Financial Statements
and Other Financial Information
December 31, 1999 and 1998**

**Report on Compliance and on Internal Control over
Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

To the Board of Trustees of the
Long Island Power Authority and Subsidiaries

We have audited the consolidated financial statements of the Long Island Power Authority and its subsidiaries (collectively, the "Company") as of December 31, 1999 and 1998, and have issued our report thereon dated March 10, 2000. We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. For purposes of this report, we have categorized the provisions of laws, regulations, contracts, and grants we tested as part of obtaining such reasonable assurance into the following categories:

- Cash and cash equivalents, designated funds and investments
- Revenues and receivables
- Purchasing and payables
- Officers and Employee Costs
- Payments in Lieu of Taxes

However, providing an opinion on compliance with those provisions was not an objective of our audits and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Company's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the consolidated financial statements being audited may occur and

not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the design of internal control over financial reporting or its operation that we consider to be material weaknesses.

This report is intended for the information of the Company. However, this report is a matter of public record, and its distribution is not limited.

PriceWaterhouseCoopers LLP
March 10, 2000

Long Island Power Authority and Subsidiaries

Index

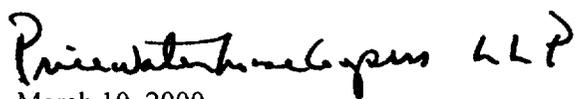
Section I.	Long Island Power Authority Consolidated Financial Statements	
	Report of Independent Accountants	1
	Statements of Financial Position	2
	Statements of Revenues, Expenses, and Changes in Retained Earnings/(Accumulated Deficit)	3
	Statements of Cash Flows	4
	Statements of Capitalization	5
	Notes to Consolidated Financial Statements	6-35
Section II.	Other Financial Information	
	Report of Independent Accountants on Other Financial Information	36
	Consolidating Statement of Financial Position	37
	Consolidating Statement of Revenues, Expenses, and Changes in Retained Earnings/(Accumulated Deficit)	38
	Consolidating Statement of Cash Flows	39
	Consolidating Statement of Capitalization	40
Section III.	Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Consolidated Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>.	41-42

Report of Independent Accountants

To the Board of Trustees
of the Long Island Power Authority and Subsidiaries

In our opinion, the accompanying consolidated statements of financial position and of capitalization and the related consolidated statements of revenues, expenses and changes in retained earnings/ (accumulated deficit) and of cash flows present fairly, in all material respects, the financial position of the Long Island Power Authority and its subsidiaries (collectively, the "Company") at December 31, 1999 and 1998, and the results of their operations and their cash flows for the twelve and nine months then ended, respectively, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2000 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.


March 10, 2000

Consolidated Statements of Financial Position
(Thousands of Dollars)

	December 31,	
	1999	1998
Assets		
Utility Plant, net	\$ 2,099,204	\$ 2,071,482
Property and Equipment, net	1,042	822
Current Assets		
Cash and cash equivalents	165,135	517,264
Investments	364,007	-
Customer accounts receivable (less allowance for doubtful accounts of \$19,480 and \$20,211, respectively)	92,082	119,161
Other accounts receivable	10,830	10,096
Accrued unbilled revenues	97,623	78,414
Promissory note receivable	-	398,000
Interest Receivable	132	-
Prepayments and other current assets	53,657	28,790
Total Current Assets	783,466	1,151,725
Promissory Note Receivable	602,427	646,902
Designated Funds	1,268	194,972
Nonutility Property and Other Investments	20,149	19,410
Deferred Charges	75,744	78,507
Regulatory Asset	233,631	-
Acquisition Adjustment (net of accumulated amortization of \$186,055 and \$68,766, respectively)	3,790,405	4,026,956
Total Assets	<u>\$ 7,607,336</u>	<u>\$ 8,190,776</u>
Capitalization		
Long-term debt	\$ 6,990,128	\$ 7,487,018
Retained earnings/(Accumulated deficit)	58,870	(100,055)
Total Capitalization	7,048,998	7,386,963
Current Liabilities		
Current maturities of long-term debt	186,426	468,880
Due to KeySpan	46,755	75,040
Accounts payable and accrued expenses	121,340	42,623
Accrued taxes	42,135	79,021
Accrued interest	54,683	63,387
Customer deposits	23,094	23,205
Total Current Liabilities	474,433	752,156
Deferred Credits	74,638	34,059
Claims and Damages	9,267	17,598
Commitments and Contingencies		
Total Capitalization and Liabilities	<u>\$ 7,607,336</u>	<u>\$ 8,190,776</u>

The accompanying notes are an integral part of these financial statements.

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

	Twelve Months Ended December 31, 1999	Nine Months Ended December 31, 1998
Electric Revenue	\$ 2,278,978	\$ 1,377,605
Expenses		
Operations - fuel and purchased power	713,303	408,192
Operations and maintenance	689,716	387,643
General and administrative	25,624	10,497
Depreciation and amortization	210,025	122,022
Capital recovery amortization	119,052	-
Payments in lieu of taxes	244,767	157,561
(Rebates recoverable) and customer rebates	(164,006)	168,806
Total Operating Expenses	<u>1,838,481</u>	<u>1,254,721</u>
Excess of operating revenues over expenses	<u>440,497</u>	<u>122,884</u>
Other income and (deductions), net		
Investment income	30,431	33,720
Other	19,025	(249)
Total other income, net	<u>49,456</u>	<u>33,471</u>
Excess of revenues over expenses before interest charges and (credits) and extraordinary gain	<u>489,953</u>	<u>156,355</u>
Interest charges and (credits)		
Interest on long-term debt, net	306,966	223,852
Other interest	34,342	9,933
Allowance for borrowed funds used during construction	(2,559)	(1,301)
Total interest charges	<u>338,749</u>	<u>232,484</u>
Excess of revenues over expenses (expenses over revenues) before extraordinary gain	151,204	(76,129)
Gain on early extinguishment of debt	7,721	-
Excess of revenues over expenses (expenses over revenues)	<u>158,925</u>	<u>(76,129)</u>
Retained earnings/(Accumulated deficit)		
Beginning	<u>(100,055)</u>	<u>(23,926)</u>
Ending	<u>\$ 58,870</u>	<u>\$ (100,055)</u>

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Cash Flows
(Thousands of Dollars)

	Twelve Months Ended December 31, 1999	Nine Months Ended December 31, 1998
Operating Activities		
Excess of revenues over expenses (expenses over revenues)	\$ 158,925	\$ (76,129)
Adjustments to reconcile excess of revenues over expenses (expenses over revenues) to net cash provided by operating activities		
Gain on early extinguishment of debt	(7,721)	-
Depreciation and amortization	210,025	122,022
Capital recovery amortization	119,052	-
Amortization of cost of issuing and redeeming securities	9,439	1,705
Other	13,644	1,973
Changes in operating assets and liabilities		
Accounts receivable, net and accrued unbilled revenue	7,867	34,568
Accounts payable and accrued expenses	78,717	33,738
Regulatory asset	(233,631)	-
Due to KeySpan	(28,285)	(136,757)
Accrued taxes	(36,885)	56,358
Accrued interest	(8,705)	63,386
Other	(4,518)	45,573
Net cash provided by operating activities	<u>277,924</u>	<u>146,437</u>
Investing Activities		
Merger costs, net of cash transferred	-	(49,827)
Acquisition of common stock, net of \$75,000 cash transferred	-	(2,422,500)
Purchases of investment securities, net of sales	(364,007)	-
Net cash used in investing activities	<u>(364,007)</u>	<u>(2,472,327)</u>
Cash Flows from Non-Capital related Financing Activities		
Proceeds from the issuance of bonds	-	163,500
Repayment of State of New York advances	-	(26,160)
Repayment of New York Power Authority advance	-	(9,000)
Net cash provided by non-capital related financing activities	<u>-</u>	<u>128,340</u>
Cash Flows from Capital and related Financing Activities		
Capital and nuclear fuel expenditures	(120,467)	(71,800)
Proceeds from notes receivable	442,475	3,000
Proceeds from the issuance of bonds	-	6,616,323
Redemption of long-term debt	(781,019)	(3,338,659)
Redemption of preferred stock	-	(221,600)
Bond issuance costs	-	(79,397)
Other	(739)	(3,991)
Net cash (used in) provided by capital and related financing activities	<u>(459,750)</u>	<u>2,903,876</u>
Net (decrease) increase in cash and cash equivalents and designated funds	<u>(545,833)</u>	<u>706,326</u>
Cash and cash equivalents and designated funds at beginning of period	712,236	5,910
Cash and cash equivalents and designated funds at end of period	<u>\$ 166,403</u>	<u>\$ 712,236</u>
Interest paid	\$ 303,007	\$ 305,993

The accompanying notes are an integral part of these financial statements.

Long Island Power Authority and Subsidiaries

5

Consolidated Statements of Capitalization (Thousands of Dollars)

	Maturity	Interest Rate	Series	December 31,	
				1999	1998
Electric System General Revenue Bonds					
Serial Bonds	December 1, 1999 to 2016	4.10% to 6.00% a	1998A	\$ 1,234,085	\$ 1,279,965
Taxable Term Bonds	December 1, 1999	5.94% a	1998A	-	25,000
Term Bonds	December 1, 2018 to 2029	5.00% to 5.75% a	1998A	1,850,575	1,998,770
Capital Appreciation Bonds	December 1, 2003 to 2028	4.40% to 5.30% a	1998A	157,662	150,095
Serial Bonds	April 1, 2000 to 2016	4.00% to 5.25% a	1998B	1,256,655	1,256,655
Term Bonds	April 1, 2018	4.75% a	1998B	57,145	57,145
Electric System Subordinated Revenue Bonds					
	May 1, 2033	5.75% b	Series 1	250,000	250,000
	May 1, 2033	5.50% b	Series 2	250,000	250,000
	May 1, 2033	3.65% b	Series 3	250,000	250,000
	May 1, 2033	3.75% b	Series 4	250,000	250,000
	May 1, 2033	4.70% b	Series 5	250,000	250,000
	May 1, 2033	4.75% b	Series 6	250,000	250,000
	April 1, 2025	4.21% b	Series 7	250,000	250,000
	April 1, 2009 to 2012	4.00% to 5.00% a	Series 8	218,300	218,300
Total General and Subordinated Revenue Bonds				<u>6,524,422</u>	<u>6,735,930</u>
Debentures					
	July 15, 1999	7.30% a		-	397,000
	January 15, 2000	7.30% a		278	278
	July 15, 2001	6.25% a		8,460	8,460
	March 15, 2003	7.05% a		5,890	5,890
	March 1, 2004	7.00% a		2,999	2,999
	June 1, 2005	7.13% a		14,307	14,307
	November 1, 2022	9.00% a		26,532	26,877
	March 15, 2023	8.20% a		270,000	270,000
Total Debentures				<u>328,466</u>	<u>725,811</u>
NYSERDA Financing Notes					
Pollution Control Revenue Bonds					
	December 1, 2006	7.50% a	1976 A	-	26,375
	December 1, 2009	7.80% a	1979 B	-	19,100
	March 1, 2016	5.15% c	1985 A,B	108,020	138,120
Electric Facilities Revenue Bonds					
	September 1, 2019	7.15% a	1989 A,B	35,030	35,030
	June 1, 2020	7.15% a	1990 A	73,900	73,900
	December 1, 2020	7.15% a	1991 A	26,560	26,560
	February 1, 2022	7.15% a	1992 A,B	13,455	13,455
	August 1, 2022	6.90% a	1992 C,D	28,060	28,060
	November 1, 2023	5.30% c	1993 B	29,600	50,000
	October 1, 2024	5.30% c	1994 A	2,600	50,000
	August 1, 2025	5.30% c	1995 A	15,200	50,000
Total NYSERDA Financing Notes				<u>332,425</u>	<u>510,600</u>
Unamortized premium and deferred amortization				<u>(8,759)</u>	<u>(16,443)</u>
Total Long-Term Debt				<u>7,176,554</u>	<u>7,955,898</u>
Less Current Maturities				<u>186,426</u>	<u>468,880</u>
Long-Term Debt				<u>6,990,128</u>	<u>7,487,018</u>
Retained Earnings/(Accumulated Deficit)				<u>58,870</u>	<u>(100,055)</u>
Total Capitalization				<u>\$ 7,048,998</u>	<u>\$ 7,386,963</u>

a - Fixed rate

b - Variable rate (rate presented is at December 31, 1999)

c - Fixed rate at December 31, 1999 and variable rate at December 31, 1998 (rate presented is at December 31, 1999)

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Note 1. Basis of Presentation

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

As used herein, the term "LILCO" refers to the Long Island Lighting Company, the publicly owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger, as described in Note 2, and the term "LIPA" refers to that company as it exists after the LIPA/LILCO Merger, as a wholly-owned electric utility subsidiary company of the Long Island Power Authority (the "Authority"), doing business as LIPA. LIPA has 1 share of \$1 par value common stock authorized, issued and outstanding, which is held by the Authority and eliminates in consolidation.

In October 1994, a not-for-profit subsidiary corporation, LIPA Resources, Inc. was formed under Section 402 of the Not-For-Profit Corporation Law. The subsidiary was formed for the purpose of marketing the Authority owned assets and providing consulting services by using the expertise developed by the Authority in decommissioning a fully licensed commercial nuclear plant. LIPA Resources, Inc. was inactive during the fiscal year ended December 31, 1999 and the nine months ended December 31, 1998 and had no assets or liabilities as of December 31, 1999 and 1998.

Subsequent to the LIPA/LILCO Merger, the Authority and its subsidiaries, LIPA and LIPA Resources, Inc. (collectively, the "Company"), changed from a March 31 year-end to a December 31 year-end. The 1998 results reflect nine months of operations and the 1999 results reflect twelve months of operations.

Note 2. Merger/Change in Control/Nature of Operations

Merger/Change in Control

On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO (the "Merger") pursuant to an Agreement and Plan of Merger dated as of June 26, 1997, by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy, "KeySpan"), and the Authority, (the "Merger Agreement").

Pursuant to the Merger Agreement, immediately prior to the Merger, all of the assets and liabilities of LILCO related to the conduct of its gas distribution business and its non-nuclear electric generation business, and all common assets used by LILCO in the operation and management of its electric transmission and distribution business and its gas distribution business and/or its non-nuclear electric generation business (the "Transferred Assets") were sold to KeySpan.

As a result of the Merger, the Authority became the holder of 1 share of LILCO's common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately \$1.048 billion. The interest rate and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed by LIPA in the Merger. KeySpan is required to make principal and interest payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA then transfers those amounts to debtholders in accordance with the original debt repayment schedule.

Notes to Consolidated Financial Statements

The cash consideration required for the Merger was obtained by the Authority from the proceeds of the issuance and sale of its Electric System General Revenue Bonds, Series 1998A and Electric System Subordinated Revenue Bonds, Series 1 through Series 6. The proceeds from the sale of the bonds were then transferred by the Authority to LIPA in exchange for a promissory note of approximately \$4.949 billion. As a result of the Merger, there was a change in control of LILCO which effectively resulted in the creation of a new reporting entity, LIPA.

The remaining assets and liabilities of LILCO acquired by LIPA consist of: (i) LILCO's electric transmission and distribution system; (ii) its net investment in Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2"); (iii) certain regulatory assets and liabilities associated with its electric business, (iv) allocated accounts receivable and other assets and liabilities; and (v) substantially all of its long-term debt.

Because of the manner in which LIPA's rates and charges are established by the Authority's Board of Trustees, the original net book value of the transmission and distribution and nuclear generation assets acquired in the Merger is considered to be the fair value of these assets. The excess of the acquisition costs over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35 year period. The acquisition adjustment arose principally through the elimination of LILCO's regulatory assets and liabilities, totaling \$6.3 billion, and net deferred federal income tax liability of approximately \$2.4 billion. The balance of the acquisition adjustment is approximately \$3.8 million and \$4.0 million at December 31, 1999 and 1998, respectively.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services for LIPA's transmission and distribution system through a management services agreement ("MSA"). Therefore, LIPA pays KeySpan directly for services and KeySpan, in turn, pays the salaries of their employees. LIPA has no employees; however, LIPA is charged a management fee by the Authority to oversee LIPA's operations. LIPA contracts for capacity from the fossil fired generating plants of KeySpan through a power supply agreement ("PSA"). Energy and fuel are purchased by KeySpan on LIPA's behalf through an energy management agreement ("EMA") (collectively; the "Operating Agreements").

The electric transmission and distribution system is located in the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways ("Service Area"). The Service Area covers an area of approximately 1,230 square miles and the population of the service area is approximately 2.75 million persons. LIPA receives approximately 50% of its revenues from residential sales, 47% from sales to commercial and industrial customers, and the balance from sales to other utilities and public authorities.

Nature of operations

LIPA, as owner of the transmission and distribution system and as party to the Operating Agreements, conducts the electric business in the Service Area. The Authority is responsible, however, for administering, monitoring and managing the performance by all parties to the Operating Agreements.

Notes to Consolidated Financial Statements

The Authority and LIPA are also parties to an Administrative Services Agreement which describes the terms and conditions under which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area.

As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above.

Note 3. Summary of Significant Accounting Policies

General

The Company complies with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," the Company also complies with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Authority and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting for the Effects of Rate Regulation

Under current New York law, the Authority's Board of Trustees is empowered to set rates for electric service in LIPA's Service Area without being required by law to obtain the approval of the Public Service Commission ("PSC") or any other State regulatory body.

The Company is subject to the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Company records these future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

In order for a rate-regulated entity to continue to apply the provisions of SFAS No. 71, it must continue to meet the following three criteria: (1) the enterprise's rates for regulated services provided to its customers must be established by an independent third-party regulator or its own governing board empowered by a statute to establish rates that bind customers; (2) the regulated rates must be designed to recover the specific enterprise's costs of providing the regulated services; and (3) in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers.

Based upon the Company's evaluation of the three criteria discussed above in relation to its operations, and the effect of competition on its ability to recover its costs, the Company believes that SFAS No. 71 continues to apply.

Notes to Consolidated Financial Statements

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. During 1999, the Company recorded a regulatory asset totaling approximately \$234 million in connection with an agreement with Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District)(collectively, the "Suffolk Taxing Jurisdictions") and Nassau County, as discussed in Note 11.

If the Company had been unable to continue to apply the provisions of SFAS No. 71, at December 31, 1999, the Company estimates that approximately \$4.0 billion would have been written off at such time.

Utility Plant and Property and Equipment

Utility plant was stated at fair value at the date of the Merger. Additions to and replacements of utility plant are capitalized at original cost, which includes material, labor, indirect costs associated with an addition or replacement, plus an allowance for funds used during construction. The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, is charged to accumulated depreciation. The cost of repairs and minor renewals is charged to maintenance expense. Mass properties (such as poles, wire and meters) are accounted for on an average unit cost basis by year of installation.

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

Depreciation

The provisions for depreciation for utility plant result from the application of straight-line rates by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The depreciation rate as a percentage of average depreciable plant costs was 2.9% in 1999 and 1998.

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. All other property and equipment are being depreciated over their estimated useful lives (5 years) using the straight-line method.

Allowance for Borrowed Funds Used During Construction

The allowance for funds used during construction ("AFC") is the net cost of borrowed funds used for construction purposes. AFC is not an item of current cash income. AFC is computed monthly on a portion of construction work in progress. The average AFC rate for the fiscal year ended December 31, 1999 and 1998 was 4.76% and 4.71%, respectively.

Cash and Cash Equivalents, Designated Funds and Investments

Funds are held in an investment pool that is administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. Certain cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific

Notes to Consolidated Financial Statements

purposes, including debt services capital expenditures and clean energy initiatives. Investments are reported at amortized cost which approximates fair market value.

Deferred Charges

Deferred charges consists primarily of bond issue costs related to the issuance of the Authority's Electric System General Revenue Bonds and Subordinated Revenue Bonds that are being amortized on a straight line basis over the life of the bonds.

Acquisition Adjustment

Represents the difference between the purchase price paid and the net assets acquired from LILCO. The acquisition adjustment is being amortized and recovered through rates on a straight line basis using a 35-year life.

During the year ended December 31, 1999, LIPA generated sufficient cash flow to allow it to purchase, via a tender offer, approximately \$148.2 million of 1998 Series A Bonds. As these bonds were used to acquire the assets of LILCO, and thereby created the acquisition adjustment, the early retirement of such debt reflects the advance recovery of costs and as a result, LIPA recorded accelerated amortization of the acquisition adjustment in 1999 totaling approximately \$119 million.

Fair Values of Financial Instruments

The Company's financial instruments approximate their fair market value at December 31, 1999 and 1998. The fair values of the Company's long-term debt are based on quoted market prices.

Revenues

Revenues are comprised of cycle billings rendered to customers, based on meter reads, and the accrual of electric revenues for services rendered to customers not billed at month-end.

Fuel and Purchased Power Cost Adjustment ("FPPCA")

LIPA's rates include the FPPCA mechanism whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA is designed to allow LIPA to recover from or return to customers any fuel costs that fall outside an established base fuel and purchased power tolerance band. The tolerance band is equal to one percent above and one percent below LIPA's base cost of fuel and purchased power costs for 1999. The tolerance band increases to two percent in 2000 and will continue to increase in one percent increments annually thereafter. Expenses for fuel and purchased power costs in excess of or below this level may be recovered from or returned to customers beginning the following year. Should fuel and purchased power costs increase in excess of five percent cumulatively over the original base cost, the FPPCA may recover, from that year forward, all costs in excess of the original base.

Under LIPA's current tariffs, the measurement of the under or over recovery of fuel costs was scheduled to begin January 1, 1999. For the year ended December 31, 1999, LIPA's fuel costs fell within the limits of the 1999 tolerance band, therefore, no FPPCA adjustment was necessary. During the period ended December 31, 1998, LIPA recovered from customers approximately \$22 million more for fuel than was incurred. In order to preserve this benefit for customers, LIPA recorded a liability in 1998 for the full amount of the over recovery. This amount is included in deferred credits.

Notes to Consolidated Financial Statements

Income Taxes

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

Payments-in-lieu-of-taxes

The Company is required to make payments-in-lieu-of-taxes ("PILOTS"), for all operating taxes previously paid by LILCO, including gross income, gross earnings, property, Metropolitan Transportation Authority and certain taxes related to fuels used in utility operations. PILOTS include payments to municipalities and school districts in which the defunct Shoreham power plant is located. Shoreham related PILOTS paid in the first year following the Authority's acquisition of Shoreham, which occurred on February 29, 1992, were equal to the taxes and assessments which would have been paid had Shoreham not been transferred to the Authority. In each succeeding year through 1999, Shoreham related PILOTS have been reduced by ten percent of the first year's required payment.

With the implementation of the Shoreham Settlement Agreement ("Settlement Agreement") discussed in Note 11, PILOTS for the Shoreham plant will be paid as follows:

Payment Date	Dollars	Period Covered
2/1/2000	\$14,307,472	3/1/99-8/31/99
3/1/2000	12,268,000	9/1/99-2/28/00
9/1/2000	8,179,000	3/1/00-8/31/00
3/1/2001	8,179,000	9/1/00-2/28/01
9/1/2001	4,089,000	3/1/01-8/31/01
3/1/2002	4,089,000	9/1/01-2/28/02

Reserves for Claims and Damages

Losses arising from claims against LIPA, including workers' compensation claims, property damage, extraordinary storm costs and general liability claims, are partially self-insured. Reserves for these claims and damages are based on, among other things, experience and risk of loss. Extraordinary storm losses incurred by LIPA are partially insured by various commercial insurance carriers, and in certain instances, may be recoverable from the Federal Emergency Management Agency. The insurance carriers provide partial insurance coverage for individual storm losses to the transmission and distribution system between \$15 million and \$35 million. Storm losses which are outside of this range are self-insured by LIPA.

Use of Estimates

The accompanying financial statements were prepared in conformity with 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 of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified in the financial statements to conform with the current period presentation.

Notes to Consolidated Financial Statements

Recent Accounting Pronouncements*Derivative Instruments*

In July 1999, Financial Accounting Standards board ("FASB") issued SFAS No. 137, "Deferral of SFAS No. 133 Effective Date." This Statement deferred the effective date of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," from fiscal years beginning after June 15, 1999, to fiscal years beginning after June 15, 2000. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The Company will adopt SFAS No. 133 in the first quarter of fiscal year 2001. The Company does not expect any material earnings effect from adoption of that statement.

Plant Decommissioning

In February 1996, the FASB issued an exposure draft ("ED") entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear power plant decommissioning. Currently the FASB is revising this ED retitled "Accounting for Obligations Associated With the Retirement of the Long Lived Assets," – which is expected to be issued later this year. If the accounting standard proposed in such exposure draft were adopted, it could result in higher annual provisions for removal or decommissioning to be recognized earlier in the operating life of nuclear and other generating units and an accelerated recognition of the decommissioning obligation. The FASB is continuing to explore various issues associated with this project, including liability measurement and recognition issues. In addition, an effective date for the new exposure draft has not yet been determined. The FASB is deliberating this issue and the resulting final pronouncement could be different from that proposed in the exposure draft. The Company can make no prediction at this time as to the ultimate form of such proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial condition or results of operations of the Company.

Note 4. Rate Matters

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

The Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Company; PILOTS; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the

Notes to Consolidated Financial Statements

terms of such resolution.

LIPA's rates include the FPPCA to adjust rates to reflect significant changes in the cost of fuel, purchased power and related costs. For further discussion regarding the FPPCA, see Note 3.

LIPA's rates are largely based on LILCO's pre-Merger rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, LIPA's rates include the FPPCA, a PILOTS recovery rider, a rider providing for the Shoreham tax settlement and a rider providing for the RICO Credits (credits to the bills of customers as a result of the settlement by LILCO of a RICO action in connection with the construction and completion of nuclear generating facilities).

The Act requires LIPA to make PILOTS for certain New York State and local revenue taxes that would otherwise have been imposed on LILCO. The PILOTS recovery rider allows for LIPA's rate adjustments to accommodate the PILOTS.

For a further discussion on the Shoreham tax and Suffolk County matters see Notes 10 and 11.

Note 5. Utility Plant and Property and Equipment

Utility Plant consists of:

	<i>(in thousands)</i>	
	December 31,	
	1999	1998
Generation - nuclear	\$ 659,591	\$ 662,893
Transmission and distribution	1,451,911	1,385,099
Common	2,929	3,827
Construction work in progress	78,458	52,897
Nuclear fuel in process and in reactor	17,052	17,053
	<u>2,209,941</u>	<u>2,121,769</u>
Less - Accumulated depreciation and amortization	<u>110,737</u>	<u>50,287</u>
Total Net Utility Plant	<u>\$ 2,099,204</u>	<u>\$ 2,071,482</u>

Notes to Consolidated Financial Statements

Property and Equipment consists of:

	<i>(in thousands)</i>	
	December 31,	
	1999	1998
Office equipment	\$ 715	\$ 422
Leasehold improvements	331	276
Office furniture	354	252
	<u>1,400</u>	<u>950</u>
Less - Accumulated depreciation and amortization	<u>358</u>	<u>128</u>
Total Net Property and Equipment	<u>\$ 1,042</u>	<u>\$ 822</u>

Note 6. Nine Mile Point Nuclear Power Station, Unit 2 (“NMP2”)

As a result of the Merger, LIPA acquired an undivided 18% interest in NMP2, located in Scriba, New York which is operated by Niagara Mohawk Power Corporation (“NMPC”). The cotenants of NMP2 and their respective percentage ownership are as follows: LIPA (18%), NMPC (41%), New York State Electric & Gas Corporation (“NYSEG”) (18%), Rochester Gas Electric Corporation (“RG&E”) (14%) and Central Hudson Gas & Electric Corporation (“CHG&E”) (9%). LIPA’s share of the rated capability is approximately 205 MW. LIPA’s net utility plant investment, excluding nuclear fuel, was approximately \$623 million and \$650 million at December 31, 1999 and 1998, respectively. Generation from NMP2 and operating expenses incurred by NMP2 are shared in the same proportions as the cotenant’s respective ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

NMPC has contracted with the United States Department of Energy (“DOE”) for the disposal of spent nuclear fuel. LIPA reimburses NMPC for its 18% share of the cost under the contract at a rate of \$1.00 per megawatt hour of net generation less a factor to account for transmission line losses. Such costs are included in the cost of fuel and recoverable from customers in accordance with the mechanics of the FPPCA.

On September 30, 1999, the Nuclear Regulatory Commission (“NRC”) issued a Plant Performance Review on the Nine Mile Point 2 and Nine Mile Point 1 (wholly owned by NMPC) Plants. The NRC stated that it will increase its scrutiny of the operation of the Nine Mile plants over the next six months as a result of a decline in the performance of those plants due to weaknesses in areas such as plant maintenance, work planning and scheduling, and engineering support. NMPC has announced significant management changes at the Nine Mile plants, including the reassignment of several experienced employees to the site. If operating performance of NMP2 deteriorates further, significant expenditures

Notes to Consolidated Financial Statements

may be required to improve performance, the impact of which cannot be predicted; however, the Company expects rates to be set at levels sufficient to recover all such operating costs.

Nuclear Plant Decommissioning

NMPC expects to commence the decommissioning of NMP2 in 2026, shortly after the cessation of plant operations, using a method which provides for the removal of all equipment and structures and the release of the property for unrestricted use. LIPA's share of decommissioning costs, based upon a "Site-Specific" 1995 study (1995 study), is estimated to be \$352 million in 2026 dollars (\$158 million in 1999 dollars using a 3.0% escalation factor). LIPA's share of the estimated decommissioning costs is currently being recovered from customers in electric rates and is being charged to operations as depreciation expense over the service life of NMP2. The amount of decommissioning costs recorded as depreciation expense for the period ended December 31, 1999 and 1998 totaled \$4.2 million and \$3.9 million, respectively.

LIPA has acquired external trust funds established for the decommissioning of the contaminated portion of NMP2. It is currently estimated that the cost to decommission the contaminated portion of the plant will be approximately 76% of the total decommissioning costs. These funds comply with regulations issued by the NRC and the Federal Energy Regulatory Commission ("FERC") governing the funding of nuclear plant decommissioning costs. As of December 31, 1999 and 1998, the balance in these funds, including re-invested net earnings, was approximately \$20 million and \$19 million, respectively. These amounts are included in Non-utility Property and Other Investments. The trust fund investments consist of U.S. Treasury debt securities and cash equivalents. The carrying amounts of these investments approximate fair market value at December 31, 1999 and 1998. If the assumed return on trust accounts is not earned, then it is probable that the additional costs will be incurred. The Company believes that any such additional costs will be recoverable through rates.

Reference is made to Note 3 under the subcaption "Recent Accounting Pronouncements" for details of the proposed changes in accounting for nuclear plant decommissioning costs.

On August 27, 1997, the PSC Staff ("Staff") issued a "Notice Soliciting Comments on Nuclear Generation" requesting comments and alternative approaches by interested parties on a "Staff Report on Nuclear Generation" ("Nuclear Report"). The Nuclear Report concludes that nuclear generation, along with non-nuclear generation facilities, should be subject to the discipline of market-based pricing.

On March 20, 1998, the PSC initiated a proceeding to examine a number of issues raised by the Nuclear Report and the comments received in response to it. In reviewing the Nuclear Report and parties' comments, the PSC: (a) adopted as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, with parties challenging that premise having to bear a substantial burden of persuasion; (b) characterized the proposals in the Staff paper as by and large consistent in concept with the PSC's goal of a competitive, market-based electricity industry; (c) questioned PSC Staff's position that would leave funding and other decommissioning responsibilities with the sellers of nuclear power interests; and, (d) indicated interest in the potential for the New York Nuclear Operating Committee ("NYNOC") to benefit customers through efficiency gains and directed pursuit of that matter in this nuclear generating proceeding or separately upon the filing of a formal NYNOC proposal. This proceeding is in abeyance pending the potential unit sale as discussed below.

Notes to Consolidated Financial Statements

NMP2 Radioactive Waste

NMPC has contracted with the U.S. Department of Energy ("DOE") for disposal of high-level radioactive waste ("spent fuel") from NMP2. Despite a court order reaffirming the DOE's obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. LIPA has been advised by NMPC that NMP2 spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If additional DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required.

Nuclear Plant Insurance

NMPC procures public liability and property insurance for NMP2, and LIPA reimburses NMPC for its 18% share of those costs.

The Price-Anderson Amendments Act mandates that nuclear power 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 \$200 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 106 presently licensed nuclear reactors in the United States to a retrospective assessment of up to \$88.1 million for each nuclear incident, payable at a rate not to exceed \$10 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of \$15.9 million, per incident, through assessments of up to \$1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor. These assessments are subject to periodic inflation indexing and to a 5% surcharge if funds prove insufficient to pay claims.

NMPC has also procured \$500 million primary nuclear property insurance with the Nuclear Insurance Pools and approximately \$2.3 billion of additional protection (including decontamination costs) in excess of the primary layer through Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately \$1.4 million per loss. This level of insurance is in excess of the NRC required minimum of \$1.06 billion of coverage.

LIPA has obtained insurance coverage from NEIL for the extra expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, should losses exceed the accumulated reserves of NEIL, each member, including LIPA, would be liable for its share of deficiency. LIPA's maximum liability per incident under the replacement power coverage, in the event of a deficiency, is approximately \$700,000.

Recent Developments

In June 1999, two cotenants of NMP2 representing 59% of the ownership interest each entered into an agreement to sell their interest in NMP2 to a single third party who would replace NMPC as the operator of NMP2. NMPC has also entered into an agreement to sell its 100% interest in the adjacent Nine Mile Point Unit No. 1 Nuclear Plant ("Nine Mile 1 Plant") to that third party.

Notes to Consolidated Financial Statements

The cotenant owners of NMP2 have rights of first refusal under the Basic Agreement, dated September 22, 1975, creating the tenancy-in-common ownership of NMP2. Pursuant to such rights, each cotenant has the right to acquire all or a proportionate share of another cotenant's interest in NMP2 by matching the terms of the cotenant's sale of its interest to a third party.

In July 1999, the potential third party buyer and sellers petitioned the PSC, seeking consent for the transfer of such interest in NMP2 (and Nine Mile 1 Plant). In July 1999, these same parties filed for requisite approvals with FERC with respect to such transfers. In September 1999, these same parties filed jointly with the NRC for requisite approvals with respect to such transfers. In early December 1999, NYSEG petitioned the PSC for an emergency declaratory ruling as to whether RG&E may acquire additional interests in NMP2 (and Nine Mile 1 Plant). By Order issued in December 1999, the NRC suspended its proceeding pending the determination of RG&E, CHG&E and LIPA's intent to exercise their rights of first refusal with respect to the proposed transfer.

On December 21, 1999, RG&E exercised its right of first refusal under NMP2 Basic Agreement to match the third party offer to purchase the collective interests of NMPC and NYSEG in NMP2 and NMPC's interest in Nine Mile 1 Plant. RG&E publicly announced that it had entered into arrangements with a separate third party to operate NMP2.

The Authority can make no prediction as to the outcome of the proposed acquisition of interests in NMP2 or the effects such acquisition would have on LIPA. LIPA has no intention of exercising its right of first refusal or selling its ownership interest in NMP2 at this time.

Note 7. Cash and Cash Equivalents, Designated Funds and Investments

Funds of the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities which authorizes investments in: (a) obligations of the U.S. Treasury and U.S. Agencies; (b) bankers' acceptance; (c) collateralized certificates of deposit; (d) collateralized repurchase agreements; (e) commercial paper rated P-1 or higher by Moody's and A-1 or higher by a Standard & Poor's; and (f) money market funds rated P-1 or higher by Moody's and A-1 or higher by Standard & Poor's. All investments of the Authority are held by designated custodians in the name of the Authority. Investments are reported at amortized cost, which approximates fair market value at December 31, 1999 and 1998. Investments with original maturities of less than 90 days are classified as cash and cash equivalents. Certain cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific purposes such as capital additions, debt repayment and clean energy initiatives. Amounts so designated are included in the caption Designated Funds.

Governmental Accounting Standards Board, Statement No. 3 "Investments, Including Repurchase Agreements" ("GASB 3"), requires state and local governments to classify their investments in three defined categories of credit risk. Category I includes investments that are insured or registered, or securities that are held by the Company or its agent in the Company's name. Category II includes investments that are collateralized with securities which are held by the pledging financial institution's trust department or agent in the Company's name. Category III includes uncollateralized investments for which the securities are held by the broker's or dealer's trust department or agent in the Company's name.

Notes to Consolidated Financial Statements

Investments held by the Authority, with the exception of money market mutual funds, qualify as Category I investments at December 31, 1999 and 1998. Money market mutual funds qualify as Category III investments at December 31, 1999 and 1998, as they are neither collateralized nor insured. It is the Company's belief that despite a Category III classification, the money market mutual funds have a very low risk of default as institutions purchasing these items on the Company's behalf are investing in U.S. Government securities or commercial paper which meets Company's minimum investments requirements, as described above.

The bank balances of \$1.2 million and \$0.6 million at December 31, 1999 and 1998, respectively, were collateralized for amounts above the Federal Depositors Income Company ("FDIC") limits with securities held by the custodian banks in the Authority's name.

Investments and cash and cash equivalents of the Authority at December 31, 1999 and 1998, are detailed below:

(in thousands of dollars)

	December 31,	
	1999	1998
Investments:		
U.S. Government/Agencies	\$ 14,244	\$ -
Commercial Paper	340,263	-
Certificates of Deposit	9,500	-
Total investments	364,007	-
Cash and cash equivalents and designated funds:		
Commercial paper	12,435	653,152
Money market mutual funds	152,760	38,392
Bank money market funds	1	73
Certificates of Deposit	-	20,000
Demand deposit	1,207	619
Total cash and cash equivalents and designated funds	166,403	712,236
Total investments, cash and cash equivalents and designated funds	\$ 530,410	\$ 712,236

Notes to Consolidated Financial Statements

Note 8. Debt

The Authority

The Authority financed the cost of the Merger and the refinancing of certain of the LILCO's outstanding debt by the issuance of approximately \$6.73 billion aggregate principal amount of Electric System General Revenue Bonds and Electric System Subordinated Revenue Bonds (collectively the "Bonds"). In accordance 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.

The Bonds are secured by a Trust Estate as pledged under the Authority's Bond Resolution (the "Resolution"). The Trust Estate consists principally of the revenues generated by the operation of LIPA's transmission and distribution system and have been pledged by LIPA to the Authority.

Electric System General Revenue Bonds

1998 Series A

This Series is comprised of Current Interest and Capital Appreciation Bonds. The Current Interest Bonds include: (i) tax exempt Serial Bonds with maturities that began in December 1999 and continue each year through December 2016; and (ii) tax exempt Term Bonds with maturities beginning in December 2018 and a final maturity in December 2029. The Capital Appreciation Bonds are tax exempt bonds with maturities beginning in December 2003 continuing each year through December 2028. During the 12-month period ended December 31, 1999, the Company retired with cash from operations the 4.5% Serial Bond of approximately \$45.9 million and the 5.94% Taxable Term Bond of \$25 million.

In November 1999, the Authority instituted a tender offer for the Electric System General Revenue Bonds, Series 1998A maturing on December 1, 2018, 2022 and 2026. The offer expired in December 1999. The Authority purchased approximately \$148.2 million par amount of the bonds as follows:

(In thousands, except price per bond)

Maturity (December 1)	Interest Rate	Par Tendered	Par Accepted	Acceptance Price	Total Paid Amount
2018	5.000%	\$102,450	\$ 505	\$ 89.000	\$ 449
2022	5.125%	237,135	28,055	89.107	24,999
2026	5.250%	<u>278,280</u>	<u>119,635</u>	90.652	<u>108,451</u>
		<u>\$617,865</u>	<u>\$148,195</u>		<u>\$133,899</u>

As a result of this tender, the Authority realized a gain on the early extinguishment of debt totaling \$7.7 million, net of the write-off of unamortized discount. This gain is shown as an extraordinary item in accordance with SFAS No. 4 "Reporting Gains and Losses from Extinguishment of Debt."

Notes to Consolidated Financial Statements

Optional Redemption

The 5.0% Serial Bonds due on December 1, 2014 (\$39.4 million) and the Serial and Term Bonds maturing on or after December 1, 2015 (except the Term Bonds maturing on December 1, 2029), which total \$207 million and \$1.4 billion, respectively, are subject to redemption prior to maturity, at the option of the Authority, at a price of 101% of the principal amounts on any date beginning on June 1, 2008 through May 31, 2009, or at 100.5% beginning on June 1, 2009 through May 31, 2010 or at 100% beginning June 1, 2010 through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

The Term Bonds maturing on December 1, 2029 (\$587.2 million) are subject to redemption prior to maturity, at the option of LIPA, on any date on and after June 1, 2003, in whole, or in part from time to time, at a redemption price of 101% of the principal amounts, together with the interest accrued on such principal amount to the redemption date.

The Serial Bonds maturing on December 1, 2000 through December 1, 2013 (\$930.9 million) and the 5.25% Serial Bonds due on December 1, 2014, (\$56.7 million) are not subject to redemption prior to maturity. In addition, the Capital Appreciation Bonds and the Taxable Term Bonds are not subject to redemption prior to maturity.

Sinking Fund

Certain Term Bonds are subject to redemption, in part, beginning on December 1, 2017 through December 1, 2029 at 100% of the principal amounts, plus accrued interest at the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

1998 Series B

This Series is comprised of Serial Bonds with maturities beginning in April 2000 and continuing each year through April 2016 and Term Bonds maturing in April 2018.

Optional Redemption

Securities maturing on and after April 1, 2009 (\$483.5 million) are subject to redemption prior to maturity, at the option of the Authority, at a redemption price of 101% of the principal amounts on any date beginning on April 1, 2008 through May 31, 2009, or at 100.5% beginning on April 1, 2009 through May 31, 2010 or at 100% beginning April 1, 2010 through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

Sinking Fund

The Term bond that matures on April 1, 2018 is subject to redemption, in part, beginning on April 1, 2017 at 100% of the principal amount, plus accrued interest to the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

Notes to Consolidated Financial Statements

Electric System Subordinated Revenue Bonds

Series 1 through 6

These Series are variable rate bonds payable from and secured by the Trust Estate subject to and subordinated to the Authority's Electric System General Revenue Bonds. These bonds are classified into various modes that determine the frequency that the interest rate is re-determined, the interest rate applied and the optional redemption features. Series 1 and 2 are currently Weekly Mode bonds, therefore, the applicable interest rate is re-determined on a weekly basis. Series 3 and 4 are currently Commercial Paper Mode bonds, and as such, interest rates can be re-determined as often as daily, but not less frequently than 270 days, and Series 5 and 6 are currently Daily Mode bonds, and as such the interest rate is re-determined daily.

Provisions of the indenture allow for a change in interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually) or a Fixed mode.

Series 1 through 6 Bonds are supported by letters of credit which expire on May 25, 2001 unless extended prior to the expiration date.

Series 7

This Series is comprised of variable rate bonds issued in the Daily Mode. In October 1999, these bonds changed to the Weekly Mode. Principal and interest on these bonds are secured by a financial guaranty insurance policy.

The Authority has executed a Standby Bond Purchase Agreement, to provide funds for the purchase of Series 7 Bonds tendered but not remarketed. The standby agreement expires in November 2008.

Provisions of the indenture allow for a change of interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually) or a Fixed term mode.

Optional and Mandatory Redemption

Series 1 through 6 and Series 7 Bonds are redeemable on their respective interest rate re-determination dates at the option of the Authority. These bonds are redeemable at face value when they are in the Weekly, Daily or Commercial Paper mode. Term or Fixed rate mode bonds are redeemable at rates varying between 100% and 101% when the life of the mode is greater than four years. Term or Fixed Rate mode bonds are not redeemable if the life of the mode is less than four years.

Series 1 through 6 and Series 7 Bonds are also subject to mandatory redemptions from sinking funds such that they will be redeemed by their respective maturity dates. Sinking funds for Series 1 through 6 and Series 7 begin on December 1, 2030 and April 1, 2019, respectively.

Notes to Consolidated Financial Statements

Interest Rate Swap Agreements

The Authority has entered into interest rate swap agreements to reduce the impact of changes in interest rates on the Series 7 Bonds. The Authority had two interest rate swap agreements outstanding having a total notional amount of \$150 million and \$100 million, respectively at December 31, 1999 and 1998. These agreements effectively change the Authority’s interest rate exposure on the Series 7 Bonds to a fixed rate of 4.2%. The interest rate swap agreements are co-terminus with the Series 7 Bonds, with optional earlier termination at the Authority’s discretion. The Authority is exposed to credit loss in the event of nonperformance by the parties to the interest rate swap agreements. However, the Authority does not anticipate nonperformance by the counterparties.

Series 8 (Subseries A-H)

This Series is comprised of Current Interest Bonds issued as follows:

This Series is Comprised of Subseries	Mandatory Purchase Date (April 1)	Maturity (April 1)	Principal Outstanding \$(000)	Interest Rate to Mandatory Purchase Date
8A	2001	2009	\$ 27,300	4.00%
8B	2002	2009	27,300	4.00%
8C	2003	2010	27,300	4.00%
8D	2004	2010	27,300	4.50%
8E	2005	2011	27,300	4.50%
8F	2006	2011	27,300	5.00%
8G	2007	2012	27,300	5.00%
8H	2008	2012	27,200	5.00%

Each bond is due on its mandatory purchase date, however, the Authority can remarket the securities on that date, and the remarketed securities would then become due at the maturity date or such earlier date as determined by the remarketing. Additionally, the original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing if the Authority determines to remarket. Principal, interest and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy.

Each Subseries of Series 8 is not subject to optional redemption nor mandatory sinking fund redemption prior to its mandatory purchase date.

LIPA

The LILCO debt assumed by LIPA as part of the Merger, consisted of \$1.186 billion of General and Refunding Bonds, (“G&R Bonds”), that were defeased by LIPA immediately upon the closing of the Merger, debentures totaling \$2.27 billion, and tax exempt debt totaling approximately \$915.7 million. As part of the Merger, KeySpan and LIPA executed Promissory Notes whereby KeySpan was obligated to LIPA for approximately \$1.048 billion of the assumed debt (the “Promissory Notes”). KeySpan is required to pay LIPA principal and interest on the Promissory Notes 30 days in advance of the date

Notes to Consolidated Financial Statements

amounts are due to bond holders. The balance of the Promissory Notes between KeySpan and LIPA totaled \$602.4 million and \$1.04 billion at December 31, 1999 and 1998, respectively.

The tax exempt debt assumed by LIPA were notes issued on behalf of LILCO by the New York State Research and Development Authority ("NYSERDA") to secure tax-exempt Industrial Development Revenue Bonds, Pollution Control Revenue Bonds ("PCRBs"), and Electric Facilities Revenue Bonds ("EFRBs") issued by NYSERDA.

Bond Defeasance/Refundings

A portion of the proceeds of the Authority's Electric System General Revenue Bonds and Subordinated Bonds (which includes fixed and variable rate debt) were used in 1998 to refund all the G&R Bonds, certain Debentures and certain NYSERDA notes issued by LILCO that were assumed by LIPA as a result of the Merger. The purpose of these refundings was to achieve debt service savings.

General and Refunding Bonds

On May 29, 1998, LIPA refunded all the G&R Bonds totaling \$1.186 billion by depositing \$1.190 billion in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on these obligations were sufficient to pay the principal and interest on the G&R Bonds, which were redeemed on June 29, 1998.

The Authority will realize gross debt service savings from this refunding of approximately \$588 million over the original life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$576 million.

Debentures

In October 1998, LIPA commenced a tender offer for its 7.30% Debentures Due 2000, 6.25% Debentures Due 2001, 7.05% Debentures Due 2003, 7.00% Debentures Due 2004, 7.125% Debentures Due 2005 and 9.00% Debentures Due 2022 (collectively, the "Debentures"). LIPA purchased an aggregate principal amount of Debentures, including accrued interest, in the amount of \$1.13 billion pursuant to the tender offers. Payment for Debentures purchased pursuant to the tender offers was made from the sale of approximately \$1.31 billion Electric System General Revenue Bonds, Series 1998B (the "Refinancing Bonds") of the Authority. Under the terms of the financing agreement dated as of May 1, 1998, between LIPA and the Authority, a portion of the proceeds from the sale of the Refinancing Bonds were advanced to LIPA to fund payment for the tendered Debentures.

In October 1998, LIPA sent a notice of redemption to the holders of its 7.50% Debentures Due 2007 calling for redemption in November of all such debentures at a redemption price equal to 103.54% of the \$142 million aggregate principal amount outstanding. In addition, LIPA sent a notice of redemption to the holders of its 8.90% Debentures due 2019 calling for redemption in November 1998 of all such debentures at a redemption price equal to 105.94% of the \$420 million aggregate principal amount outstanding.

As a result of the refundings described above, the Authority will realize gross debt service savings of approximately \$547 million over the original life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$376 million.

Notes to Consolidated Financial Statements

In March 2000, the Authority deposited approximately \$58 million in an irrevocable escrow deposit account to be invested in direct obligations of the United States of America. The Company has received certification from an independent verification agent that the maturing principal of and interest on these obligations will be sufficient to pay the principal and interest on the following debentures that LIPA assumed as part of the Merger (reflected at the Company's carrying value).

(In thousands)

Maturity	Interest Rate	Balance at December 31, 1999
7/15/2001	6.250%	\$ 8,460
3/15/2003	7.050%	5,890
3/01/2004	7.000%	2,999
6/01/2005	7.125%	14,307
11/01/2022	9.000%	26,532

NYSERDAs

In October 1999, LIPA entered into an agreement with KeySpan, whereby KeySpan advanced approximately \$47.2 million of its promissory note payable to LIPA, including interest, to be used to fund the optional redemption at par of NYSERDA Bonds, 1976 Series A and 1979 series B totaling \$26.4 million and \$19.1 million, respectively. The bonds were redeemed in December 1999.

During 1998, the Authority deposited \$379 million in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on such securities will be sufficient to pay the principal, interest and applicable call premium on the following issues of NYSERDA Notes: approximately \$11.9 million Series 1985A, approximately \$50 million Series 1989A, approximately \$15 million Series 1989B, approximately \$26 million Series 1990A, approximately \$73 million Series 1991A, \$50 million Series 1992A, approximately \$36.5 million Series 1992B, \$50 million Series 1992C and approximately \$22 million Series 1992D, (collectively, the "Refunded NYSERDA Notes").

As a result of this refunding and the deposit with the Escrow Agent, the Refunded NYSERDA Notes are deemed to have been paid, and they cease to be a liability of LIPA. Accordingly, the Refunded NYSERDA Notes (and the related deposit with the Escrow Agent) are excluded from the Statement of Financial Position. The Authority will realize gross debt service savings from this refunding of approximately \$287 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$66 million.

In November 1998, LIPA sent a notice of redemption to the holders of its 1982 NYSERDA Notes calling for redemption in December of all such NYSERDA Notes at a redemption price equal to the \$17.2 million aggregate principal amount outstanding.

The Authority will realize gross debt service savings from the refunding of approximately \$14.9 million over the original life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately \$6.5 million.

Deferred Amortization

A debt refinancing charge of \$61.9 million resulted from the transactions described above primarily because of the difference between the amounts paid for refundings, including amounts deposited with the

Notes to Consolidated Financial Statements

Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, the \$61.9 million has been deferred and is shown in the Statement of Financial Position as Deferred Amortization within long term debt and is being amortized, on a straight line method, over the shorter of the life of the new debt or the old debt. The unamortized balance at December 31, 1999 and 1998 totaled \$48.5 million and \$60.3 million, respectively.

The Company

Debt Maturity Schedule

The total long-term debt maturing in each of the next five years ending December 31 is as follows: 2000, \$186.4 million; 2001, \$119.8 million; 2002, \$140.1 million; 2003, \$147.2 million; and 2004, \$163.1 million.

Fair Values of Long - Term Debt

The carrying amounts and fair values of the Company's long-term debt at December 31, 1999 and 1998 were as follows:

<i>Fair Value</i>	<i>(In thousands of dollars)</i>	
	December 31,	
	1999	1998
Electric System General Revenue Bonds, Series 1998 A	\$ 3,019,431	\$ 3,565,699
Electric System General Revenue Bonds, Series 1998 B	1,276,607	1,351,923
Electric System Subordinated Revenue Bonds, Series 1 through 6	1,500,000	1,500,000
Electric System Subordinated Revenue Bonds, Series 7	250,000	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	215,005	224,050
Debentures	315,367	745,822
NYSERDA Notes	334,189	536,401
Total	\$ 6,910,599	\$ 8,173,895

<i>Carrying Amount</i>	December 31,	
	1999	1998
Electric System General Revenue Bonds, 1998 Series A	\$ 3,242,322	\$ 3,453,830
Electric System General Revenue Bonds, 1998 Series B	1,313,800	1,313,800
Electric System Subordinated Revenue Bonds, Series 1 through 6	1,500,000	1,500,000
Electric System Subordinated Revenue Bonds, Series 7	250,000	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	218,300	218,300
Debentures	328,466	725,811
NYSERDA Notes	332,425	510,600
Total	\$ 7,185,313	\$ 7,972,341

Notes to Consolidated Financial Statements

Debt Covenants

Certain debt agreements require the maintenance by the Company of certain financial ratios and contain other restrictive covenants.

Note 9. Retirement Plans

The Authority participates in the New York State Employees' Retirement System, which is a cost-sharing, multi-employer, public employee retirement system. The plan benefits are provided under the provisions of the New York State Retirement and Social Security Law which are guaranteed by the State Constitution and may be amended only by the State Legislation. The Authority's election to participate in the plan is irrevocable. The New York State Employees' Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement Systems, A.E. Smith State Office Building, Albany, New York 12244. The Employees' Retirement System is subdivided into the following four classes:

- Tier I - members who last joined prior to July 1, 1973.
- Tier II - members who last joined on or after July 1, 1973 and prior to July 27, 1976.
- Tier III - members who last joined on or after July 27, 1976 and prior to September 1, 1983.
- Tier IV - members who joined on or after September 1, 1983.

Tier I members are eligible for retirement at age 55. If members retire with 20 or more years of total service, the service retirement benefit is 2% of the final average salary for each year of service. If members retire with less than 20 years of total service, the service retirement benefit is 1.66% of the final average salary for each year of service. Under this plan, the pension portion of retirement allowance cannot exceed 75% of the member's final average salary, unless the member's date of membership is prior to April 1, 1970, then an alternative calculation is used.

Tier II members are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service, and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Retirement benefits are equivalent to Tier I members. Under this plan, the pension portion of the retirement allowance cannot exceed 75% of the member's final average salary.

Tier III members with 10 or more years of credited service after July 27, 1976 are eligible to retire with full benefits between the ages of 55 and 62 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are integrated with Social Security beginning at age 62. If members retire at age 62 and have 25 or more years of credited service, the service retirement benefit will be 2% of final average salary for each year of service (not to exceed 30 years), plus 1.5% of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 25 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year service.

Tier IV members with 5 or more years of credited service are eligible to retire with full benefits at age 62 or between the ages of 55 and 62 with 30 years or more of credited service. Tier IV members with less than 30 years of credited service will receive reduced benefits if they retire prior to age 62. Benefits are

Notes to Consolidated Financial Statements

equivalent to Tier III members.

Retirement benefits vest after 5 years of credited service and are payable at various rates at age 55 or greater. The Employees' Retirement System also provides death and disability benefits. Tier III and IV members are required by law to contribute 3% of their annual salary to the Employees' Retirement System and eligible Tier I and II members may make contributions under certain conditions. The Authority is required by the same statute to contribute the remaining amounts necessary to pay benefits when due.

The State of New York and the various local governmental units and agencies which participate in the Retirement System are jointly represented, and it is not possible to determine the actuarial computed value of benefits for the Authority on a separate basis.

The Authority's required contributions and payments made to the retirement plan were approximately \$40,000, \$27,000 and \$12,000 for the twelve and nine month periods ended December 31, 1999 and 1998 and for the twelve month period ended March 31, 1998, respectively.

Note 10. Commitments and Contingencies

Operating Lease

In December 1996, the Authority entered into a noncancelable office lease agreement for the period January 1, 1997 through January 31, 2003. In November 1997 and April 1998, the lease was amended to include additional premises. As a result of the amendments, the lease expiration date was changed to September 30, 2003. The future minimum payments under the lease are as follows:

<u>Year Ended</u> <u>December 31,</u>	<i>(In thousands)</i>
2000	\$ 518
2001	537
2002	557
2003	417
	<hr/>
	\$ 2,029
	<hr/>

Legal Proceedings

Shoreham Tax Matters

Through November 1992, the Suffolk Taxing Jurisdictions levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates

Notes to Consolidated Financial Statements

sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments on the Shoreham plant, claiming the plant was overassessed. Since 1992, the Authority has made such PILOT payments, in whole or in part, pursuant to interim PILOT agreements. Subsequent to the Merger, the Authority has been collecting the costs thereof pursuant to the PILOTs rider which is part of LIPA's rates.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding \$868 million, including interest as of the date of the judgment. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain of the Suffolk Taxing Jurisdictions sought leave from the Appellate Division to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

On January 11, 2000, the Authority, LIPA, and the Suffolk Taxing Jurisdictions entered into a Settlement Agreement. Pursuant to the Suffolk County Settlement Agreement, an amended Judgment will be filed, reducing the amount of the Judgment and the Authority's PILOT claims to the greater of (1) \$620 million, plus interest, less the principal of the Shoreham Tax Settlement Bonds paid with the surcharge or (2) the amount required to fully satisfy the Authority's remaining debt service and related obligations in connection with the Suffolk County Tax Settlement Bonds. The amended Judgment would be enforceable by the Authority or LIPA in the event, among others, that any portion of the Settlement Agreement is declared invalid or unenforceable. See note 11 for a further discussion of the Settlement Agreement.

On September 15, 1998, Suffolk County filed an action against the Authority in the Supreme Court of the State of New York, Suffolk County seeking to enjoin the Authority from recovering tax refunds based upon the over-assessment of the Shoreham nuclear plant. The action claims that the Authority does not have the right to recover property taxes previously assessed against LILCO for tax years 1984-1985 through 1991-1992. On March 19, 1999, the Court ruled that the Authority was not entitled to collect any refund of property taxes assessed against the Shoreham plant. In addition, the court stated that the Authority has a duty to discontinue and abandon all proceedings which seek the repayment of all or part of the taxes assessed against the Shoreham plant. The Authority filed a notice of appeal on April 15, 1999 and filed its brief on April 23, 1999. By Opinion & Order dated July 26, 1999, the Appellate Division unanimously held that the Authority was not prohibited by the LIPA Act from enforcing any part of the Shoreham tax certiorari judgment for real property tax refunds attributable to overassessments on the Shoreham plant after the January 15, 1987 effective date of the LIPA Act. This ruling confirms the Authority's position that it is entitled to enforce the Shoreham property tax judgment in an amount which the Authority estimates is in excess of \$800 million. By motion returnable September 24, 1999, Suffolk moved in the Appellate Division for reargument or, in the alternative, for permission to appeal to the Court of Appeals. The Authority filed papers in opposition to the motion. By order dated October 14, 1999, the Appellate Division denied the motion. By motion returnable December 6, 1999, Suffolk has

Notes to Consolidated Financial Statements

moved in the Court of Appeals for permission to appeal. The Authority has opposed the motion. By order dated January 11, 2000, the Court of Appeals denied Suffolk's motion. Pursuant to the Settlement Agreement, the Suffolk Taxing Jurisdictions will discontinue this proceeding with prejudice.

On February 1, 1999, a lawsuit was filed in the Supreme Court of the State of New York, Nassau County, by the Association for a Better Long Island against the Authority and LIPA. This lawsuit seeks: (i) to require the Authority to collect the full amount of the judgment obtained by the Authority in the Shoreham Property Tax Litigation as well as certain overpaid PILOTs; and (ii) to declare that the offer of the Authority to settle the Shoreham Property Tax Litigation is void and legally unenforceable. The Authority answered the complaint in February 2000.

On March 23, 1999, the Shoreham Wading River Central School District filed an action against the Authority in the Supreme Court of the State of New York, County of Nassau seeking an order directing the Authority to pay approximately \$6.4 million of PILOTs which the plaintiff alleges are due and owing and approximately \$24.6 million of PILOTs which the plaintiff alleges is the cumulative deficiency as of June 1, 1998. By Stipulation dated August 19, 1999, the School District withdrew its petition. Pursuant to the Settlement Agreement, the School District will discontinue this proceeding with prejudice.

Merger Matters

LIPA has been named as a nominal defendant in a derivative suit pending in the United States District Court for the Eastern District of New York entitled Sylvester v. Catacosinos, et al. A motion to dismiss on behalf of LIPA was filed on September 23, 1998 and argued on January 28, 1999. In addition, LIPA has been named as a defendant in an action brought by the County of Suffolk that is pending in New York State Supreme Court, Suffolk County, entitled County of Suffolk v. KeySpan, et al. The response date has been postponed until such time as it is determined whether the action will be consolidated with a class action pending in New York State Supreme Court, Nassau County, entitled In re KeySpan Corporation Shareholder Litigation. Former officers and directors of LILCO also have been named as defendants in each of these actions.

The complaints in the foregoing actions allege in substance that certain former officers of LILCO received excessive compensation which totaled approximately \$67 million in connection with the closing of the Brooklyn Union merger with LILCO and with the Authority's acquisition of all common stock of LILCO. The Sylvester lawsuit seeks damages of an unspecified amount. The complaint brought by the County of Suffolk seeks to make the defendants pay restitution, or damages, of \$67 million. On September 8, 1999, the parties in Sylvester filed a Stipulation in the District Court dismissing the action with prejudice, subject to the approval by the District Court. The District Court signed the Stipulation on September 21, 1999. This proceeding is thus concluded.

The County of Suffolk action was voluntarily discontinued by plaintiffs without prejudice. The plaintiffs have refiled their claims related to executive compensation in a federal action entitled The County of Suffolk et al. v. Long Island Power Authority, et al.

On September 28, 1998, Suffolk County and the Towns of Huntington and Babylon (collectively, the "Plaintiffs") brought a class action on behalf of themselves and all electric utility ratepayers in Suffolk County (the "Ratepayers") against the Authority, LIPA, KeySpan and others in the United States District Court for the Eastern District of New York entitled County of Suffolk, et al. v. Long Island Power

Notes to Consolidated Financial Statements

Authority, et al. (the "Huntington Lawsuit"). The Huntington Lawsuit alleges that (i) LIPA and the Authority failed to refund alleged capital gains directly to Ratepayers as a result of the Merger, unlawfully depriving Ratepayers of their property under federal and state constitutional provisions and (ii) LIPA failed to refund to Ratepayers certain deferred tax reserves carried on LILCO's books at the time of the Merger, unjustly enriching KeySpan. An amended complaint was filed and served on or about January 5, 1999. KeySpan and the Authority filed motions to dismiss the complaint for failure to state a cause of claim. On December 3, 1999, the court declined to consider KeySpan's motion to dismiss and defendants moved for summary judgment on or about December 13, 1999. Plaintiffs are required to file opposition to the summary judgment motion on or before January 20, 2000. Pursuant to the Settlement Agreement, Suffolk will discontinue its claims against all defendants with prejudice.

In an action commenced on May 26, 1998 (*Schulz et al. v. New York State Public Authorities Control Board et al.*, United States District Court, Northern District of New York), plaintiff's complaint, in several claims for relief, sought a judgment declaring, *inter alia*, the resolution of the PACB authorizing the Authority to issue bonds to be null and void on State and federal constitutional grounds and sought a temporary restraining order or preliminary injunction prohibiting and enjoining the issuance of bonds. On May 27, 1998, the District Court denied the plaintiff's request for a temporary restraining order or preliminary injunction and dismissed the plaintiff's action on the ground that the plaintiffs lack standing to assert the claims pleaded in the complaint. On February 8, 1999, the United States Court of Appeals for the Second Circuit affirmed the District Court's dismissal of the plaintiff's action. This proceeding is thus concluded.

On May 27, 1998, the Initiative for Competitive Energy (the "ICE") filed an action in the Supreme Court of the State of New York, County of Suffolk, against the Authority seeking, *inter alia*, an injunction enjoining the Authority from selling bonds "whose purpose is to finance the proposed Shoreham Property Tax Settlement, the Shoreham Rebates, Credits and Suffolk Surcharge." The action further requested a judgment declaring invalid and directing the rescission of the sale of such bonds. By decision dated October 7, 1998, the Supreme Court dismissed the complaint and rules in favor of the Authority on all issues. On October 28, 1998, the ICE filed a notice of appeal. The Appellate Division, Second Department, granted ICE's second motion to enlarge its time to perfect its appeal. On or about August 1, 1999, ICE filed its brief and appendix with the Appellate Division. The Authority moved to strike ICE's appendix as incomplete. On or about September 14, 1999, the Appellate Division granted the Authority's motion and directed ICE to file a corrected appendix on or before October 1, 1999. ICE moved in the Appellate Division for reargument. The Appellate Division denied the motion and directed ICE to file a corrected appendix on or before November 9, 1999. Rather than file the corrected appendix, ICE withdrew its appeal. This proceeding is thus concluded.

In May 1995, eight participants of LILCO's Retirement Income Plan ("RIP") filed a lawsuit against LILCO, the RIP and Robert X. Kelleher, the Plan Administrator, in the United States District Court for the Eastern District of New York. In January 1996, the Court ordered that this action be maintained as a class action. This proceeding arose in connection with the plaintiff's withdrawal, approximately 25 years ago, of contributions made to the RIP, thereby resulting in a reduction of their pension benefits. On January 7, 1999, a settlement agreement was filed with the Court providing for the payment of \$7.75 million to the plaintiffs. The Authority would be responsible for approximately \$5.4 million. A revised proposed settlement was submitted to the Court for approval on February 22, 1999. A fairness hearing on

Notes to Consolidated Financial Statements

the proposed settlement was held on August 12, 1999, and the Court approved the settlement and entered a judgment on August 13, 1999. The case is now concluded.

In December 1997, Suffolk County brought a suit against the Authority and others in the Supreme Court of the State of New York seeking a judgment, among other things: (i) annulling and vacating the acceptance by the Authority of certain conditions contained in the July 1997 PACB resolution approving the Authority's acquisition of LILCO and related transactions; (ii) declaring that all or any actions taken by the Authority to implement or carry out the PACB conditions are null and void; and (iii) directing that the Authority take no further action to acquire the stock or assets of LILCO unless and until such acquisition has been approved by the PACB in the manner approved by law. A decision was rendered in March 1998 which held for the Authority on all substantive issues. Suffolk County filed a notice of appeal to the Appellate Division of the State of New York, Second Department, and on September 18, 1998 filed its brief with that court. The Authority's brief was filed with the Appellate Division, Second Department, on December 28, 1998. Suffolk County filed its reply brief on January 6, 1999. Oral argument has yet to be calendared. Pursuant to the Settlement Agreement, this proceeding will be discontinued with prejudice.

LIPA may from time to time become a party to various legal proceedings arising in the ordinary course of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material effect on the financial position, results of operations or cash flows of LIPA.

Environmental

In connection with the Merger, KeySpan and LIPA entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and LIPA on the basis of whether they relate to assets transferred to KeySpan or retained by LIPA as part of the Merger. In addition, to clarify and supplement these agreements, KeySpan and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan after the Merger (the "Transferred Business").

KeySpan is responsible for all liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those currently or formerly operated by KeySpan or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, KeySpan is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business may be recoverable by KeySpan as part of the capacity charge under the PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities that exist as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan.

Notes to Consolidated Financial Statements

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection (“DEP”) and the New York State Department of Environmental Conservation (“DEC”) separately have issued Administrative Consent Orders (“ACOs”) in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound. The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA is working cooperatively with the Suffolk County Department of Health, the DEC and Novartis to conduct studies and monitoring activities in connection with the presence of this herbicide. The liability, if any, resulting from the use of this herbicide cannot yet be determined. However, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

Superfund Sites

Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”, also commonly referred to as the “Superfund Legislation”), parties who generated or arranged for disposal of hazardous substances are liable for costs incurred by the Environmental Protection Agency (“EPA”) in responding to a release or threat of release of the hazardous substances.

Metal Bank. In December 1997, the EPA issued its Record of Decision (“ROD”), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is \$17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 PRPs, including LIPA, for the remedial design and for remedial action at the site. LIPA can not predict with reasonable certainty the actual cost of the selected remedy, who will implement the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability of \$1.6 million representing its estimated share of the additional cost to remediate this site.

PCB Treatment Inc. LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing PCBs. According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and have developed a work plan for investigating environmental conditions at the site. The EPA provided LILCO with documents indicating that LILCO was responsible for less than 1% of the materials that were shipped to this site. LIPA is currently unable to determine its share of the cost to remediate these sites.

Notes to Consolidated Financial Statements

Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA Asharoken. In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (*Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company*). The Village is seeking monetary damages and injunctive relief based upon theories of negligence, gross negligence and nuisance in connection with the LILCO design and construction of the Northport Power Plant which the Village alleges upset the littoral drift, thereby causing beach erosion. In November 1996, the court decided LILCO's motion to dismiss the lawsuit, dismissing two of the three causes of action. The court limited monetary damages on the surviving continuous nuisance claim to three years prior to the commencement of the action. The liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility Other Superfund Sites. In connection with a lawsuit filed against LILCO and nine other PRPs by the Town of Oyster Bay for indemnification for remediation and investigation costs for a federal Superfund site in Syosset, New York, a settlement agreement has been reached and is subject to court approval. If approved, the settlement would not have a material adverse effect on LIPA's financial position, cash flows or results of operations. In addition, LILCO was notified by the Attorney General of the State of New York that it may be responsible for the disposal of wastes and/or for the generation of hazardous substances that may have been disposed of at the Blydenburgh Superfund site. LILCO conducted a search of its corporate records and did not locate any documents concerning waste disposal practices associated with this landfill.

The DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The DEC investigation is in its preliminary stages, and LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site.

Other Matters

As a result of the Merger, LIPA has assumed contracts with numerous Independent Power Producers ("IPPs") and the New York Power Authority ("NYPA") for electric generating capacity. Under the terms of the agreement with NYPA, which will expire in May 2014, LIPA may purchase up to 100% of the electric energy produced at the NYPA facility located within LIPA's service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed non-energy payments associated with operating and maintaining the plant.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs if they fail to deliver energy. For purposes of the table below, LIPA has assumed full performance by the IPPs, as no event has occurred to suggest anything less than full performance by these parties. The contracts with the IPPs expire on various dates through 2022.

LIPA had also assumed a contract with NYPA for firm transmission ("wheeling") capacity in connection with a transmission cable that was constructed, in part, for the benefit of LIPA. With the inception of the New York Independent System Operator ("ISO") on November 18, 1999, this contract was provided with "grandfathered rights" status. Grandfathered rights allow the contract parties to continue business as

Notes to Consolidated Financial Statements

usual under the ISO. That is, the concept of firm physical transmission service continues. LIPA was provided with the opportunity to convert its grandfathered rights for this existing transmission agreement (“ETA”) into Transmission Congestion Contracts (“TCCs”). TCCs provide an alternative to physical transmission reservations, which were required to move energy from point A to point B prior to the ISO. Under the rules of the ISO, energy can be moved from point A to point B without a transmission reservation however, the entity moving such energy is required to pay a tolling fee to the owner of the TCC. This tolling fee is called transmission congestion and is set by the ISO.

Although LIPA has elected to convert its ETAs into TCCs, LIPA will continue to pay all transmission charges per the ETA, which expires in 2020. In return, LIPA has the potential to receive added revenues from congestion charges. All such charges and revenue associated with the TCCs are considered components of or reductions to fuel costs, and as such are included in the FPPCA calculation.

The following table represents LIPA’s commitments under purchased power contracts:

(In millions of dollars)

	NYPA Holtsville			Firm Transmission	IPPs*	Total Business*
	Debt Service	Other Fixed Charges	Energy*			
For the years ended						
2000	\$ 21.791	\$ 12.865	\$ 8.554	\$ 12.250	\$ 135.100	\$ 190.560
2001	21.873	15.085	9.406	19.250	137.9	203.514
2002	21.960	15.386	9.465	19.250	141.4	207.461
2003	22.050	15.738	9.575	19.250	145.0	211.613
2004	22.146	16.099	9.648	19.250	127.7	194.843
Subsequent thereto	193.743	169.012	97.721	420.750	878.8	1,760.026
Total	303.563	244.185	144.369	510.000	1,565.9	2,768.017
Less: Imputed Interest	127.519	110.057	64.222	317.336	611.2	1,230.334
	\$ 176.044	\$ 134.128	\$ 80.147	\$ 192.664	\$ 954.700	\$ 1,537.683

* Assumes full performance by the IPPs and NYPA.

Note 11. Regulatory Asset

Settlement Agreement

As discussed in Note 10, in January 2000, the Authority reached an agreement with the Suffolk Taxing Jurisdictions and Nassau County regarding the over assessment of the Shoreham Nuclear Power Station. Under the terms of the agreement, the Authority is to issue \$457.5 million of rebates and credits to customers over a five-year period which began May 29, 1998. In addition, non Suffolk County customers

Notes to Consolidated Financial Statements

will receive additional rebates totaling approximately \$25 million. In order to fund such rebates and credits, the Authority issued \$142.5 million Electric System General Revenue Bonds, Series 1998A in May 1998 and is to issue approximately \$323 million Electric System General Revenue Bonds, Series 2000A in 2000. Beginning in May 2003, LIPA's Suffolk County customers' bills will include a surcharge (the Suffolk Surcharge) to be collected over the succeeding 25 year period to repay the Authority for the principal on the bonds plus interest, and administrative fees associated with the issuance of the credits, rebates and related financing.

As future rates will be established at a level sufficient to recover all such costs identified above, LIPA has, at December 31, 1999, recorded a regulatory asset totaling approximately \$234 million in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation". This \$234 million is comprised of costs recorded in 1998 which includes rebates and credits to customers and costs of administering the program totaling approximately \$169 million and interest incurred between the dates that the rebates were issued and December 31, 1998 totaling approximately \$1 million. The remainder of the regulatory asset is comprised of costs incurred during 1999 and includes approximately \$58 million of credits and rebates and approximately \$1 million for the proportionate share of the unamortized costs of issuing the \$142.5 million 1998 Series A Bonds, and interest charges incurred plus carrying charges totaling approximately \$10 million, offset by the \$5 million LIPA contribution to the settlement which will not be collected through the Suffolk Surcharge.

As indicated above, the costs incurred during 1998, which were charged to customer rebates, have been recorded as a regulatory asset in 1999, with a corresponding offset in the Statement of Revenues, Expenses, and Changes in Retained Earnings/(Accumulated Deficit) entitled rebates recoverable. In accordance with Emerging Issues Task Force Issue No. 93-4 "Accounting for Regulatory Assets" (EITF 93-4), costs incurred that did not previously qualify as a regulatory asset can be capitalized as a regulatory asset in a subsequent period (i.e. 1999), when the capitalization criteria are met. As the requirements of SFAS No. 71 were met upon completing the Settlement Agreement, which took place subsequent to year-end but prior to the issuance of the financial statements, the Company has reflected the effects of the Settlement in its 1999 financial statements as a Type I subsequent event as defined in Statement on Auditing Standards No. 1.

Costs incurred during 1999 were capitalized as a regulatory asset during the period.

In addition to the items described above, other costs related to the Settlement were incurred, but as future rates will not be established at levels to recover such costs, they fail to meet the capitalization criteria of SFAS No. 71. These costs include \$25 million to be contributed to Nassau County to fund the Clean Energy initiative.

Other Financial Information

**Report of Independent Accountants
on Other Financial Information**

March 10, 2000

To the Board of Trustees
of the Long Island Power Authority and Subsidiaries

Our report on the audit of the consolidated financial statements of the Long Island Power Authority and its subsidiaries, (collectively, the "Company") as of December 31, 1999, and for the year then ended appears on page 1. This audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary consolidating information accompanying the consolidated financial statements is not necessary for fair presentation of the consolidated financial position and of capitalization, and the related consolidated statements of revenues, expenses and changes in retained earnings/(accumulated deficit), and cash flows of the Company in conformity with generally accepted accounting principles. The supplementary information is presented only for purposes of additional analysis and is not a required part of the consolidated financial statements. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

PricewaterhouseCoopers LHP

Consolidating Statement of Financial Position
December 31, 1999
(Thousands of Dollars)

	LIPA	Authority	Eliminations	Consolidated
Assets				
Utility Plant, net	\$ 2,099,204	\$ -	\$ -	\$ 2,099,204
Property and Equipment, net	-	1,042	-	1,042
Current Assets				
Cash and cash equivalents	-	165,135	-	165,135
Investments	-	364,007	-	364,007
Customer accounts receivable (less allowance for doubtful accounts of \$19,480)	92,082	-	-	92,082
Other accounts receivable	10,830	-	-	10,830
Accrued unbilled revenues	97,623	-	-	97,623
Promissory note receivable - KeySpan	-	-	-	-
Interest receivable	-	132	-	132
Due from LIPA	-	127,960	(127,960)	-
Prepayments and other current assets	53,448	209	-	53,657
Total Current Assets	253,983	657,443	(127,960)	783,466
Promissory Note Receivable - KeySpan	602,427	-	-	602,427
Note Receivable - LIPA	-	2,954,886	(2,954,886)	-
Designated Funds	1,268	-	-	1,268
Nonutility Property and Other Investments	20,149	-	-	20,149
Deferred Charges	75,744	-	-	75,744
Due from LIPA	-	2,999,396	(2,999,396)	-
Regulatory Asset	233,631	-	-	233,631
Investment in Subsidiary	-	60,601	(60,601)	-
Acquisition Adjustment (net of accumulated amortization of \$186,055)	3,790,405	-	-	3,790,405
Total Assets	\$ 7,076,811	\$ 6,673,368	\$ (6,142,843)	\$ 7,607,336
Capitalization				
Long-term debt	\$ 553,891	\$ 6,436,237	\$ -	\$ 6,990,128
Note payable to the Authority	2,954,886	-	(2,954,886)	-
Due to the Authority	2,999,396	-	(2,999,396)	-
	6,508,173	6,436,237	(5,954,282)	6,990,128
Retained earnings	60,601	58,870	(60,601)	58,870
Total Capitalization	6,568,774	6,495,107	(6,014,883)	7,048,998
Current Liabilities				
Current maturities of long-term debt	58,466	127,960	-	186,426
Current maturities of note payable to the Authority	127,960	-	(127,960)	-
Due to KeySpan	46,793	(38)	-	46,755
Accounts payable and accrued expenses	110,449	10,891	-	121,340
Accrued taxes	42,135	-	-	42,135
Accrued interest	15,235	39,448	-	54,683
Customer deposits	23,094	-	-	23,094
Total Current Liabilities	424,132	178,261	(127,960)	474,433
Deferred Credits	74,638	-	-	74,638
Claims and Damages	9,267	-	-	9,267
Commitments and Contingencies				
Total Capitalization and Liabilities	\$ 7,076,811	\$ 6,673,368	\$ (6,142,843)	\$ 7,607,336

**Consolidating Statement of Revenues, Expenses, and
Changes in Retained Earnings/(Accumulated Deficit)
For the Year Ended December 31, 1999
(Thousands of Dollars)**

	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Electric Revenue	\$ 2,278,978	\$ -	\$ -	\$ 2,278,978
Expenses				
Operations - fuel and purchased power	713,303	-	-	713,303
Operations and maintenance	715,570	-	(25,854)	689,716
General and administrative	-	25,624	-	25,624
Depreciation and amortization	209,795	230	-	210,025
Capital recovery amortization	119,052	-	-	119,052
Payment in lieu of taxes	244,767	-	-	244,767
Rebates recoverable	(164,006)	-	-	(164,006)
Total Operating Expenses	<u>1,838,481</u>	<u>25,854</u>	<u>(25,854)</u>	<u>1,838,481</u>
Excess of operating revenues over expenses (expenses over revenues)	<u>440,497</u>	<u>(25,854)</u>	<u>25,854</u>	<u>440,497</u>
Other income and (deductions), net				
Investment of Subsidiary	-	140,582	(140,582)	-
Investment income	2,132	313,549	(285,250)	30,431
Management fee	-	25,854	(25,854)	-
Other	18,819	206	-	19,025
Total other income and (deductions), net	<u>20,951</u>	<u>480,191</u>	<u>(451,686)</u>	<u>49,456</u>
Excess of revenues over expenses before interest charges and extraordinary gain	<u>461,448</u>	<u>454,337</u>	<u>(425,832)</u>	<u>489,953</u>
Interest charges and (credits)				
Interest on long-term debt, net	4,421	309,969	(7,424)	306,966
Interest on note payable to the Authority	277,826	-	(277,826)	-
Other interest	39,570	(5,228)	-	34,342
Allowance for borrowed funds used during construction	(2,559)	-	-	(2,559)
Total interest charges	<u>319,258</u>	<u>304,741</u>	<u>(285,250)</u>	<u>338,749</u>
Excess of revenues over expenses before extraordinary (loss) gain	142,190	149,596	(140,582)	151,204
(Loss) Gain on early extinguishment of debt	(1,608)	9,329	-	7,721
Excess of revenues over expenses	140,582	158,925	(140,582)	158,925
Retained earnings/(Accumulated deficit)				
Beginning	(79,981)	(100,055)	79,981	(100,055)
Ending	<u>\$ 60,601</u>	<u>\$ 58,870</u>	<u>\$ (60,601)</u>	<u>\$ 58,870</u>

Consolidating Statement of Cash Flows
For the Year Ended December 31, 1999
(Thousands of Dollars)

	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Activities				
Net Excess of revenues over expenses	\$ 140,582	\$ 158,925	\$ (140,582)	\$ 158,925
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities				
Loss (gain) on early extinguishment of debt	1,608	(9,329)	-	(7,721)
Depreciation and amortization	209,795	230	-	210,025
Capital recovery amortization	119,052	-	-	119,052
Amortization of cost of issuing and redeeming securities	10,194	(755)	-	9,439
Gain on investment in subsidiary	-	(140,582)	140,582	-
Other	13,644	-	-	13,644
Changes in operating assets and liabilities				
Accounts receivable, net and accrued unbilled revenue	7,867	-	-	7,867
Accounts payable and accrued expenses	74,528	4,189	-	78,717
Regulatory asset	(233,631)	-	-	(233,631)
Due to KeySpan	(28,292)	7	-	(28,285)
Accrued taxes	(36,885)	-	-	(36,885)
Accrued interest	(14,617)	5,912	-	(8,705)
Other	(4,382)	(136)	-	(4,518)
Net cash provided by operating activities	<u>259,463</u>	<u>18,461</u>	<u>-</u>	<u>277,924</u>
Investing Activities				
Purchase of investment securities, net of sales	-	(364,007)	-	(364,007)
Net cash used in investing activities	<u>-</u>	<u>(364,007)</u>	<u>-</u>	<u>(364,007)</u>
Cash Flows from Non-Capital related Financing Activities				
Proceeds (Repayment) of note payable to the Authority	2,072,832	(2,072,832)	-	-
Net cash provided by (used in) provided by non-capital related financing activities	<u>2,072,832</u>	<u>(2,072,832)</u>	<u>-</u>	<u>-</u>
Cash Flows from Capital and related Financing Activities				
Capital and nuclear fuel expenditures	(120,018)	(449)	-	(120,467)
Proceeds from notes receivable	442,475	-	-	442,475
Proceeds (issuance) of note payable to the Authority	(2,272,239)	2,272,239	-	-
Redemption of long-term debt	(575,478)	(205,541)	-	(781,019)
Other	(739)	-	-	(739)
Net cash (used in) provided by capital and related financing activities	<u>(2,525,999)</u>	<u>2,066,249</u>	<u>-</u>	<u>(459,750)</u>
Net decrease in cash and cash equivalents and designated funds	(193,704)	(352,129)	-	(545,833)
Cash and cash equivalents and designated funds at beginning of period	194,972	517,264	-	712,236
Cash and cash equivalents and designated funds at end of period	<u>\$ 1,268</u>	<u>\$ 165,135</u>	<u>\$ -</u>	<u>\$ 166,403</u>
Interest paid	\$ 45,061	\$ 257,946	\$ -	\$ 303,007

Consolidating Statement of Capitalization
December 31, 1999
(Thousands of Dollars)

	<u>Maturity</u>	<u>Interest Rate</u>	<u>Series</u>	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Electric System General Revenue Bonds							
Serial Bonds	December 1, 2000 to 2016	4.10% to 6.00% a	1998A	\$ -	\$ 1,234,085	\$ -	\$ 1,234,085
Term Bonds	December 1, 2018 to 2029	5.00% to 5.75% a	1998A	-	1,850,575	-	1,850,575
Capital Appreciation Bonds	December 1, 2003 to 2028	4.40% to 5.30% a	1998A	-	157,662	-	157,662
Serial Bonds	April 1, 2000 to 2016	4.00% to 5.25% a	1998B	-	1,256,655	-	1,256,655
Term Bonds	April 1, 2018	4.75% a	1998B	-	57,145	-	57,145
Electric System							
Subordinated Revenue Bonds							
	May 1, 2033	5.75% b	Series 1	-	250,000	-	250,000
	May 1, 2033	5.50% b	Series 2	-	250,000	-	250,000
	May 1, 2033	3.65% b	Series 3	-	250,000	-	250,000
	May 1, 2033	3.75% b	Series 4	-	250,000	-	250,000
	May 1, 2033	4.70% b	Series 5	-	250,000	-	250,000
	May 1, 2033	4.75% b	Series 6	-	250,000	-	250,000
	April 1, 2025	4.21% b	Series 7	-	250,000	-	250,000
	April 1, 2009 to 2012	4.00% to 5.00% b	Series 8	-	218,300	-	218,300
Total General and Subordinated Revenue Bonds				-	6,524,422	-	6,524,422
Debentures							
	January 15, 2000	7.30% a		278	-	-	278
	July 15, 2001	6.25% a		8,460	-	-	8,460
	March 15, 2003	7.05% a		5,890	-	-	5,890
	March 1, 2004	7.00% a		2,999	-	-	2,999
	June 1, 2005	7.13% a		14,307	-	-	14,307
	November 1, 2022	9.00% a		26,532	-	-	26,532
	March 15, 2023	8.20% a		270,000	-	-	270,000
Total Debentures				328,466	-	-	328,466
NYSERDA Financing Notes							
Pollution Control Revenue Bonds							
	March 1, 2016	5.15% a	1985A,B	108,020	-	-	108,020
Electric Facilities Revenue Bonds							
	September 1, 2019	7.15% a	1989A,B	35,030	-	-	35,030
	June 1, 2020	7.15% a	1990A	73,900	-	-	73,900
	December 1, 2020	7.15% a	1991A	26,560	-	-	26,560
	February 1, 2022	7.15% a	1992A,B	13,455	-	-	13,455
	August 1, 2022	6.90% a	1992C,D	28,060	-	-	28,060
	November 1, 2023	5.30% a	1993B	29,600	-	-	29,600
	October 1, 2024	5.30% a	1994A	2,600	-	-	2,600
	August 1, 2025	5.30% a	1995A	15,200	-	-	15,200
Total NYSERDA Financing Notes				332,425	-	-	332,425
Unamortized premium and deferred amortization				(48,534)	39,775	-	(8,759)
Subtotal				612,357	6,564,197	-	7,176,554
Note Payable to the Authority				3,082,846	-	(3,082,846)	-
Due to the Authority				2,999,396	-	(2,999,396)	-
Total				6,694,599	6,564,197	(6,082,242)	7,176,554
Less Current Maturities				186,426	127,960	(127,960)	186,426
Total Long-Term Debt				6,508,173	6,436,237	(5,954,282)	6,990,128
Retained earnings/(Accumulated deficit)				60,601	58,870	(60,601)	58,870
Total Capitalization				\$ 6,568,774	\$ 6,495,107	\$ (6,014,883)	\$ 7,048,998

a - Fixed rate

b - Variable rate (rate presented is at December 31, 1999)