

**ANNUAL REPORT**  
**OF THE**  
**LONG ISLAND POWER AUTHORITY**  
**AND THE LONG ISLAND LIGHTING COMPANY d/b/a LIPA**  
**For The 2006 Fiscal Year**  
**As Required By Certain**  
**Continuing Disclosure Certificates**

**Executed With Respect To The Following Bonds:**

**Electric System General Revenue Bonds, Series 1998A**  
**Electric System General Revenue Bonds, Series 1998B**  
**Electric System Subordinated Revenue Bonds, Series 8 (Subseries A-C, F)**  
**Electric System General Revenue Bonds, Series 2000A**  
**Electric System General Revenue Bonds, Series 2001A**  
**Electric System General Revenue Bonds, Series 2001B-K**  
**Electric System General Revenue Bonds, Series 2001M-P**  
**Electric System General Revenue Bonds, Series 2003A**  
**Electric System General Revenue Bonds, Series 2003B**  
**Electric System General Revenue Bonds, Series 2003C**  
**Electric System General Revenue Bonds, Series 2003I-O**  
**Electric System General Revenue Bonds, Series 2004A**  
**Electric System General Revenue Bonds, Series 2006A-B**  
**Electric System General Revenue Bonds, Series 2006C-D**  
**Electric System General Revenue Bonds, Series 2006E**  
**Electric System General Revenue Bonds, Series 2006F**

**and**

**NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY**

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

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

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

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**INTRODUCTION**

This Annual Report for the 2006 Fiscal Year ending December 31 (together with the Appendices attached hereto, the "Annual Report") is furnished by the Long Island Power Authority, a corporate municipal instrumentality and political subdivision of the State of New York (the "Authority") and by its wholly-owned subsidiary, the Long Island Lighting Company ("LILCO") which does business under the name LIPA ("LIPA"), to provide the information regarding the Authority and LIPA required by the various Continuing Disclosure Certificates described below (the "Continuing Disclosure Certificates").

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

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

The Authority's Electric System General Revenue Bonds, Series 1998B, issued on November 12, 1998.

The Authority's Electric System Subordinated Revenue Bonds, Series 8 (Subseries A-C, F), issued on November 12, 1998.

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

The Authority's Electric System General Revenue Bonds, Series 2001A, issued on March 29, 2001.

The Authority's Electric System General Revenue Bonds, Series 2001B – Series 2001K, issued on May 16, 2001.

The Authority's Electric System General Revenue Bonds, Series 2001M – Series 2001P, issued on May 23, 2001.

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

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

The Authority's Electric System General Revenue Bonds, Series 2003I – Series 2003O, issued on May 29, 2003.

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

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

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

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

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

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

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

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

Certain of the information contained in this Annual Report may be in addition to that required by the Continuing Disclosure Certificates. Pursuant to the terms of the Continuing Disclosure Certificates, the Authority and LIPA are under no obligation to update such additional information in the future or include it in any future annual report.

## **OPERATING RESULTS**

The operating results of the Authority and LIPA for the years ended December 31, 2006 and 2005 are contained in the audited basic financial statements included as Appendix B hereto. Certain prior period amounts have been reclassified to conform to the current year presentation.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2006**

Management's Discussion of Financial Condition and Consolidated Results of Operations for the year ended December 31, 2006 is contained in Appendix B hereto and is incorporated by reference herein.

## CAPITAL IMPROVEMENT PLAN

During the period 2001 through 2006, an average of approximately \$230 million per year was spent on capital additions and improvements including Nine Mile Point 2 Nuclear Power Station ("NMP2") expenditures. Such expenditures included interconnection costs associated with new generating stations on Long Island, reliability enhancements, capability expansion, new customer connections, facility replacements and public works. Capital expenditures for 2003, 2004, 2005 and 2006 were \$202 million, \$208 million, \$229 million and \$298 million respectively. Capital expenditures for 2007 are estimated to total approximately \$317 million. The 2007 capital expenditure program provides for a continuation of the historical programs to improve reliability and quality of electric service, as well as expenditures for capability expansion, new customer connections, facility replacements, reliability enhancements and public work projects that are comparable to historical levels.

As shown in the table below, LIPA's 18 percent share of capital expenditures for NMP2 during the period 2002 through 2006 averaged approximately \$11 million annually for plant modifications and nuclear fuel purchases.

### **LIPA's 18% Share of NMP2 Capital Expenditures (Millions of Dollars)**

<b><u>Year</u></b>	<b><u>Plant Modifications</u></b>	<b><u>Fuel</u></b>	<b><u>Total</u></b>
2002*	\$3.6	\$8.2	\$11.8
2003	4.7	1.3	6.0
2004*	7.1	9.4	16.5
2005*	3.1	11.1	14.2
2006	4.6	1.7	6.3

\* Year of a refueling or fuel purchase.

Budgeted capital expenditures for NMP2 for calendar year 2007 total \$18.7 million reflecting approximately \$6.2 million for anticipated expenditures for routine projects and approximately \$12.5 million for nuclear fuel costs.

## SYSTEM LOADS AND RESOURCES

### Historical Power and Energy Requirements

Electricity usage patterns and seasonal weather conditions in LIPA's service area result in maximum electrical demand during the summer season and relatively low load factors on an annual basis. The following table sets forth historical annual peak demands and energy requirements for the period 2002 through 2006.

## HISTORICAL LOADS AND RESOURCES

	Calendar Year				
	2002	2003	2004	2005	2006
<b>Annual Peak Demand (Summer) (MW)<sup>1</sup></b>	4,929	4,794	4,581	5,115	5,667
<b>Capacity (MW)<sup>2</sup></b>					
Nuclear <sup>3</sup> .....	204	207	207	207	205
Purchased Capacity:					
GENCO					
Steam <sup>4</sup> .....	2,634	2,650	2,658	2,691	2,683
Other <sup>4</sup> .....	1,405	1,412	1,397	1,385	1,361
Other Purchased Capacity <sup>5</sup> .....	1,070	1,104	1,016	1,190	1,395
Total Purchased Capacity .....	5,109	5,166	5,071	5,266	5,439
Total Capacity .....	5,313	5,373	5,278	5,473	5,644
Annual Reserve Margin:					
MW <sup>6</sup> .....	384	579	697	358	-23
Percent .....	7.8	12.1	15.2	7.0	-0.4
<b>Energy (MWh)</b>					
Annual Energy Requirements:					
Retail Requirements .....	20,238,273	20,478,552	20,992,607	21,779,217	21,077,467
Sales for Resale .....	572,817	147,713	0	0	0
Total Energy Requirements <sup>7</sup> .....	20,811,090	20,626,265	20,992,607	21,779,217	21,077,467
Generating Resources:					
Nuclear <sup>3</sup> .....	1,519,573	1,721,549	1,548,432	1,784,200	1,627,979
Purchased Energy:					
GENCO					
Steam .....	11,785,320	11,051,773	10,502,799	10,706,291	9,328,915
Other .....	789,626	749,514	494,989	424,776	218,913
Other Purchased Energy <sup>5</sup> .....	6,716,571	7,103,429	8,446,387	8,863,950	9,901,660
Total Purchased Energy .....	19,291,517	18,904,716	19,444,175	19,995,017	19,449,488
Total Energy .....	20,811,090	20,626,265	20,992,607	21,779,217	21,077,467

<sup>1</sup> Includes Long Island Choice load, Power-for-Jobs and the Grumman campus.

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

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

<sup>4</sup> Values from KeySpan Energy.

<sup>5</sup> Includes on and off-island resources under contract at time of peak. Resources include capacity associated with independent power producers, firm capacity purchases, and Power-for-Jobs, and power supply agreements. Excludes short-term bi-lateral and NYSIO capacity market auction purchases.

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

<sup>7</sup> Includes Power-for-Jobs, Long Island Choice and the Grumman campus.

In 2006, LIPA's new record setting peak demand was 5,667 MW, 552 MW higher than the peak demand in 2005. On a weather-normalized basis, the 2006 peak load approximated 5,200 MW, which reflects an increase of approximately 1.4 percent over the weather-normalized 2005 peak load of 5,130 MW.

In 2005, LIPA's then new record setting peak demand was 5,115 MW, 534 MW higher than the peak demand in 2004 and 186 MW higher than the previous record high peak demand in 2002. On a weather-normalized basis, the 2005 peak load approximated 5,130 MW, which reflects an increase of approximately 3.5 percent over the weather-normalized 2004 peak load of 4,955 MW.

In 2004, LIPA's peak demand was 4,581 MW, approximately 213 MW less than the peak load for 2003. The decrease is attributable to weather and conservation efforts. On a weather-normalized basis, the 2004 peak load approximated 4,955 MW, which reflects an increase of approximately 2.9 percent over the weather normalized 2003 all-time peak load of 4,815 MW.

In 2003, LIPA's peak demand was 4,794 MW, approximately 135 MW less than the previous record peak load of 4,929 MW set in the summer of 2002. The decrease is attributable to the impact of weather, as LIPA experienced year-over-year weather normalized system load growth from 2002 to 2003. Weather conditions during 2003, were within 1% of normal, based on the past 30 years of data. On a weather-normalized basis, the 2003 peak load approximated 4,815 MW, which reflects an increase of approximately 4.4 percent over the weather normalized 2002 all-time peak load of 4,611 MW.

### **Existing Power Supply Resources**

LIPA is expected to rely on existing power supply resources, together with certain new resources described below under "New Power Supply Resources", to meet the bulk of its capacity and energy requirements. The table shown above sets forth the historical annual contribution of the KeySpan Generation LLC ("GENCO") facilities, the NMP2 facility, and Independent Power Producers on Long Island and elsewhere. Combined, these resources were able to provide the Service Area's capacity and energy requirements during the 2002 through 2006 period. The table set forth on the following page provides additional information on the historical operating performance of the GENCO facilities.

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**HISTORICAL GENCO GENERATION<sup>1</sup>**  
(GWh)

Generating Facility	Calendar Year				
	2002	2003	2004	2005	2006
Steam Turbine:					
E.F. Barrett 1,2 .....	1,634.4	1,336.4	1,207.0	1,213.5	1,369.6
Far Rockaway 4 .....	404.2	263.8	220.2	238.1	273.3
Glenwood 4,5 .....	804.0	545.0	404.1	188.9	333.0
Northport 1-4 .....	7,297.4	7,507.3	6,797.1	7,423.7	5,918.0
Port Jefferson 3,4 .....	1,645.3	1,399.2	1,873.8	1,642.2	1,434.9
Total Steam Turbine .....	11,785.3	11,051.7	10,502.2	10,706.4	9,328.9
Combustion Turbine:					
E.F. Barrett 1-12 .....	155.8	89.0	129.3	91.9	73.8
Wading River .....	256.2	305.6	192.6	156.2	55.7
East Hampton 1 .....	16.4	16.4	4.0	5.4	7.7
Glenwood 1-3 .....	35.8	23.6	13.3	24.3	9.9
Holtsville 1-10 .....	290.9	284.1	147.5	135.2	61.9
Northport G-1 .....	1.4	0.0	0.2	0.1	0.2
Port Jefferson GT .....	1.2	0.7	0.2	0.3	0.2
Shoreham 1-2 .....	12.1	10.4	1.7	5.1	3.9
Southampton 1 .....	2.0	1.7	0.0	0.4	0.4
Southhold 1 .....	4.9	3.0	0.9	1.0	0.7
West Babylon 4 .....	5.9	7.7	2.5	3.1	2.2
Total Combustion Turbine .....	782.6	742.2	492.2	423.0	216.7
Internal Combustion:					
East Hampton 2-4 .....	3.9	4.0	1.8	0.9	1.1
Montauk 2-4 .....	3.2	3.2	1.2	0.8	1.1
Total Internal Combustion .....	7.1	7.2	3.0	1.7	2.2
Total .....	12,575.0	11,801.1	10,997.8	11,131.1	9,547.8

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

The following table sets forth for each calendar year 2002 through 2006 the actual generation attributable to LIPA's 18% ownership interest in NMP2.

**NMP2 ENERGY GENERATION**

	2002	2003	2004	2005	2006
Energy (GWh).....	1,519.7	1,721.5	1,548.4	1,784.2	1,628

The tables set forth below contain a summary of existing power supply agreements and show for each calendar year 2002 through 2006 the energy output from such power purchase agreements.



**SUMMARY OF POWER SUPPLY AGREEMENTS <sup>1</sup>  
(EXCLUDING GENCO)**

<b>Unit Name</b>	<b>Capacity (MW)<sup>1,2</sup></b>	<b>Contract Expiration</b>	<b>Unit Type<sup>3</sup></b>	<b>Primary Fuel Type</b>
NYPA Flynn .....	136	2020	CC	Natural Gas <sup>4</sup>
Hempstead Resource Recovery.....	70	2009	ST	Refuse
Trigen NDEC Combined Cycle .....	46	2016	CC/Cogen	Natural Gas <sup>5</sup>
Huntington Resource Recovery .....	24	2012	ST	Refuse
Babylon Resource Recovery .....	14	2008	ST	Refuse
Islip Resource Recovery .....	9	2010	ST	Refuse
Yaphank Landfill .....	1	2008	IC	Methane
Smithtown Landfill .....	N/A	2010	IC	Methane
PPL Global Shoreham.....	76	2017	SC	Kerosene <sup>6</sup>
KeySpan Glenwood Landing .....	80 <sup>7</sup>	2027	SC	Natural Gas <sup>5,6</sup>
KeySpan Port Jefferson.....	79	2027	SC	Natural Gas <sup>5,6</sup>
FPL Bayswater.....	54	2020	SC	Natural Gas <sup>6</sup>
FPL Jamaica Bay .....	55	2018	SC	Kerosene <sup>6</sup>
Global Common Greenport.....	52	2018	SC	Kerosene <sup>6</sup>
Equus .....	47	2017	SC	Natural Gas <sup>5</sup>
NYPA Power-for-Jobs .....	14	2007	N/A	N/A
Gilboa .....	50	2015	PS	Water
Village of Freeport.....	10	2034	SC	Natural Gas <sup>5</sup>
Pinelawn Power .....	75	2025	CC	Natural Gas <sup>5,6</sup>
Calpine Bethpage 3 .....	77	2025	CC	Natural Gas
Bear Swamp Power.....	330 <sup>8</sup>	2021	PS/Hydro	Water
PPL Global Brentwood .....	73	2008	SC	Natural Gas <sup>6</sup>

<sup>1</sup> In addition, LIPA has entered into two contracts to provide a total of 84 MW of temporary generation capacity at substation facilities located at Shoreham and Holtsville expiring October 31, 2007.

<sup>2</sup> Summer capacity based upon summer 2006 DMNC test results.

<sup>3</sup> CC = Combined Cycle; ST = Steam; Cogen = Cogeneration; IC = Internal Combustion; SC = Simple Cycle; PS = Pumped Storage.

<sup>4</sup> Also burns No. 2 fuel oil.

<sup>5</sup> Also burns kerosene.

<sup>6</sup> LIPA is responsible for fuel procurement and has contracted with KeySpan for this service.

<sup>7</sup> Limited to 79.9 MW by permit.

<sup>8</sup> Available capacity expected to drop to 100MW effective June 2010 due to regulatory changes.

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

<b>Type of Resource</b>	<b>Calendar Year</b>				
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Independent Power Producers</b>					
NYPA Flynn .....	1,250.2	1,068.9	1,229.4	1,171.9	1,212.7
Other <sup>2</sup> .....	1,811.3	1,756.3	1,490.6	1,373.1	1,332.2
Subtotal IPPs.....	3,061.5	2,825.2	2,720.0	2,544.9	2,544.9
NYPA Off-Island: Fitzpatrick & Gilboa .....	1,524.8	873.0 <sup>5</sup>	1,072.7	1,186.1	1,126.3
Off-Island Purchases <sup>3</sup> .....	1,080.2	2,362.6	4,086.8	3,916.1	2,950.0
Other Purchases <sup>4</sup> .....	1,050.0	894.9	566.8	1,217.2	1369.2
Total Purchases.....	6,716.5	6,955.7	8,446.3	8,864.3	7,990.4

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

<sup>2</sup> Various suppliers or vendors.

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

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

<sup>5</sup> Reflects the termination of capacity agreement with Fitzpatrick during 2003.

## New Power Supply Resources

LIPA announced in May 2004 a comprehensive energy resource plan that will add over 1,000 megawatts (MW) of new capability under contract to LIPA over the succeeding four to six years. LIPA's plan is designed to help meet the region's growing demand for electricity in the most cost efficient way possible.

The comprehensive energy resource plan contained five key elements: (1) energy efficiency and demand reduction; (2) renewables and distributed generation; (3) additional on-island power supply; (4) new on-island "base-load" capacity; and (5) a new cable from New Jersey to Long Island capable of delivering capacity and/or energy.

New resources added during the five-year period ended December 31, 2006 are shown in the chart below. In addition LIPA has entered into an agreement with Neptune Regional Transmission System LLC to purchase 660 MW of capacity over an undersea high voltage cable that has been installed between Sayreville, New Jersey and Levittown, New York. The cable is currently being tested and will permit LIPA to import 660 MW of power and related energy from the Pennsylvania, New Jersey and Maryland markets. LIPA also entered into an agreement with Caithness Long Island LLC ("Caithness") to acquire 286 MW from a 326 MW combined cycle plant under construction by Caithness and expected to be in operation no later than 2009.

### Resources Added During 2002 – 2006

<u>Location</u>	<u>Vendor</u>	<u>Number of Units</u>	<u>Capacity (MW)<sup>1</sup></u>
Babylon (2005)	Pinelawn Power LLC	1 <sup>2</sup>	75
Oyster Bay (2005)	Bethpage Energy Center 3 Turbine, Inc.	1 <sup>2</sup>	77
Freeport (2004)	Village of Freeport	1	50 <sup>3</sup>
Freeport (2004)	Equus	1	47
Greenport (2003)	Global Common	1	52
Bayswater (2003)	FPL Energy	1	54
Jamaica Bay (2002)	FPL Energy	1	55
Bethpage (2002)	Calpine <sup>5</sup>	1	47
Glenwood Landing (2002)	KeySpan	2	70 <sup>4</sup>
Port Jefferson (2002)	KeySpan	2	79
Shoreham (2002)	PPL Global	2	79
Pilgrim (2002)	PPL Global	2	73
New England	Bear Swamp Power	Various	330

<sup>1</sup> Summer capacity based on 2006 DMNC test results.

<sup>2</sup> Combined cycle

<sup>3</sup> LIPA contracts for 10 MW of capacity.

<sup>4</sup> Limited to 79.9 MW by permit.

<sup>5</sup> Contract expired December 31, 2005.

## RATES AND CHARGES

The statute which created the Authority requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Authority; payments in lieu of taxes; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such

resolution as the same become due and payable; and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

LIPA's base retail electric rates generally reflect traditional rate designs and include fixed customer charges for all customer classes, reasonable energy rates for all customer classes except lighting, and reasonably differentiated demand charges for non-residential customer classes (greater than seven kW). Economic development and load retention incentives are provided to a small number of commercial customers. Miscellaneous service charges, pole attachment charges, and rental rates are also assessed on a monthly basis. In addition, the Authority's charges include a Fuel and Purchased Power Cost Adjustment ("FPPCA"), a PILOT payments recovery rider, a rider providing for the Shoreham Credits and the Suffolk Surcharge. On June 22, 2006, the Board of Trustees approved a revision to LIPA's base schedule of rates to include in the FPPCA substantially all elements of the fuel and purchased power costs previously recovered through the base rates as determined at the time of LIPA's initial tariff. This change, which was effective for all bills issued on and after July 5, 2006, substantially consolidates fuel and purchased power costs in the FPPCA which is shown separately in the bills sent to customers but does not otherwise affect the amounts billed to customers.

### **Fuel and Purchased Power Costs**

LIPA's FPPCA provides for the recovery of fuel and purchased power costs in the period incurred, in amounts sufficient to allow the Authority to earn a financial target of \$75 million with a variance of \$50 million above or below such amount in each year. Should fuel and purchased power prices change such that LIPA would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can LIPA recover an amount that exceeds its fuel and purchased costs incurred.

As a result of lower than anticipated fuel and purchased power costs, the Authority decreased the FPPCA in January 2006 by \$24 million annually. In October 2006, the FPPCA was decreased by an additional \$161 million followed by an additional \$71 million annual reduction in February 2007.

Litigation has been commenced against the Authority challenging its rates and the FPPCA surcharge. See "LITIGATION" below.

On May 3, 2006, LIPA voluntarily filed two petitions with the New York Public Service Commission ("PSC") requesting a review of the reasonableness and appropriateness of the costs recovered through the FPPCA including the appropriateness of its charges to customers and seeking a confirmation that LIPA is treating fuel and purchased power costs properly and similar to other New York electric companies. The first petition sought a declaratory ruling regarding the PSC's interpretation of its rule on escalation clauses to the effect that utilities may automatically recover increased fuel and purchased power and other costs through escalation clauses. The second petition asked the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, also on June 20, 2006, the PSC issued an Order declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. The PSC noted that LIPA is not subject to PSC jurisdiction except in very limited circumstances unrelated to ratemaking, and LIPA's rates, services and practices are not governed by, and need not comply with, the provisions of the Public Service Law and PSC's regulations. A Petition for Rehearing of the PSC's order was filed on July 19, 2006. On November 13, 2006, the PSC issued an Order Denying Petition for Rehearing. The PSC stated in the Order that the relief sought by the Petition for Rehearing -- full review of LIPA's rates and practices

-- is not within the PSC's jurisdiction, and authority to grant that relief has not been granted to the PSC by the State Legislature. In a separate letter to LIPA at the time the PSC declined to review the FPPCA calculations, the Chairman of the PSC offered technical assistance to LIPA in procuring and overseeing an independent consultant to perform a review of the FPPCA, should LIPA choose to pursue that option. By letter dated June 19, 2007, LIPA requested that the PSC review increases in its base rates or increases effected through operation of the FPPCA which increase LIPA's total retail revenues in an amount equal to or greater than 2.5% of the prior year's total retail revenues. Pursuant to LIPA's proposal, the PSC would have the authority to reject a proposed rate increase only if the PSC finds it to be arbitrary, capricious, in violation of law, or not set at the lowest level consistent with sound fiscal and operating practices of the Authority and which provide for safe and adequate services.

To help protect its customers from significant market price fluctuations for the purchase of fuel oil, natural gas and electricity, LIPA uses derivative financial instruments, which are recorded at their market value. Effective with the 2003 modifications to the FPPCA, any unrealized gains and losses derived from these derivatives are deferred as a regulatory asset or regulatory liability until realized, at which time they are included in current period results as a reduction to or as a component of fuel and purchased power. Prior to the 2003 modifications, unrealized gains and losses were included in fuel and purchased power expense, but were not included in the FPPCA calculation until realized.

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

## **BILLING AND COLLECTIONS**

At December 31, 2006, the Authority had approximately 1.1 million customers in its service area. Prior to 2003, approximately 40% of the customers received a single bill for both electric service from LIPA and natural gas service from KeySpan Energy Corporation ("KeySpan") which acquired the natural gas distribution business from LILCO. During 2003, LIPA successfully separated the bills so that customers receive one invoice from LIPA for electric service and a separate bill from KeySpan for gas service. This separation alleviated significant confusion within the customer population, helped solidify the LIPA name and provided LIPA with clearer information with respect to customer payments.

At the time of the LIPA/LILCO Merger on May 28, 1998, the 12-month revolving write-off of electric accounts amounted to 0.72% of sales on a six-month lag basis. Since then, the write-off experience has improved. For the 12-month periods ended December 31, 2002, December 31, 2003, December 31, 2004, December 31, 2005 and December 31, 2006 the rates were 0.35%, 0.35%, 0.44%, 0.57% and 0.49%, respectively.

## **LITIGATION**

LIPA is involved in numerous actions arising from the ordinary conduct of its business both prior to and subsequent to the LIPA/LILCO Merger including environmental claims brought by governments and individual plaintiffs alleging that LIPA is responsible for all or a portion of the clean-up costs or personal injuries or damages as a result of the alleged use, release or deposit of hazardous substances,

including asbestos. While LIPA cannot presently predict the costs of such pending claims, or additional similar claims which may arise in the future, LIPA believes that such litigation, in the aggregate, will not have a material adverse effect on the business or the affairs of the Authority or LIPA. See the Authority's Consolidated Financial Statements for the years ended December 31, 2006 and 2005, Note 12 for a description of certain litigation in which LIPA is involved, including litigation challenging its rates and the FPPCA surcharge. The appeal of the New York State Supreme Court's dismissal of the class action lawsuit filed in 2006 challenging the FPPCA surcharge referred to in Note 12 was perfected by plaintiffs on May 1, 2007. On June 1, 2007, LIPA filed its response. Plaintiff's reply was filed June 10, 2007. In addition, Suffolk County has commenced litigation against the New York State Public Service Commission seeking to force it to review LIPA's rates. LIPA is not a party to this litigation but is a party to a similar lawsuit commenced by New York State Assemblyman Marc Alessi on which argument was held before the Albany Supreme Court on June 8, 2007.

### **STRATEGIC ORGANIZATION REVIEW**

In December 2005, the Authority, after an extensive analysis, announced that it would remain in its current structure as a governmental authority and retain its public/private partnership model. The Authority also announced that, in connection with this determination, it had reached an agreement in principle with KeySpan to (i) substantially amend the MSA between the Authority and KeySpan Electric Services LLC and extend its term to December 31, 2013 (ii) settle certain disputes with KeySpan and the KeySpan Subs and (iii) provide the Authority with an option to acquire one or both of KeySpan's Barrett and Far Rockaway generating facilities with a combined capacity of 450 megawatts. In January 2006, prior to the KeySpan proposed acquisition by National Grid PLC (described below), LIPA entered into definitive agreements with certain of the KeySpan Subs to amend the MSA and certain other Operating Agreements. LIPA also entered into a Settlement Agreement, dated as of January 1, 2006 (the "2006 Settlement Agreement"), with KeySpan and certain of the KeySpan Subs to resolve certain outstanding disputes. LIPA will receive approximately \$120 million in payments or credits pursuant to the 2006 Settlement Agreement. LIPA also entered into an option agreement (the "2006 Option Agreement") with KeySpan Generation LLC (GENCO) which provides LIPA with an option (the "2006 Purchase Option"), exercisable until the later of December 31, 2007, or 180 days following the effective date of the Operating Agreements (defined below), to acquire the Barrett and/or Far Rockaway plants from GENCO. In the event that LIPA acquires either or both of such plants, LIPA and KeySpan have agreed that KeySpan, acting through a subsidiary to be designated, will operate and maintain such plant(s) until it is retired or repowered.

Such agreements are subject to approval by the New York State Comptroller and, as to form, by the New York State Attorney General and are also subject to the condition that each of the 2006 Settlement Agreement, the 2006 Option Agreement and the amendment to the Management Services Agreement must become effective or none will become effective. If such agreements become effective, the Authority's existing option to acquire the former LILCO on-Island generation consisting of 53 generating units at 13 locations totaling approximately 4,000 megawatts (the "GPRA Option") will expire. However, if such agreements do not become effective, the Authority will have 90 days to exercise the GPR A Option. The Authority does not expect the Comptroller or the Attorney General to take action on this matter until after the Authority resolves certain matters regarding the proposed acquisition of KeySpan by National Grid as described below.

On February 27, 2006 KeySpan announced a definitive agreement under which KeySpan would be acquired by an affiliate of National Grid plc, a company organized under the laws of England and Wales ("National Grid"). The transaction is subject to various regulatory approvals. In the event there is a change of control of KeySpan, the Authority and LIPA would have the option of canceling their

contracts with KeySpan and the KeySpan Subs. The Authority announced in March 2007 that it had reached an agreement in principle with National Grid regarding the acquisition.

On June 6, 2007, the Authority's Board of Trustees authorized the execution of an agreement with National Grid and KeySpan in which the Authority and LIPA agreed to waive their change of control option in exchange for certain payments and other considerations. The Board of Trustees also authorized the execution of certain other agreements with National Grid and KeySpan pursuant to which (i) the January 2006 amendment to the MSA would be amended to address concerns LIPA has regarding reliability and potential conflicts of interest raised by the proposed acquisition of KeySpan by National Grid; (ii) the Option Agreement would be amended to permit LIPA to purchase at book value the combustion turbines at the E.F. Barrett site in addition to the E.F. Barrett and Far Rockaway steam generating power plants; (iii) a second Option Agreement would be entered into to permit LIPA to purchase at 1.25 times book value one or both of the combustion turbines at the Shoreham and Wading River sites; (iv) LIPA will obtain a right of first refusal to purchase, on substantially the same terms as offered, all (but not less than all) Genco generating facilities which Genco may decide to sell to a foreign or foreign-controlled entity and (v) KeySpan's agreement to provide certain interruptible gas transportation services would be amended in certain respects including to extend the termination date from November 2009 to May 28, 2013. As of the date of this Annual Report these agreements have not been executed pending the resolution with Keyspan of certain matters which arose after the Board of Trustees approved the agreements. If and when executed, these agreements will not be effective until required approvals from the Comptroller and Attorney General are obtained.

#### **OTHER**

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

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

During 2006, the Authority issued certain of its Electric System General Revenue Bonds and used a portion of the proceeds to provide for the redemption of certain of its outstanding Electric System General Revenue Bonds and certain of its outstanding Electric System Subordinated Revenue Bonds as described on Appendix C.

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

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

By: \_\_\_\_\_  
Name: Elizabeth M. McCarthy  
Title: Chief Financial Officer

DATE: June \_\_\_\_, 2007

**List of CUSIP Numbers**



**Audited Basic Financial Statements**