

Long Island Power Authority and Subsidiaries

**Consolidated Financial Statements
and Other Financial Information
December 31, 2000 and 1999**

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	6-36
Section II.	Other Financial Information	
	Report of Independent Accountants on Other Financial Information	37
	Consolidating Statement of Financial Position	38
	Consolidating Statement of Revenues, Expenses, and Changes in Retained Earnings/(Accumulated Deficit)	39
	Consolidating Statement of Cash Flows	40
	Consolidating Statement of Capitalization	41
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> .	42



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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, 2000 and 1999, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2001 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.

/s/ **PricewaterhouseCoopers LLP**
March 22, 2001

Consolidated Statements of Financial Position
(Thousands of Dollars)

	December 31,	
	2000	1999
Assets		
Utility Plant, net	<u>\$ 2,197,656</u>	<u>\$ 2,099,204</u>
Property and Equipment, net	<u>942</u>	<u>1,042</u>
Current Assets		
Cash and cash equivalents	97,850	165,135
Investments	277,074	365,275
Accounts receivable (less allowance for doubtful accounts of \$21,480 and \$19,480, respectively)	208,644	200,535
Fuel inventory	50,251	48,826
Interest receivable	1,754	132
Prepayments and other current assets	<u>2,085</u>	<u>4,831</u>
Total Current Assets	<u>637,658</u>	<u>784,734</u>
Promissory Note Receivable	<u>602,427</u>	<u>602,427</u>
Nonutility Property and Other Investments	<u>32,789</u>	<u>20,149</u>
Deferred Charges	<u>67,198</u>	<u>75,744</u>
Regulatory Assets		
Shoreham settlement	335,061	233,631
Fuel and purchased power cost recoverable (payable)	<u>125,600</u>	<u>(22,013)</u>
Total Regulatory Assets	<u>460,661</u>	<u>211,618</u>
Acquisition Adjustment (net of accumulated amortization of \$452,169 and \$305,106 respectively)	<u>3,643,342</u>	<u>3,790,405</u>
Total Assets	<u>\$ 7,642,673</u>	<u>\$ 7,585,323</u>
Capitalization		
Long-term debt	\$ 7,218,889	\$ 6,990,128
(Accumulated deficit)/Retained earnings	<u>(61,670)</u>	<u>58,870</u>
Total Capitalization	<u>7,157,219</u>	<u>7,048,998</u>
Current Liabilities		
Current maturities of long-term debt	119,830	186,426
Due to KeySpan	86,412	46,755
Accounts payable and accrued expenses	89,547	121,340
Accrued taxes	29,163	42,135
Accrued interest	51,925	54,683
Customer deposits	<u>24,550</u>	<u>23,094</u>
Total Current Liabilities	<u>401,427</u>	<u>474,433</u>
Deferred Credits	<u>60,955</u>	<u>52,625</u>
Claims and Damages	<u>23,072</u>	<u>9,267</u>
Commitments and Contingencies	<u> </u>	<u> </u>
Total Capitalization and Liabilities	<u>\$7,642,673</u>	<u>\$7,585,323</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,	
	2000	1999
Electric Revenue	\$2,199,741	\$2,278,978
Expenses		
Operations - fuel and purchased power	883,673	713,303
Operations and maintenance	638,627	684,789
General and administrative	33,162	30,551
Depreciation and amortization	208,295	210,025
Capital recovery amortization	34,209	119,052
Payments in lieu of taxes	230,319	244,767
Rebates recoverable	-	(164,006)
Total Operating Expenses	<u>2,028,285</u>	<u>1,838,481</u>
Excess of operating revenues over expenses	<u>171,456</u>	<u>440,497</u>
Other income, net		
Investment income	31,713	30,431
Other	<u>18,423</u>	<u>19,025</u>
Total other income, net	<u>50,136</u>	<u>49,456</u>
Excess of revenues over expenses before interest charges and (credits) and extraordinary gain	<u>221,592</u>	<u>489,953</u>
Interest charges and (credits)		
Interest on long-term debt, net	322,095	306,966
Other interest	27,371	34,342
Allowance for borrowed funds used during construction	<u>(5,646)</u>	<u>(2,559)</u>
Total interest charges	<u>343,820</u>	<u>338,749</u>
Excess of (expenses over revenues) revenues over expenses before extraordinary gain	(122,228)	151,204
Gain on early extinguishment of debt	<u>1,688</u>	<u>7,721</u>
Excess of (expenses over revenues) revenues over expenses	(120,540)	158,925
Retained earnings/(Accumulated deficit)		
Beginning	<u>58,870</u>	<u>(100,055)</u>
Ending	<u>\$ (61,670)</u>	<u>\$ 58,870</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,	
	2000	1999
Operating Activities		
Excess of (expenses over revenues) revenues over expenses	\$ (120,540)	\$ 158,925
Adjustments to reconcile excess of (expenses over revenues) revenues over expenses to net cash provided by operating activities		
Gain on early extinguishment of debt	(1,688)	(7,721)
Depreciation and amortization	208,295	210,025
Capital recovery amortization	34,209	119,052
Shoreham Credits	(91,830)	(233,631)
Amortization of cost of issuing and redeeming securities	30,067	9,439
Other	(280)	13,644
Changes in operating assets and liabilities		
Accounts receivable, net	(8,109)	7,867
Fuel inventory	(1,425)	(21,041)
Fuel and purchased power costs recoverable (payable)	(147,613)	-
Accounts payable and accrued expenses	(31,793)	78,717
Due to KeySpan	39,657	(28,285)
Accrued taxes	(12,972)	(36,885)
Accrued interest	(2,758)	(8,705)
Other, net	31,748	16,523
Net cash (used in) provided by operating activities	<u>(75,032)</u>	<u>277,924</u>
Investing Activities		
Net sales (purchases) of investment securities	88,201	(365,275)
Other	(12,640)	-
Net cash provided by (used in) investing activities	<u>75,561</u>	<u>(365,275)</u>
Cash Flows from Non-Capital related Financing Activities		
Proceeds from the issuance of bonds	325,165	-
Bond issuance costs	(9,599)	-
Net cash provided by non-capital related financing activities	<u>315,566</u>	<u>-</u>
Cash Flows from Capital and related Financing Activities		
Capital and nuclear fuel expenditures	(198,920)	(120,467)
Proceeds from notes receivable	-	442,475
Redemption of long-term debt	(184,460)	(781,019)
Other	-	(739)
Net cash used in capital and related financing activities	<u>(383,380)</u>	<u>(459,750)</u>
Net decrease in cash and cash equivalents	(67,285)	(547,101)
Cash and cash equivalents at beginning of period	165,135	712,236
Cash and cash equivalents at end of period	<u>\$ 97,850</u>	<u>\$ 165,135</u>
Interest paid	\$ 346,708	\$ 303,007

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

Long Island Power Authority and Subsidiaries

5

Consolidated Statements of Capitalization December 31, 2000 (Thousands of Dollars)

	Maturity	Interest Rate	Series	December 31,	
				2000	1999
Electric System General Revenue Bonds					
Capital Appreciation Bonds	June 1, 2005 to 2029	5.00% to 5.95%	a 2000A	\$ 337,235	\$ -
Serial Bonds	December 1, 2000 to 2016	4.10% to 6.00%	a 1998A	1,186,140	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	165,607	157,662
Serial Bonds	April 1, 2000 to 2016	4.00% to 5.25%	a 1998B	1,176,640	1,256,655
Term Bonds	April 1, 2018	4.75%	a 1998B	57,145	57,145
Electric System Subordinated Revenue Bonds					
	May 1, 2033	4.85%	b Series 1	250,000	250,000
	May 1, 2033	4.60%	b Series 2	250,000	250,000
	May 1, 2033	4.13%	b Series 3	250,000	250,000
	May 1, 2033	4.15%	b Series 4	250,000	250,000
	May 1, 2033	4.90%	b Series 5	250,000	250,000
	May 1, 2033	4.90%	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>6,741,642</u>	<u>6,524,422</u>
Debentures					
	January 15, 2000	7.30%	a	-	278
	July 15, 2001	6.25%	a	-	8,460
	March 15, 2003	7.05%	a	-	5,890
	March 1, 2004	7.00%	a	-	2,999
	June 1, 2005	7.13%	a	-	14,307
	November 1, 2022	9.00%	a	-	26,532
	March 15, 2023	8.20%	a	270,000	270,000
Total Debentures				<u>270,000</u>	<u>328,466</u>
NYSERDA Financing Notes					
Pollution Control Revenue Bonds	March 1, 2016	5.15%	a 1985 A,B	108,020	108,020
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%	a 1993 B	29,600	29,600
	October 1, 2024	5.30%	a 1994 A	2,600	2,600
	August 1, 2025	5.30%	a 1995 A	15,200	15,200
Total NYSERDA Financing Notes				<u>332,425</u>	<u>332,425</u>
Unamortized premium and deferred amortization				<u>(5,348)</u>	<u>(8,759)</u>
Total Long-Term Debt				<u>7,338,719</u>	<u>7,176,554</u>
Less Current Maturities				<u>119,830</u>	<u>186,426</u>
Long-Term Debt				7,218,889	6,990,128
(Accumulated Deficit)/Retained Earnings				<u>(61,670)</u>	<u>58,870</u>
Total Capitalization				<u>\$ 7,157,219</u>	<u>\$ 7,048,998</u>

a - Fixed rate

b - Variable rate (rate presented is at December 31, 2000)

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 years ended December 31, 2000 and 1999 and had no assets or liabilities as of December 31, 2000 and 1999.

The Authority and its subsidiaries, LIPA and LIPA Resources, Inc. are referred to collectively, as the "Company."

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

Merger/Change in Control

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

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

As a result of the Merger, the Authority became the holder of 1 share of LILCO's common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately \$1.048 billion. 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 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 approximately \$6.3 billion, and net deferred federal income tax liability of approximately \$2.4 billion. The balance of the acquisition adjustment is approximately \$3.6 billion and \$3.8 billion at December 31, 2000 and 1999, 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, formerly owned by LILCO, 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"). For the year ended December 31, 2000, LIPA received approximately 50% of its revenues from residential sales, 48% 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 for administering, monitoring and managing the performance by all parties to the Operating Agreements.

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

Notes to Consolidated Financial Statements

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 New York 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.

If the Company had been unable to continue to apply the provisions of SFAS No. 71, at December 31, 2000, the Company estimates that approximately \$460.7 million of regulatory assets would be considered for write-off, and the acquisition adjustment, totaling approximately \$3.6 billion would be considered for impairment.

Shoreham Settlement Agreement

During 1999, the Company recorded a regulatory asset (Shoreham settlement regulatory asset on Statement of Financial Position) 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. The balance of the Shoreham settlement regulatory asset at December 31, 2000 totaled approximately \$335 million as a result of additional credits and rebates issued combined with carrying charges earned on such credits and rebates.

Fuel and Purchased Power Cost Adjustment ("FPPCA")

LIPA's tariff includes a fuel recovery provision--the Fuel and Purchased Power Cost Adjustment ("FPPCA"). 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 cost tolerance band. The tolerance band increases in 1% percent increments annually. The tolerance band for the year ended December 31, 2000, was 2% above and 2% below LIPA's base cost of fuel and purchased power. The tolerance band for the year ended December 31, 1999, was 1% above or below the base cost of fuel and purchased power. Should fuel and purchased power costs increase in excess of 5% cumulatively over the original base cost, as it did for the year ended December 31, 2000, the FPPCA may recover, from that year forward, all costs in excess of the original base. Accordingly, effective January 1, 2001, no tolerance band exists with regard to fuel costs and all such excess costs are eligible for recovery.

During the year ended December 31, 2000, LIPA incurred costs for fuel and purchased power, totaling approximately \$1.03 billion, or approximately \$329 million in excess of the tolerance band, and accordingly, such excess costs were deferred during the period for future recovery. However, LIPA's Board of Trustees approved a plan to limit the recovery of this excess to approximately \$126 million over the 12 month period which began March 2001. As a result of this recovery limitation, additional fuel expense totaling approximately \$181 million was recognized in 2000.

Had the fuel and purchased power mechanism operated as designed, approximately \$307 million of excess fuel and purchased power costs (net of the \$22 million over recovery from 1998) would have remained deferred at year end.

Notes to Consolidated Financial Statements

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 approximately 2.9% in 2000 and 1999.

Leasehold improvements are being amortized over the lesser of, the life of the assets or the term of the lease, using the straight-line method. Property and equipment is being depreciated over its estimated useful life using the straight-line method.

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 AFC rate for the years ended December 31, 2000 and 1999 was 4.76%.

Fuel Inventory

Effective July 2000, LIPA took title to all existing fuel oil in storage facilities owned by KeySpan located at generating stations on Long Island formerly owned by LILCO. Fuel inventory represents the value of low sulfur and internal combustion fuels that LIPA had on hand at each year-end in order to meet the demand requirements of these generating stations. Fuel inventory is valued using the weighted average cost method.

Cash and Cash Equivalents and Investments

Funds held by the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. Certain investments and cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific purposes, including debt service, capital expenditures, the issuance of credits in accordance with the Shoreham Settlement Agreement, and clean energy initiatives. Investments are reported at amortized cost which approximates fair market value.

Notes to Consolidated Financial Statements

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

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

LIPA generated sufficient cash flow to allow it to retire in the first quarter of 2000, before maturity, approximately \$58 million of Debentures and to retire during 1999 approximately \$148.2 million of 1998 Series A Bonds. The early retirement of debt reflects the advanced recovery of costs and as a result, LIPA recorded accelerated amortization of the acquisition adjustment totaling approximately \$34 million and approximately \$119 million in 2000 and 1999, respectively.

Fair Values of Financial Instruments

The Company's financial instruments approximate their fair market value at December 31, 2000, and 1999. 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.

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 also include payments to municipalities and school districts in which the defunct Shoreham power plant is located. Shoreham related PILOTS paid in the first year following the Company's acquisition of Shoreham, which occurred on February 29, 1992, were equal to the taxes and assessments which would have been paid had Shoreham not been transferred to the Company. In each succeeding year through 2000, Shoreham related PILOTS have been reduced by ten percent of the first year's required payment.

Notes to Consolidated Financial Statements

With the implementation of the Shoreham Settlement Agreement (“Settlement Agreement”) discussed in Note 11, PILOTs obligations for the Shoreham plant have been, and will continue to be paid as follows:

<u>Payment Date</u>	<u>Dollars</u>	<u>Period Covered</u>
02/01/2000	\$ 14,307,472	3/1/99-8/31/99
03/01/2000	12,268,000	9/1/99-2/28/00
09/01/2000	8,179,000	3/1/00-8/31/00
03/01/2001	8,179,000	9/1/00-2/28/01
09/01/2001	4,089,000	3/1/01-8/31/01
03/01/2002	4,089,000	9/1/01-2/28/02

Upon payment of the March 1, 2002 PILOTs, the Company will have satisfied all PILOT payments with respect to the Shoreham property.

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 expected loss. Extraordinary storm losses incurred by LIPA are partially insured by various commercial insurance carriers. The insurance carriers provide partial insurance coverage for individual storm losses to the transmission and distribution system between \$15 million and \$25 million. Storm losses that are outside of this range are self-insured by LIPA. In certain instances, significant portions of extraordinary storm losses may be recoverable from the Federal Emergency Management Agency.

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.

Recent Accounting Pronouncements

Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local Governments

In June 1999, Governmental Accounting Standards Board issued GASB Statement No. 34, “Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments,” which requires the basic financial statements to include management’s discussion and analysis (“MD&A”) and required supplementary information other than MD&A. The Company will adopt GASB Statement No. 34 for periods beginning after the fiscal year ended December 31, 2001. Adoption of GASB Statement No. 34 is not expected to have a material effect on the Company’s financial statements.

Notes to Consolidated Financial Statements

Derivative Instruments

In June 1998, the FASB issued statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which was subsequently amended in June 2000 by FASB No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." These statements establish accounting and reporting requirements for derivative instruments and for hedging activities. These standards require that an entity recognize the fair value of all derivative instruments as either assets or liabilities in the balance sheet with the offsetting gains or losses recognized in earnings. These standards permit the deferral of hedge gains and losses, under specific hedge accounting provisions, until the hedged transaction is realized. These statements also provide an exception for certain derivative transactions that meet the criteria of "normal purchases and normal sales." Transactions that can be excepted from these statements are those that provide for the purchase or sale of something other than a financial or derivative instrument that will be delivered in quantities expected to be used or sold by the reporting entity over a reasonable period in the normal course of business.

The Company implemented these statements on January 1, 2001. A contract review system for the ongoing identification of derivative transactions (freestanding and embedded in host transactions) is currently being performed and the Authority believes that all contracts that contain derivative transactions will be identified. The majority of the transactions reviewed qualify for the "normal purchases and normal sales" exception and include commodity transactions for the purchase of electricity and petroleum and natural gas products. The derivative transactions that do not qualify for the exception are those resulting from hedging activities consistent with the Company's risk management policy relating to the use of derivative instruments. In accordance with implementation requirements, open hedge instruments were redesignated at January 1, 2001 for eligibility under hedge accounting. Hedge instruments for fuel procurement were not redesignated under these provisions because the related gains and losses will be included as part of LIPA's total commodity costs included in its FPPCA and thus, deferrable under that mechanism. The implementation of these statements will not have a significant impact on the financial position or results of operations of the Authority since the majority of its transactions will be excluded under the "normal purchases and normal sales" exception.

Plant Decommissioning

In February 1996, the FASB issued an exposure draft entitled "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets," which includes nuclear power plant decommissioning. On February 17, 2000, the FASB issued an exposure draft entitled "Accounting for Obligations Associated with the Retirement of Long-Lived Assets," to amend its initial draft and which proposed that the exposure draft be effective for financial statements for fiscal years beginning after June 15, 2001. A final statement is expected to be issued during the second quarter of 2001. If the accounting standard proposed in this 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, and the resulting final pronouncement could be different from that proposed in the exposure draft. The Authority can make no prediction at this time as to the ultimate form of the proposed accounting standard, assuming it is adopted, nor can it make any prediction as to its ultimate effect(s) on the financial position or results of operations of the Company.

Notes to Consolidated Financial Statements

The Nuclear Regulatory Commission (“NRC”) issued a policy statement on the Restructuring and Economic Deregulation of the Electric Utility Industry (“Policy Statement”) in 1997. The Policy Statement addresses the NRC’s concerns about the adequacy of decommissioning funds and about the potential impact on operational safety and reserves. It gives the NRC the right, in highly unusual situations where adequate protection of public health and safety would be compromised, to consider imposing joint and several liability on minority co-owners when one or more co-owners have defaulted on their contractual obligations. On January 5, 1999, the NRC commenced review of a petition for rulemaking filed by a group of utilities which are non-operating joint owners of nuclear plants. These utilities requested that the enforcement provisions of the NRC regulations be amended to clarify NRC policy regarding the potential liability of joint owners if other joint owners become financially incapable of bearing their share of the burden for safe operation or decommissioning of a nuclear power plant. On July 25, 2000, the NRC denied the petition and reaffirmed its position recognizing joint and several regulatory responsibility on co-owners. The Authority is unable to predict how this ruling may ultimately affect the results of operations or financial position.

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 terms of such resolution.

LIPA’s tariff includes the FPPCA to allow LIPA to adjust customers’ bills to reflect significant changes in the cost of fuel and purchased power and related costs. 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 tariff includes the FPPCA, a PILOTS recovery rider, a rider providing for the recovery of costs associated with the Shoreham tax settlement (credits and rebates) 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

Notes to Consolidated Financial Statements

construction and completion of nuclear generating facilities). RICO Credits expired in May 2000.

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 settlement and Suffolk County matters see Notes 10 and 11.

Note 5. Utility Plant and Property and Equipment

	<i>(in thousands)</i>	
	December 31,	
Utility Plant consists of:	<u>2000</u>	<u>1999</u>
Generation - nuclear	\$ 657,335	\$ 659,591
Transmission and distribution	1,573,076	1,451,911
Common	4,096	2,929
Construction work in progress	117,894	78,458
Nuclear fuel in process and in reactor	<u>25,696</u>	<u>17,052</u>
	2,378,097	2,209,941
Less - Accumulated depreciation and amortization	<u>180,441</u>	<u>110,737</u>
Total Net Utility Plant	<u>\$ 2,197,656</u>	<u>\$ 2,099,204</u>
Property and Equipment consists of:		
Office equipment	\$ 870	\$ 715
Leasehold improvements	352	331
Office furniture	<u>377</u>	<u>354</u>
	1,599	1,400
Less - Accumulated depreciation and amortization	<u>657</u>	<u>358</u>
Total Net Property and Equipment	<u>\$ 942</u>	<u>\$ 1,042</u>

Notes to Consolidated Financial Statements

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 megawatts (“MW”). LIPA’s net utility plant investment, excluding nuclear fuel, was approximately \$630 million and \$650 million at December 31, 2000 and 1999, 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 purchased power.

Change of Ownership and Control

In June 2000, all co-tenants except LIPA announced their intention to auction their interests in NMP2 through an open, competitive bidding process. In December 2000, Constellation Nuclear, L.L.C. (“Constellation Nuclear”) was announced as the successful bidder. LIPA has elected to retain its ownership interest in NMP2. This transaction requires the approval of the Nuclear Regulatory Commission (“NRC”), Federal Energy Regulatory Commission, and the PSC. If this transaction closes as anticipated in July 2001, Constellation Nuclear will own 82% of NMP2 and the Company will own the remaining balance of 18%.

The NMP2 operating agreement establishes a management committee (the “Management Committee”) comprised of one representative from each co-tenant. If Constellation Nuclear completes its acquisition of the non-LIPA shares of NMP2, it will control the decisions of the Management Committee through its 82% ownership interest. LIPA, with the assistance of KeySpan, is currently in discussions with Constellation Nuclear regarding the following issues: (i) the approval process for key decisions; (ii) consolidation of committees; (iii) quorum provisions; (iv) life extensions/capacity increases; (v) run/retire decisions; (vi) decommissioning plans; (vii) owner’s representative on-site; (viii) payments for owners that do not pay; (ix) audits; (x) Operating Agreement term; (xi) operation by third parties; (xii) miscellaneous other provisions. LIPA employs an on-site nuclear oversight consultant, MATS, who continues to carry out its responsibilities while the change in ownership proceeds. Once the new ownership structure is in place, the funding and role of MATS will be reevaluated.

Nuclear Plant Decommissioning

LIPA is making provisions for decommissioning costs for NMP2 based on a site specific study performed in 1995. LIPA’s share of the total decommissioning costs for both the contaminated and non-contaminated portions is estimated to be \$145 million in 1996 dollars. LIPA maintains a trust fund for its share of the decommissioning costs of the contaminated portion of NMP2, which at December 31, 2000 had an approximate value of \$29.3 million. LIPA established a separate decommissioning fund for its

Notes to Consolidated Financial Statements

share of the non-contaminated portion of NMP2 which had a value at December 31, 2000 totaling approximately \$3.4 million. Through continued quarterly deposits and investments returns being maintained within these trusts, the Company believes that the value of these trusts will, in 2026, be sufficient to meet the Company's decommissioning obligations.

NMP2 Radioactive Waste

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 the NMP2 spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If additional DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required.

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 generators secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of \$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 of primary nuclear property insurance and approximately \$2.5 billion of additional protection (including decontamination costs) in excess of the primary layer through the Nuclear Electric Insurance Limited ("NEIL"). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately \$2.0 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 any such deficiency. LIPA's maximum liability per incident under the replacement power coverage, in the event of a deficiency, is approximately \$700,000.

Notes to Consolidated Financial Statements

Note 7. Investments and Cash and Cash Equivalents

Funds of the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. The Authority's investments may also be required to conform with additional restrictions contained in financing documents. The Authority is authorized to make investments in any of the following securities: (a) obligations of the U.S. Treasury and U.S. Agencies; (b) obligations of any state or direct obligations of any state agency rated in one of the three highest rating categories by a rating agency; (c) bankers' acceptance or certificates of deposit issued by a commercial bank within the State having capital and surplus greater than \$100 million; (d) commercial paper rated in one of the three highest rating categories for comparable types of obligations by a rating agency; (e) collateralized repurchase agreements; (f) investment agreements or guaranteed investment contracts with any financial institution who is rated in one of the three highest rating categories for comparable types of obligations by a rating agency; (g) money market funds rated in one of the three highest rating categories for comparable types of obligations by a rating agency; (h) municipal obligations rated in the highest rating category by a rating agency; and, (j) obligations of any person or entity rated in one of the three highest rating categories by a rating agency. The Authority's guidelines and any additional restrictions required by financing documents comply with the New York State Comptroller's investment guidelines for public authorities.

All investments of the Authority are held by designated custodians in the name of the Authority. Investments are reported at amortized cost, which approximates fair market value at December 31, 2000 and 1999. Investments with original maturities of less than 90 days are classified as cash and cash equivalents. Certain cash and cash equivalents and investments have been designated by the Authority's Board of Trustees to be used for specific purposes such as capital additions, debt repayment, the funding of credits in accordance with the Shoreham Settlement Agreement and clean energy initiatives.

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. Investments held by the Authority, with the exception of money market mutual funds, qualify as Category I investments at December 31, 2000 and 1999. Money market mutual funds qualify as Category III investments at December 31, 2000 and 1999, 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 Authority's behalf are investing in U.S. Government securities or commercial paper which meets Authority's minimum investment requirements, as described above.

The bank balances of approximately \$2.3 million and approximately \$1.2 million at December 31, 2000 and 1999, 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.

Notes to Consolidated Financial Statements

Investments and cash and cash equivalents of the Authority at December 31, 2000 and 1999, are detailed below:

(in thousands of dollars)

	December 31,	
	<u>2000</u>	<u>1999</u>
Investments:		
U.S. Government/Agencies	\$ -	\$ 15,512
Commercial Paper	102,105	340,263
Repurchase Agreement	174,969	-
Certificates of Deposit	<u>-</u>	<u>9,500</u>
 Total investments:	 <u>277,074</u>	 <u>365,275</u>
 Cash and cash equivalents:		
Commercial paper	50,179	12,435
Money market mutual funds	45,832	151,493
Demand deposits	<u>1,839</u>	<u>1,207</u>
 Total cash and cash equivalents	 <u>97,850</u>	 <u>165,135</u>
 Total investments and cash and cash equivalents	 <u>\$ 374,924</u>	 <u>\$ 530,410</u>

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.

Notes to Consolidated Financial Statements

Electric System General Revenue Bonds

2000 Series A

During the year ended December 31, 2000, the Authority issued Series 2000A Electric System General Revenue Bonds totaling approximately \$325 million. These bonds were issued to fund certain rebates and credits in accordance with the Shoreham Settlement Agreement, as more fully discussed in Note 11. These Bonds are comprised of tax-exempt Capital Appreciation Bonds with maturities beginning in June 2005 and continuing each year through 2029 and are not subject to optional redemption, mandatory sinking fund redemptions or any other redemption prior to maturity.

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 year ended December 31, 2000, the Company retired at maturity the 4.1% Serial Bonds totaling approximately \$47.9 million. During the year ended December 31, 1999, the Company retired at maturity, with cash from operations, the 4.5% Serial Bond totaling 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 with cash generated from operations 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."

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%

Notes to Consolidated Financial Statements

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 through December 1, 2013 (\$883 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 that began in April 2000 and continuing each year through April 2016 and Term Bonds maturing in April 2018.

During the year ended December 31, 2000, the Company retired at maturity, with cash from operations, two Serial Bonds totaling approximately \$80 million.

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.

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

Notes to Consolidated Financial Statements

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. The Authority is currently engaged in discussions with potential letter of credit providers for extension or replacement of such letters of credit.

In March 2001, the Board of Trustees approved a Plan of Finance to restructure the Series 1 through 6 Bonds, by refunding them with senior or subordinate lien bonds. This Plan of Finance anticipates that a portion of the Series 1 through 6 Bonds would continue to be secured by letters of credit, a portion would be refunded with fixed rate bonds, and a portion would be refunded with auction rate bonds.

Series 7

This Series is comprised of variable rate bonds in 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.

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, 2000 and 1999.

Notes to Consolidated Financial Statements

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:

<u>This Series is Comprised of Subseries</u>	<u>Mandatory Purchase Date (April 1)</u>	<u>Maturity (April 1)</u>	<u>Principal Outstanding \$(000)</u>	<u>Interest Rate to Mandatory Purchase Date</u>
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%

Immediately prior to the mandatory purchase date, the Authority will determine to either purchase the Subseries or have such Subseries remarketed. Remarketed securities would then become due at the maturity date or such earlier date as determined by the remarketing. Additionally, the original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing if the Authority chooses to remarket. Principal, interest and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy. The Authority is planning to remarket the Subseries 8A that has a mandatory purchase date of April 1, 2001 and accordingly, such amount is not classified as current maturities of long term debt.

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 amounts are due to bond holders. The balance of the Promissory Notes between KeySpan and LIPA totaled \$602.4 million at December 31, 2000 and 1999, respectively.

Notes to Consolidated Financial Statements

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 defeased on June 29, 1998. At December 31, 2000, approximately \$1.130 billion of the G&R Bonds, outstanding are considered defeased.

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

Debentures

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

(In thousands)		
Maturity	Interest Rate	Carrying Value
7/15/2001	6.250%	\$ 8,460
3/15/2003	7.050%	5,890
3/01/2004	7.000%	2,999
6/01/2005	7.125%	14,307
11/01/2022	9.000%	26,532

As a result of this defeasance, LIPA realized a gain on the early extinguishment of debt totaling approximately \$1.7 million. This gain is shown as an extraordinary item in accordance with SFAS No. 4, “Reporting Gains and Losses from Extinguishment of Debt.”

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

Notes to Consolidated Financial Statements

the optional redemption at par of NYSERDA Bonds, 1976 Series A and 1979 Series B totaling \$26.4 million and \$19.1 million, respectively. These 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"). At December 31, 2000, the above mentioned outstanding Refunded NYSERDA Notes are considered defeased.

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

Deferred Amortization

A debt refinancing charge of \$61.9 million resulted from the refundings that the Authority has undertaken between May 28, 1998 and December 31, 2000, primarily because of the difference between the amounts paid for refundings, including amounts deposited with the Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, approximately \$61.9 million was deferred and shown in the Statement of Financial Position as Deferred Amortization within long term debt and is being amortized, on a straight line method, over the shorter of the life of the new debt or the old debt. The unamortized balance at December 31, 2000 and 1999 totaled \$37.2 and \$48.5 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: 2001, \$119.8 million; 2002, \$140.1 million; 2003, \$147.2 million; 2004, \$163.1 million; and 2005, \$171.5 million.

Notes to Consolidated Financial Statements

Fair Values of Long - Term Debt

The carrying amounts and fair values of the Company's long-term debt at December 31, 2000 and 1999 were as follows:

<i>Fair Value</i>	<i>(In thousands of dollars)</i>	
	December 31,	
	2000	1999
Electric System General Revenue Bonds, Series 1998 A	\$ 3,210,817	\$ 3,019,431
Electric System General Revenue Bonds, Series 1998 B	1,250,375	1,276,607
Electric System General Revenue Bonds, Series 2000 A	362,009	-
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)	222,816	215,005
Debentures	278,100	315,367
NYSERDA Notes	324,874	334,189
Total	\$ 7,398,991	\$ 6,910,599

<i>Carrying Amount</i>	December 31,	
	2000	1999
Electric System General Revenue Bonds, 1998 Series A	\$ 3,202,322	\$ 3,242,322
Electric System General Revenue Bonds, 1998 Series B	1,233,785	1,313,800
Electric System General Revenue Bonds, 2000 Series A	337,235	-
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	270,000	328,466
NYSERDA Notes	332,425	332,425
Total	\$ 7,344,067	\$ 7,185,313

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

Notes to Consolidated Financial Statements

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 of 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 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.

Notes to Consolidated Financial Statements

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 \$82,000, \$40,000, and \$27,000 for the years ended December 31, 2000 and 1999 and the nine month period ended December 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 January 2001, the lease was amended to include additional premises. As a result of the amendments, the lease expiration date was changed to January 31, 2011. The future minimum payments under the lease are as follows:

Year Ended <u>December 31,</u>	<i>(In thousands)</i>
2001	\$ 858
2002	1,160
2003	1,202
2004	1,247
2005	1,294
Thereafter	<u>7,231</u>
	<u>\$ 12,992</u>

The Company has also entered into a lease with TransEnergies U.S. Ltd. to construct and operate a submarine cable from Connecticut to Long Island, in exchange for monthly lease payments from LIPA. Assuming an in-service date of May 2002, and assuming 300 megawatts of firm capacity is made available, the Company would be obligated to make minimum lease payments as follows:

	<i>(In thousands)</i>
May 2002 through April 2003	\$ 19,350
2004	19,350
2005	19,350
2006	19,350
2007	19,415
Thereafter through April 2022	<u>838,088</u>
	<u>\$ 934,903</u>

Notes to Consolidated Financial Statements

Before this agreement can become operative, federal and state regulatory approvals must be obtained.

Legal Proceedings

Shoreham Tax Matters

Through November 1992, Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District)(collectively, the “Suffolk Taxing Jurisdictions”), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments on the Shoreham plant, claiming the plant was overassessed. 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 Shoreham Settlement Agreement. Pursuant to the Shoreham Settlement Agreement, an amended Judgment was filed, reducing the amount of the Judgment and the Authority’s PILOT claims to the greater of (i) \$620 million, plus interest, less the principal of the Shoreham Tax Settlement Bonds paid with the surcharge or (ii) the amount required to fully satisfy the Authority’s remaining debt service and related obligations in connection with the Shoreham Tax Settlement Bonds. The amended Judgment is enforceable by the Authority or LIPA in the event, among others, that any portion of the Shoreham Settlement Agreement is declared invalid or unenforceable.

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 claimed that the Authority did 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 had a duty to discontinue and abandon all proceedings which sought the repayment of all or

Notes to Consolidated Financial Statements

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 confirmed 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 Suffolk motion. By motion returnable December 6, 1999, Suffolk moved in the Court of Appeals for permission to appeal. The Authority opposed the motion. By order dated January 11, 2000, the Court of Appeals denied Suffolk's motion. Pursuant to the Shoreham Settlement Agreement, the Suffolk Taxing Jurisdictions discontinued this proceeding with prejudice in May 2000. This proceeding is thus concluded.

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 seeking an order: (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 on or about February 17, 2000. A Stipulation of Discontinuance was signed by the parties and filed with the Court in January 2001. This proceeding is thus concluded.

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 alleged were due and owing and approximately \$24.6 million of PILOTs which the plaintiff alleged were the cumulative deficiency as of June 1, 1998. By Stipulation dated August 19, 1999, the School District withdrew its petition. Pursuant to the Shoreham Settlement Agreement, the School District discontinued this proceeding with prejudice in May 2000. This proceeding is thus concluded.

In April 2000, an Article 78 proceeding was filed by the Town of Islip, its Supervisor and the Supervisors of three other townships, against the Authority, LIPA, the Suffolk Taxing jurisdictions and the County of Nassau. The lawsuit seeks a judgment declaring illegal those provisions of the Shoreham Settlement Agreement providing for the repayment of certain tax certiorari judgments by imposition of a surcharge on electric rates. On August 18, 2000, the Authority submitted its papers in opposition to the petition. A hearing was held on October 5, 2000 in the Supreme Court, State of New York, Suffolk County. Supplemental memoranda of law were submitted on October 19, 2000. In a decision dated December 5, 2000, the Court held that to the extent the Shoreham Settlement Agreement imposes a surcharge on electric rates on Suffolk County ratepayers, the Settlement Agreement violates the Suffolk County Tax Act. The Suffolk County Tax Act provides that Suffolk County shall pay the full amount of a tax judgment against Suffolk County and the other affected municipalities and shall recover from such other affected municipalities their share of the judgment. All defendants have filed notices of appeal.

Notes to Consolidated Financial Statements

Merger Matters

LIPA was named as a defendant in an action brought by the County of Suffolk in the Supreme Court of the State of New York, challenging the \$67 million in compensation received by certain former LILCO officers in connection with the closing of the Brooklyn Union merger with LILCO and the Authority's acquisition of the common stock of LILCO. This action was voluntarily discontinued by plaintiffs without prejudice. The plaintiffs refiled their claims related to executive compensation in federal court, where they were consolidated with an existing action entitled The County of Suffolk, et al. v. Long Island Power Authority, et al., 98-5996 (TCP) (E.D.N.Y.), as set forth below.

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 Authority, et al. (the "Huntington Lawsuit"). The Huntington Lawsuit alleged 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. The Public Service Commission has since been discontinued from the litigation. Pursuant to the Shoreham Settlement Agreement, in May 2000, Suffolk discontinued its claims against all defendants with prejudice. KeySpan and the Authority filed motions to dismiss the complaint for failure to state a 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. By order dated August 14, 2000, the United States District Court granted the motions to dismiss the complaint. Plaintiffs filed a motion to reargue, which was denied. Plaintiffs have prosecuted an appeal with the Second Circuit Court of Appeals.

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. Pursuant to the Shoreham Settlement Agreement, this proceeding was discontinued with prejudice in May 2000. This proceeding is thus concluded.

Notes to Consolidated Financial Statements

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

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection (“DEP”) and the New York State Department of Environmental Conservation (“DEC”) separately have issued Administrative Consent Orders (“ACOs”) in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound. 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.

Notes to Consolidated Financial Statements

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 Potential Responsible Parties ("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 Polychlorinated Biphenyls ("PCBs"). According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and 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.

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 approved by the Court in March 2000. The settlement did not have a material adverse effect on LIPA's financial position, cash flows or results of operations. This matter is thus concluded.

Notes to Consolidated Financial Statements

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 Attorney General has not renewed the tolling agreement executed with LILCO in 1998, which expired on March 18, 1999 nor has LIPA been involved with any PRP activity in connection with this site since 1999.

DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The estimated response cost for remediating this site is \$19.1 million. LILCO records do not reflect any evidence to suggest it may have been responsible for disposing of any substances, hazardous or otherwise, at this site. LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site.

The EPA notified LILCO that LIPA may be responsible for the disposal of a hazardous substance at the Port Washington Landfill, another municipal landfill property. Remediation efforts are being pursued by the EPA and the Attorney General of the State of New York. The cleanup cost for this site is estimated at \$45 million. LIPA is currently unable to determine its share of costs to investigate and remediate this site. LIPA has entered into a tolling agreement with the Attorney General to allow for further investigation regarding this matter.

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 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

Notes to Consolidated Financial Statements

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						
2001	\$ 21.873	\$ 14.789	\$ 19.162	\$ 21.840	\$ 138.500	\$ 216.164
2002	21.960	15.059	15.961	19.250	141.300	213.530
2003	22.050	15.397	14.832	19.250	143.600	215.129
2004	22.146	15.693	12.271	19.250	126.000	195.360
2005	22.246	15.917	12.391	19.250	113.400	183.204
Subsequent thereto	171.497	145.313	428.748	401.500	766.300	1,913.358
Total	281.772	222.168	503.365	500.340	1,429.100	2,936.745
Less: Imputed Interest	82.962	69.876	372.138	239.974	391.400	1,156.350
	\$ 198.810	\$ 152.292	\$ 131.227	\$ 260.366	\$ 1,037.700	\$ 1,780.395

* Assumes full performance by the IPPs and NYPA.

Note 11. Regulatory Asset

Shoreham 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 received additional rebates totaling approximately \$25 million. In order to fund such rebates and credits, the Authority issued \$142.5 million of Electric System General Revenue Bonds, Series 1998A in May 1998 and issued approximately \$325 million of Electric System General Revenue Bonds, Series 2000A in 2000. Beginning in June 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.

Notes to Consolidated Financial Statements

As future rates will be established at a level sufficient to recover all such costs identified above, LIPA has, at December 31, 2000, recorded a regulatory asset totaling approximately \$335 million in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." This \$335 million is comprised of costs recorded from 1998 through 2000 which include rebates and credits to customers and costs of administering the program and interest incurred between the dates that the rebates and credits were issued and December 31, 2000.

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.

Costs incurred during 1999 and 2000 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**

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, 2000, and for the year then ended. 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 accounting principles generally accepted in the United States of America. 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.

/s/ PricewaterhouseCoopers LLP
March 22, 2001

Consolidated Statement of Financial Position
December 31, 2000
(Thousands of Dollars)

	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets				
Utility Plant, net	\$ 2,197,656	\$ -	\$ -	\$ 2,197,656
Property and Equipment, net	-	942	-	942
Current Assets				
Cash and cash equivalents	-	97,850	-	97,850
Investments	-	288,593	(11,519)	277,074
Accounts receivable (less allowance for doubtful accounts of \$21,480)	208,623	21	-	208,644
Interest receivable	-	1,754	-	1,754
Due from LIPA	-	119,830	(119,830)	-
Fuel inventory	50,251	-	-	50,251
Prepayments and other current assets	1,761	324	-	2,085
Total Current Assets	260,635	508,372	(131,349)	637,658
Promissory Note Receivable - KeySpan	602,427	-	-	602,427
Note Receivable - LIPA	-	785,056	(785,056)	-
Designated Funds	(11,519)	-	11,519	-
Nonutility Property and Other Investments	32,789	-	-	32,789
Deferred Charges	67,198	-	-	67,198
Due from LIPA	-	5,549,213	(5,549,213)	-
Regulatory Assets				
Shoreham settlement	335,061	-	-	335,061
Fuel and purchased power cost recoverable	125,600	-	-	125,600
Total Regulatory Assets	460,661	-	-	460,661
Investment in Subsidiary	-	(75,469)	75,469	-
Acquisition Adjustment (net of accumulated amortization of \$452,169)	3,643,342	-	-	3,643,342
Total Assets	\$ 7,253,189	\$ 6,768,114	\$ (6,378,630)	\$ 7,642,673
Capitalization				
Long-term debt	\$ 565,221	\$ 6,653,668	\$ -	\$ 7,218,889
Note payable to the Authority	785,056	-	(785,056)	-
Due to the Authority	5,549,213	-	(5,549,213)	-
	6,899,490	6,653,668	(6,334,269)	7,218,889
Retained earnings	(75,469)	(61,670)	75,469	(61,670)
Total Capitalization	6,824,021	6,591,998	(6,258,800)	7,157,219
Current Liabilities				
Current maturities of long-term debt	-	119,830	-	119,830
Current maturities of note payable to the Authority	119,830	-	(119,830)	-
Due to KeySpan	86,412	-	-	86,412
Accounts payable and accrued expenses	71,213	18,334	-	89,547
Accrued taxes	29,163	-	-	29,163
Accrued interest	13,973	37,952	-	51,925
Customer deposits	24,550	-	-	24,550
Total Current Liabilities	345,141	176,116	(119,830)	401,427
Deferred Credits	60,955	-	-	60,955
Claims and Damages	23,072	-	-	23,072
Commitments and Contingencies				
Total Capitalization and Liabilities	\$ 7,253,189	\$ 6,768,114	\$ (6,378,630)	\$ 7,642,673

**Consolidated Statement of Revenues, Expenses, and
Changes in Retained Earnings/(Accumulated Deficit)
For the Year Ended December 31, 2000
(Thousands of Dollars)**

	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Electric Revenue	\$2,199,741	\$ -	\$ -	\$ 2,199,741
Expenses				
Operations - fuel and purchased power	883,673	-	-	883,673
Operations and maintenance	638,627	-	-	638,627
General and administrative	33,461	27,882	(28,181)	33,162
Depreciation and amortization	207,996	299	-	208,295
Capital recovery amortization	34,209	-	-	34,209
Payment in lieu of taxes	230,319	-	-	230,319
Total Operating Expenses	<u>2,028,285</u>	<u>28,181</u>	<u>(28,181)</u>	<u>2,028,285</u>
Excess of operating revenues over expenses (expenses over revenues)	<u>171,456</u>	<u>(28,181)</u>	<u>28,181</u>	<u>171,456</u>
Other income and (deductions), net				
Investment of Subsidiary	-	(136,070)	136,070	-
Investment income	4,927	330,564	(303,778)	31,713
Management fee	-	28,181	(28,181)	-
Other	18,031	392	-	18,423
Total other income and (deductions), net	<u>22,958</u>	<u>223,067</u>	<u>(195,889)</u>	<u>50,136</u>
Excess of revenues over expenses before interest charges and extraordinary gain	<u>194,414</u>	<u>194,886</u>	<u>(167,708)</u>	<u>221,592</u>
Interest charges and (credits)				
Interest on long-term debt, net	711	321,384	-	322,095
Interest on note payable to the Authority	303,778	-	(303,778)	-
Other interest	33,329	(5,958)	-	27,371
Allowance for borrowed funds used during construction	(5,646)	-	-	(5,646)
Total interest charges	<u>332,172</u>	<u>315,426</u>	<u>(303,778)</u>	<u>343,820</u>
Excess of expenses over revenues before extraordinary gain	(137,758)	(120,540)	136,070	(122,228)
Gain on early extinguishment of debt	1,688	-	-	1,688
Excess of expenses over revenues	(136,070)	(120,540)	136,070	(120,540)
Retained earnings/(Accumulated deficit)				
Beginning	60,601	58,870	(60,601)	58,870
Ending	<u>\$ (75,469)</u>	<u>\$ (61,670)</u>	<u>\$ 75,469</u>	<u>\$ (61,670)</u>

**Consolidated Statement of Cash Flows
For the Year Ended December 31, 2000
(Thousands of Dollars)**

	<u>LIPA</u>	<u>Authority</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Activities				
Net excess of (expenses over revenues) revenues over expenses	\$ (136,070)	\$ (120,540)	\$ 136,070	\$ (120,540)
Adjustments to reconcile excess of (expenses over revenues) revenues over expenses to net cash provided by operating activities				
Gain on early extinguishment of debt	(1,688)	-	-	(1,688)
Depreciation and amortization	207,996	299	-	208,295
Capital recovery amortization	34,209	-	-	34,209
Shoreham credits	(91,830)	-	-	(91,830)
Amortization of cost of issuing and redeeming securities	17,972	12,095	-	30,067
Gain on investment in subsidiary	-	136,070	(136,070)	-
Other	(280)	-	-	(280)
Changes in operating assets and liabilities				
Accounts receivable, net	(8,088)	(21)	-	(8,109)
Fuel inventory	(1,425)	-	-	(1,425)
Fuel and purchased power costs recoverable (payable)	(147,613)	-	-	(147,613)
Accounts payable and accrued expenses	(39,236)	7,443	-	(31,793)
Due to KeySpan	39,619	38	-	39,657
Accrued taxes	(12,972)	-	-	(12,972)
Accrued interest	(1,262)	(1,496)	-	(2,758)
Other, net	33,484	(1,736)	-	31,748
Net cash (used in) provided by operating activities	<u>(107,184)</u>	<u>32,152</u>	<u>-</u>	<u>(75,032)</u>
Investing Activities				
Purchase of investment securities, net of sales	-	75,414	12,787	88,201
Other	(12,640)	-	-	(12,640)
Net cash (used in) provided by investing activities	<u>(12,640)</u>	<u>75,414</u>	<u>12,787</u>	<u>75,561</u>
Cash Flows from Non-Capital related Financing Activities				
Proceeds from issuance of long-term debt	-	325,165	-	325,165
Bond issuance costs	(9,599)	-	-	(9,599)
Net cash provided by provided by non-capital related financing activities	<u>(9,599)</u>	<u>325,165</u>	<u>-</u>	<u>315,566</u>
Cash Flows from Capital and related Financing Activities				
Capital and nuclear fuel expenditures	(198,721)	(199)	-	(198,920)
Proceeds (issuance) of note payable to the Authority	2,549,817	(2,549,817)	-	-
Payment of note payable to the Authority	(2,177,960)	2,177,960	-	-
Redemption of long-term debt	(56,500)	(127,960)	-	(184,460)
Net cash provided by (used in) capital and related financing activities	<u>116,636</u>	<u>(500,016)</u>	<u>-</u>	<u>(383,380)</u>
Net decrease in cash and cash equivalents and designated funds	(12,787)	(67,285)	12,787	(67,285)
Cash and cash equivalents and designated funds at beginning of period	1,268	165,135	(1,268)	165,135
Cash and cash equivalents and designated funds at end of period	<u>\$ (11,519)</u>	<u>\$ 97,850</u>	<u>\$ 11,519</u>	<u>\$ 97,850</u>
Interest paid	\$ 32,778	\$ 313,930	\$ -	\$ 346,708

Consolidated Statement of Capitalization
December 31, 2000
(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							
Capital Appreciation Bonds	June 1, 2005 to 2029	5.00% to 5.95%	a 2000A	\$ -	\$ 337,235	\$ -	\$ 337,235
Serial Bonds	December 1, 2001 to 2016	4.10% to 6.00%	a 1998A	-	1,186,140	-	1,186,140
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	-	165,607	-	165,607
Serial Bonds	April 1, 2001 to 2016	4.00% to 5.25%	a 1998B	-	1,176,640	-	1,176,640
Term Bonds	April 1, 2018	4.75%	a 1998B	-	57,145	-	57,145
Electric System							
Subordinated Revenue Bonds							
	May 1, 2033	4.85%	b Series 1	-	250,000	-	250,000
	May 1, 2033	4.60%	b Series 2	-	250,000	-	250,000
	May 1, 2033	4.13%	b Series 3	-	250,000	-	250,000
	May 1, 2033	4.15%	b Series 4	-	250,000	-	250,000
	May 1, 2033	4.90%	b Series 5	-	250,000	-	250,000
	May 1, 2033	4.90%	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				-	6,741,642	-	6,741,642
Debentures							
	March 15, 2023	8.20%	a	270,000	-	-	270,000
Total Debentures				270,000	-	-	270,000
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				(37,204)	31,856	-	(5,348)
Subtotal				565,221	6,773,498	-	7,338,719
Note Payable to the Authority				904,886	-	(904,886)	-
Due to the Authority				5,549,214	-	(5,549,214)	-
Total				7,019,321	6,773,498	(6,454,100)	7,338,719
Less Current Maturities				119,830	119,830	(119,830)	119,830
Total Long-Term Debt				6,899,491	6,653,668	(6,334,270)	7,218,889
Retained earnings/(Accumulated deficit)				(75,469)	(61,670)	75,469	(61,670)
Total Capitalization				\$ 6,824,022	\$ 6,591,998	\$ (6,258,801)	\$ 7,157,219

a - Fixed rate

b - Variable rate (rate presented is at December 31, 2000)

**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, 2000 and 1999, and have issued our report thereon dated March 22, 2001. 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.

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 solely for the information and use of the Company and is not intended to be and should not be used by anyone other than the specified party.

/s/ PricewaterhouseCoopers LLP
March 22, 2001