

MINUTES OF THE NINETY-NINTH MEETING OF THE  
AUDIT AND FINANCE COMMITTEE  
HELD ON APRIL 14, 2008

Pursuant to notice dated April 4, 2008, the ninety-ninth (99th) meeting of the Audit and Finance Committee of the NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY ("Authority") was convened at 10:30 a.m. on Monday, April 14, 2008, in the Authority's conference room at 485 Seventh Avenue, New York, New York; by video conference in the Authority's board room at 17 Columbia Circle, Albany, New York; and by webcast.

The following members of the Committee were present in New York, unless otherwise indicated:

Robert B. Catell, Chair

Vincent A. DeIorio, Esq., *ex officio*

Jay L. Gottlieb, Vice-Chair

George F. Akel, Jr. (*by video conference from Albany*)

Also present were Authority Members Parker D. Mathusa and Garry A. Brown; Paul D. Tonko, President and CEO; Robert G. Callender, Vice President for Programs; Jeffrey J. Pitkin, Treasurer; Hal Brodie, Esq., General Counsel; Jacquelyn L. Jerry, Esq., Deputy Counsel and Secretary to the Audit and Finance Committee; Mark B. Mitchell, Director of Internal Audit; John V. Connorton, Jr., Esq., and James R. Eustis, Esq., from Hawkins Delafield & Wood, LLP; Brian Betancourt, Esq., from Dewey & LeBoeuf LLP; Howard Coon from Energy East Corporation; Sigmund Peplowski from the New York State Public Service Commission; and various other staff of the Authority.

As Mr. Catell was unavoidably delayed, Mr. Gottlieb, Vice Chair of the Committee, called the meeting to order and noted the presence of a quorum. The first item on the agenda

concerned the approval of the minutes of the ninety-eighth (98th) meeting of the Committee held on September 24, 2007.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the minutes of the ninety-eighth (98th) meeting of the Committee held on September 24, 2007, were approved.

Mr. Gottlieb said that the next item on the agenda concerned a report on a preliminary assessment of fraud risks and related internal controls. Jeffrey J. Pitkin, the Authority's Treasurer, explained that Dorfman – Robbie Certified Public Accountants ("CPAs"), an independent public accounting firm, was engaged to review the adequacy of the Authority's policies and procedures concerning fraud risk assessment, fraud prevention, and fraud detection methods. The Authority is pleased with the outcome of this report. The report states that the Authority has created effective policies and procedures and an appropriate organizational culture to address fraud risks. The report also includes several suggestions for further improving controls, which management has largely agreed to implement. One suggestion involves a change in the process for reviewing and approving new vendors. In response to this suggestion, staff will be assessing the credibility of vendors by performing an Internet search on a sample basis, focusing on vendors who appear to pose a higher risk of being a fictitious vendor.

Another suggestion is for the Authority to monitor vendor database change reports to ensure that changes to vendor information are properly authorized. Staff have implemented this suggestion and are investigating the creation of similar reports with respect to other changes in the accounting system.

Another suggestion is to have more than one staff person involved in opening solicitations, and this recommendation has been implemented.

Furthermore, the report suggested that the Authority conduct contract audits across all program areas, not just research, development, and demonstration contracts. This recommendation is being implemented.

Other changes include conducting more on-site contract audits; expanding the new employee hiring practice by including a verification of employment history and a criminal background check; requiring mandatory staff vacations and job rotation for high financial risk positions and other decision making positions within the Authority; and increasing employee dishonesty insurance coverage limits.

A final suggestion concerns evaluating whether sufficient internal audit resources are being provided and being used effectively to evaluate the adequacy of internal controls. This coverage and the benefits accruing from internal audit activities can be better assessed in April 2009 for the implementation of the proposed fiscal year 2008-09 internal audit plan. In the interim, management has worked with the Director of Internal Audit to reassign certain activities that prevented the completion of last year's internal audit plan. Management recommends that the Committee reassess coverage in April 2009, based upon the results accruing from the completion of the 2008-09 Audit Plan.

Mr. Gottlieb commented that the report confirmed the Authority's good business practices, but the organization must remain focused on improving its processes when appropriate and finding a best practice for ensuring the effectiveness of the internal audit process.

Mr. Gottlieb asked Mr. Pitkin to discuss the next item on the agenda, which concerned a report on Authority tax compliance. Mr. Pitkin stated that Toski, Schaefer & Co., CPAs, were hired to review the Authority's compliance with various tax reporting, tax withholding, and tax payment requirements. Overall, the Authority is complying with the requirements. The report does offer suggestions for areas where compliance can be improved or strengthened, however.

One suggestion is that the Authority consider retaining a benefit plan tax adviser for the purpose of apprising it no less frequently than annually of changes in applicable laws and regulations. This would ensure that all benefit plans are written, designed, and operating in compliance with the most recent statutory requirements. Staff is investigating the costs and benefits of this recommendation. (During this discussion, Mr. Catell arrived.)

Additionally, the report recommended that the Authority use an Internal Revenue Service (“IRS”) published table to determine the value of pre-tax employee contributions for life insurance, and different IRS table with respect to non-resident-alien Federal income tax withholding. These recommendations are being implemented.

A further recommendation suggests issuing Form 1099-Gs for taxable grants or subsidies in excess of \$600 that are paid annually to any one entity for certain energy projects. Due to the complex nature of this subject matter and the many different programs the Authority offers, Dorfman-Robbie CPAs has been hired to provide a more detailed analysis of the process for issuing 1099-Gs and, based on the results, the Authority will make necessary changes to its process in accordance with IRS regulations.

Other recommendations involve filing a refund application for motor fuel taxes paid based on annual corporate fleet vehicle gasoline purchases, and pursuing a request for a Private Letter Ruling from the IRS on whether project recoupment income constitutes unrelated business income, which could be subject to Federal and State income tax. Staff will annually review the cost benefits of requesting the refund and have asked Dorfman-Robbie CPAs to provide a more detailed review of the Private Letter Ruling issue.

Lastly, the report recommends issuing Form 1099-MISC for reimbursed travel expenses in excess of \$600 paid annually to Technical Evaluation Panel members and Board Members, and this recommendation will be implemented next year.

Mr. DeForio commended staff on the results of these reviews, but commented that the Committee should reassess the effectiveness of its internal audit efforts at the April 2009 meeting.

Mr. Catell said that the next item on the agenda concerned the independent audit of the Authority's financial statements for fiscal year 2006-07. Mr. Pitkin stated that pursuant to Section 2802 of the Public Authorities Law, the Authority's independent auditor is required to report to the Committee on a timely basis: all critical accounting policies and practices to be used; all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management; and other material written communications between the auditors and management. Consistent with these requirements, John Schiavone, Audit Engagement Partner with Lumsden & McCormick, addressed the Committee by telephone from his office in Buffalo, New York.

Mr. Schiavone gave a detailed presentation on all aspects of the audit, including a detailed description of the accounting standards that would be used. A summary of his presentation is that the independent audit will begin at the end of April 2008 and will be completed by the middle of May 2008. The auditors plan to issue drafts of the report by the June 2008 Audit and Finance Committee and Board Meetings and will issue a final report following the meetings. The audit will follow U.S. auditing standards and will: assess and test controls over payroll procedures, procurement procedures and disbursements relating to contracts; review revenues, receivables and expenditures allocation by program; assess accrued liabilities; review cash and investments; and review financial reporting.

Mr. Pitkin asked whether the Committee had any guidance with respect to the rotation of audit partners. The Committee members concurred that staff should analyze this issue from legal and policy perspectives, look at what other public authorities are doing, and then report their findings to the Committee.

Mr. Catell then called upon Mark B. Mitchell, Director of Internal Audit. Mr. Mitchell explained that the Committee members had been provided with an Annual Internal Audit Report that summarizes his activities over the last fiscal year. Mr. Mitchell said that, earlier this year, he provided the Members with an oral report on the results of an audit of the contract unit's process for reviewing and accepting contractor indirect cost rates. The process for certifying indirect rates has improved following implementation of recommendations contained in an audit issued by the State Comptroller's Office in early 2006, but further improvements were recommended by Mr. Mitchell and are in the process of being implemented.

With respect to an audit of the Authority's invoice process, the audit found that invoices are being processed consistent with existing policies and procedures and that the controls in place are operating as intended. No significant exceptions were identified. Mr. Mitchell added, however, that he found that the Authority places a high degree of reliance on project managers to review and approve invoices. The audit neither included an evaluation of the degree to which Authority management should be concerned about this high degree of reliance nor did it evaluate the use of implementation contractors that review and forward documentation that results in a relatively large number of incentives being paid to program applicants. The audit recommends further evaluation of these practices. In addition, the audit identified opportunities to improve project managers' understanding of how certain functions operate within the electronic invoice review process. This included conducting periodic, "refresher" training and changes instituting processes that would permit project managers to more closely monitor invoices that have not yet been billed or paid. More timely invoicing could lower the amount of the Authority's accounts payable. Management is in agreement with the recommendations.

When the Internal Audit Plan for Fiscal Year 2007-08 ("2007-08 Plan") was presented to the Committee members for approval, it was noted that it was subject to change based on changing circumstances. There were four significant factors that resulted in completing significantly fewer audits than had been approved. These include, according to Mr. Mitchell, an overly ambitious 2007-08 Plan; a delay in commencing the first audit due to Mr. Mitchell's position that he had an ethical obligation to provide documentation on a confidential

investigation to other State agencies that were involved in the matter; under-estimating the amount of time that would be required to conduct the first audit due to its complexity; and his investigation of nine unplanned complaints.

After several discussions with management and after a discussion with Mr. Catell, Mr. Mitchell said that he has agreed to rebalance Internal Audit activities so that most of his time may be spent auditing. Any new complaints, unless it is inappropriate to do so because of the nature of the complaint, will be delegated by the General Counsel to an attorney who will act as the lead person responsible for overseeing the investigation of the matter.

In response to comments from Mr. Catell and Mr. Gottlieb, both Mr. Pitkin and Mr. Brodie assured the Committee members that all complaints will be reviewed on a case-by-case basis to ensure objectivity and independence.

Mr. Catell then indicated that the next agenda item concerned approval of the Internal Audit Plan for Fiscal Year 2008-09 ("2008-09 Plan"). Mr. Mitchell stated that the proposed 2008-09 Plan includes an emphasis on ensuring that internal controls are adequate and effective in areas where the Authority is managing some of its most significant risks. The proposed 2008-09 Plan includes five audits relating to topics that are of high interest to the Authority. It is based upon a risk assessment that Mr. Mitchell said he recently conducted. It carries forward three audits that were part of last year's audit plan, but were not completed for various reasons: an entity-wide transactions review; a review of the Multifamily Performance Program; and a review of information technology ("IT") security controls and a vulnerability assessment. Two additional audits will review newer deployments programs that carry an inherently higher level of risk than those that have been in place for a longer period of time. This includes the Renewable Portfolio Standard program and the PeopleSoft Financials implementation.

The Authority is in the process of implementing a significant upgrade to its financial system software. Rather than wait until implementation is complete, Internal Audit is adopting

the newly accepted practice of reviewing and assessing the internal controls, once the project design work is completed and before the programmers start to customize the software.

Mr. Mitchell added that outside consultants will be engaged to provide specialized expertise with respect to the IT planned audits.

Lastly, Mr. Mitchell reported that he will review whether the recommendations contained in past audits are being implemented. An internal policy has been established that commits the Authority to implementing recommendations within twelve months of Internal Audit's receipt of management's written response to the audit. This commitment will be the basis for conducting follow-up reviews.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members, the following resolution was adopted.

#### Resolution No. 331

RESOLVED, that the Audit and Finance Committee approves the Internal Audit Plan for the Fiscal Year 2008-09, as presented at this meeting, in the form submitted to the Committee (attached as Exhibit A).

The next item on the agenda concerned the Authority's financing program and Mr. Catell called upon Mr. Pitkin to discuss this item. Mr. Pitkin explained that, at the January 2008 Board Meeting, the Members were advised that the disruptions in the sub-prime mortgage industry have had an adverse effect on a number of financial institutions, including insurance companies that provide support facilities for bonds issued by the Authority on behalf of various utility companies. This has led to rating agency downgrades for many bond insurers, related increases in bond interest rates, a lack of investors interested in participating in the auction rate bond market, and some bondholders who are unable to sell their bonds. In the past several months, there have been widespread failures of auctions for auction rate securities, including the Authority's 32 auction interest rate series, totaling over \$2.2 billion. It is important to note that

this situation is primarily related to the insurers' downgrades, and all the utilities have been making the required interest payments and no bonds are in default.

Staff has been in contact with each of the utilities with auction rate bonds and has offered the Authority's assistance with respect to these financing issues.

Energy East Corporation ("Company") has contacted the Authority, on behalf of New York State Electric & Gas Corporation and Rochester Gas and Electric Company, and has requested that the Authority consider taking action with respect to 12 different series of outstanding auction rate bonds, totaling more than \$750 million. A copy of the Company's requests, an explanatory memorandum, and a proposed resolution were included in the meeting materials.

First, the Company has requested that the Authority convert two series of bonds to a fixed rate. Conversions are permitted under the existing documents previously approved by the Members and there is no need for further action with respect to this request.

Next, the Company is considering converting certain series of bonds to a different variable interest rate mode and adding a new support facility to each series, such as new letters of credit, while maintaining the bond insurance already in place. These changes are also authorized under the previously approved documents and require no further authorization. Staff will work with the utilities to fulfill these requests.

With respect to the Company's remaining requests, the Members are requested to approve a resolution permitting two types of action. Recently, the Securities and Exchange Commission ("SEC"), the Internal Revenue Service ("IRS"), and the Department of Treasury have provided guidance that authorizes borrowers to participate in their own auctions, while retaining the bond's tax-exempt interest underlying status which will allow the bonds to be remarketed as tax exempt bonds at a later date. The SEC indicated that a borrower may participate in such auctions, provided that there is full disclosure, and the participation is not

inconsistent with the underlying documents. Authority bond documents do not explicitly allow the utilities to participate in their own auctions, therefore, the Members are first asked to approve a resolution that would allow the Authority's Authorized Representatives to execute documents permitting utilities, consistent with the SEC, IRS, and Department of Treasury guidance, to participate in auctions. It is anticipated that a completed auction will reduce the interest rate payable on the bonds, while the utility analyzes other possible, long-term alternative options. Before any changes to the documents would be effective, Bond Counsel will have to deliver an opinion stating that the action is permitted by the Indenture and that, except while the utility holds the bonds, for which they will offer no opinion, there will not be an adverse effect on the exclusion of interest on the bonds as a result of the action. The bonds may be taxable to the utility while it holds them.

In response to inquiries by Mr. Catell, Mr. Pitkin indicated that the resolution would allow utilities to participate in their own auctions. John V. Connorton, Jr., Esq., from Hawkins Delafield & Wood, LLP ("Hawkins Delafield"), Bond Counsel to the Authority, indicated that the SEC and the IRS have issued guidance and taken action to facilitate the proposed action, thus the Authority is not alone in considering this option. The guidance makes clear that issuers and borrowers are allowed to participate in auctions and that this will not be viewed as manipulating the market.

In response to an inquiry from Mr. DeIorio, Mr. Connorton indicated that the utilities must continue to pay interest on the bonds, even when they are the holder of the bonds. James R. Eustis, Esq., also from Hawkins Delafield, explained that there are two classes of tax-exempt financings. The first class is for governmental issuers such as the New York Power Authority that issue bonds on its own behalf. The second class covers conduit issuers such as the Authority that issue bonds on behalf of third parties. In the conduit structure, when a bond is held by the benefited entity, interest is not exempt for that period of time it holds the bond. When the bond reenters the marketplace and a third party owns the bond, then the tax-exemption reattaches itself to the bond. The Internal Revenue Code addresses this possibility and provides the rules that are to be followed.

Mr. Pitkin added that even though the interest is taxable when the bond is held by the utility, it is anticipated that this intermediate step will reduce the interest rate cost on the bond when compared to the current interest rates in the auction bond market. The Company has indicated that it does not believe that it is in its best interest to simply convert all bonds to a fixed rate at this time and that participation in auctions would be a temporary response to the current market situation.

In response to an inquiry from Mr. DeIorio, Mr. Pitkin stated that there does not appear to be any provisions in the Public Authorities Control Board (“PACB”) approval that are inconsistent with what is proposed. Mr. Pitkin also explained that this action would have no effect on Private Activity Bond Ceiling (“Volume Cap”) and the proposed action is being done to preserve the tax-exempt status.

Mr. Connorton concurred, adding that the participation of the utility in auctions would not constitute a re-issuance and would have no effect on Volume Cap.

There being no further discussion on these points, Mr. Pitkin continued his discussion by stating that the second approval that is proposed concerns the removal of insurance policies. Historically, the auction rate bond market has required bond insurance. However, other variable interest rate modes do not require insurance, although they do require that a liquidity facility, such as letters of credit, be in place. The underlying documents for Authority bonds have regularly permitted the substitution of liquidity facilities, because of market fluctuations in the availability and cost of liquidity facilities. Historically, however, insurance company ratings rarely changed, so the documents are silent on the possible removal of insurance policies. Recent market events have changed this. For example, one insurance company has been downgraded from “AAA” rating to an “A” rating, resulting in lowered bond ratings on utilities’ bonds and higher interest rates payable. Therefore, through the same resolution, the Members would authorize the removal of insurance policies provided that the bonds meet all the requirements of the related documents, including, but not limited to, meeting liquidity facility

requirements. It is expected that removal of insurance would only be done in instances where the removal improves the rating on the bonds, and therefore lowers the applicable interest rate. In addition, removal will only go forward, if there is delivered an opinion of Bond Counsel stating that the action is permitted by the documents and that, except during the period that the bonds are held by the utility, for which they offer no opinion, there will not be an adverse effect on the exclusion of interest on the bonds as a result of the action.

In response to an inquiry by Mr. Akel, Mr. Pitkin responded that the proposed resolution would apply to all utilities and that there is no limit on the term of the authorization. Staff will report to the Members on the status of requests to implement the actions that would be approved through adoption of the resolution.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members, the following resolution was adopted.

#### Resolution No. 332

WHEREAS, New York State Energy Research and Development Authority (“Authority”) has issued numerous adjustable interest rate bonds (collectively, the “Adjustable Interest Rate Bonds”) for the benefit of various electric and gas utilities (each such utility hereinafter referred to as a “Utility”) in the State; and

WHEREAS, pursuant to the terms of the Adjustable Interest Rate Bonds and related trust indentures (each such indenture hereinafter referred to as a “Indenture”) and related participation agreements (each such participation agreement hereinafter referred to as a “Participation Agreement”), Adjustable Interest Rate Bonds (other than when in the auction rate mode, a certain long-term mode, and fixed rate mode, as may be provided in the related Indenture) must be secured by a liquidity facility, i.e., a facility providing for the purchase price for bonds tendered for purchase; and

WHEREAS, Adjustable Interest Rate Bonds must meet certain minimum ratings by major rating agencies pursuant to the related Indenture; and

WHEREAS, municipal bond insurance policies have been obtained by the Utilities to provide additional security for their Adjustable Interest Rate Bonds or to meet the minimum rating requirements; and

WHEREAS, various municipal bond insurance companies have been downgraded by the major rating agencies and such downgrades have adversely affected the ratings on certain Adjustable Interest Rate Bonds and have contributed to failed auctions with respect to Adjustable Interest Rate Bonds in an auction rate mode, resulting in the Utilities' paying higher interest rates; and

WHEREAS, various financial institutions that had provided liquidity facilities have been downgraded by the major rating agencies and the downgrades may adversely affect the availability of letters of credit and other comparable instruments that provide support for meeting the minimum liquidity requirements for certain interest rate modes under the related Indenture and Participation Agreement;

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY AS FOLLOWS:

Section 1. The Chair, Vice-Chair, President, Secretary, Treasurer, and Assistant Treasurer (collectively, the "Authorized Representatives"), upon receipt of a request by or direction from an authorized representative of a Utility, are each authorized to execute such agreements, notices, and other documents, including, but not limited to, the execution of supplemental indentures and supplemental participation agreements, that authorize the Utility to participate in auctions and purchase their Adjustable Interest Rate Bonds in the auction rate mode; provided that there is delivered an Opinion of Bond Counsel stating that such action is permitted by the related Indenture, is permitted under the New York State Energy Research and Development Authority Act (the "Act"), and will not have an adverse effect on the exclusion of interest on such Bonds from gross income for federal income tax purposes, except during the time that such Adjustable Interest Rate Bonds are held by the Utility.

Section 2. The Authorized Representatives, upon receipt of a request by or direction from an authorized representative of a Utility in accordance with the provisions of the related Indenture, are each authorized to execute such agreements, notices, and other documents, including, but not limited to, execution of supplemental indentures and supplemental participation agreements, authorizing cancellation of a municipal bond insurance policy by a Utility, provided that the related Adjustable Interest Rate Bonds meet all other requirements of the related Indenture and Participation Agreement, including, but not limited to, liquidity facility requirements and provided further that there is delivered an Opinion of Bond Counsel stating that such action is permitted by the related Indenture and under the Act, is permitted under the Act, and will not have an adverse effect on the exclusion of interest on such Bonds from gross income for federal income tax purposes.

Section 3. The Authorized Representatives are each hereby further authorized and directed to execute and deliver any such other documents, to do and cause to be done any such other acts and things as he or she may determine necessary or proper for

carrying out, giving effect to, and consummating the transactions contemplated by this resolution.

Mr. Catell then asked Mr. Pitkin to brief the Committee on another request made by Energy East. Mr Pitkin explained that Energy East has also requested that the Authority allow the utility to “warehouse” bonds. This would be accomplished by the utility requesting a conversion to another variable interest rate mode, meeting all the mechanics for accomplishing the conversion, but at the moment of conversion, amending the bond documents to allow the waiver of the requirement that there be a liquidity facility in place during the period that the utility holds the bonds in its own name, and then having the utility hold the bonds, without a liquidity facility, until the market stabilizes when it would revisit its available options. To the best of staff knowledge, this has not been done with respect to any New York State bonds, and staff is still analyzing the issues associated with this proposal. However, staff wanted to have a discussion with the Audit and Finance Committee on this request and get feedback. A representative from the Company was invited to address the Committee and to describe what the Company sees as the benefit of this request. Bond Counsel is also present to answer questions.

Mr. Pitkin then called upon Howard Coon, the Company;s Director of Corporate Finance, to address the Committee. Mr. Coon explained that, on April 7, 2008, the Company sent a letter to the Authority describing its request and that the request evolved over the last several weeks, changing in response to rapid changes in the marketplace. The Company believes that there are two viable options for addressing the current situation. First, it may participate in its own auctions. Second, it may convert its auction rate bonds to a different variable interest rate mode, such as a weekly rate, amend the Indenture to allow the utility to hold, or “warehouse”, the bonds in its name for an indeterminate period of time, without benefit of a liquidity facility, hold the bonds in its name, and then remarket them once the market settles as authorized by the bond documents. Since the Company would merely be paying itself during this period, no liquidity should be necessary. Once the market settles, the company would perform further financial analyses and make a determination on how to remarket the bonds.

Mr. Coon explained that either option would assist the Company in stabilizing its tax-exempt bond portfolio. He said that he believed, however, the first option would be administratively burdensome, because the utilities would be required to disclose to the market their intention to participate in the auctions before the commencement of each auction and then to report the results of each auction, which occur every seven days. Since this would be required with respect to five issues, the Company believes this option would be administratively burdensome. Additionally, there is no guarantee that the utilities would be able to purchase all of their bonds in the first auction. Nonetheless, authorizing both options will provide the utilities with maximum flexibility.

Mr. Coon then called upon the Company's counsel, Brian Betancourt, Esq., from Dewey & LeBoeuf, LLP. Mr. Betancourt explained to the Committee that the Company is requesting maximum flexibility. The Company is not seeking to do anything that is not allowed by the documents. While warehousing has been done across the country, it has not yet been done in New York State. Mr. Betancourt said that he has personally assisted with six other warehousing transactions, three of which involved utility bonds.

In response to an inquiry from Mr. Catell, Mr. Betancourt detailed the warehousing process. Under the existing documents, the utility bonds are in auction rate mode and the Authority may change the interest rate mode at the request of related utility. Under the existing documents, the bond insurer must consent to a change in the interest rate mode, because the bond insurer is currently the sole credit obligor and has control of defaults. With the addition of a liquidity facility, there would be a second credit obligor, which would also claim rights with respect to the bonds. When there is a change in the interest rate mode, bondholders are required to deliver their bonds for purchase and the utilities would provide the funds for purchasing their respective bonds using the required letter of credit. After purchasing the bonds, the utility would cancel the liquidity facility and agree not to remarket, sell, or take any other actions with respect to the bonds, until it complied with the terms of the Indenture, which is to have in place a liquidity facility prior to any remarketing in a different variable interest rate mode.

Mr. Betancourt explained that the bonds would be held by the two utilities until such time as the utilities devised a plan, in accordance with the underlying documents, to place the bonds back in the market. The overall purpose of the transaction is to limit the financial consequences from the continued failure of auctions.

In response to an inquiry from Mr. Catell, Mr. Betancourt explained that the interest rate on the bonds would be calculated pursuant to provisions included in the documents. The utility would be required to pay interest during the period the bonds are warehoused which in essence they would be paying to it self; however, the interest would not be tax-exempt. Mr. Betancourt assured the Committee that based on opinions from various bond counsel, the bonds would still be tax-exempt when they are remarketed.

Mr. Pitkin added that, with respect to the auction participation option, staff was advised that participation in the auction would be done using full disclosure. It was not as clear how the warehousing option would be effected and what type of disclosure would be necessary.

Mr. Betancourt continued the discussion by stating that there were no provisions in the documents prohibiting the utilities from buying their own bonds. Furthermore, there is a mechanic in all variable rate deals that establishes the interest rate. In addition, it would be much easier to put the bonds on the shelf than to participate in auctions. As part of the transaction, the utilities would agree to any provisions that would provide the Members with a level of comfort in approving the warehousing option. He explained that he has spoken to various counsel for the bond insurers and they have indicated that they would not require a liquidity facility while the bonds are held by the utilities, the bonds may be warehoused for a period of up to thirty years, and that, in the other warehousing transactions he has worked on, the transactions were able to be completed solely on the staff level with the advice of bond counsel since the actions were permitted under the documents. He claimed that this is being done daily in other states and is being done without Board approval because the documents allow it.

Mr. Betancourt continued by explaining that the position of the bond issuers has been changing over the last several months. Therefore, the company is seeking as broad an approval as possible, allowing warehousing, letter of credit wraps, and any other changes that are deemed appropriate by staff and Bond Counsel. The Company is looking to minimize the risk associated with the bonds by obtaining and attaching a letter of credit to the bonds at the moment of conversion and to resell in another variable interest rate. However, the utilities have not yet been able to secure liquidity facilities for all of their needs. Accordingly, the Company is requesting adoption of a broad resolution that would provide the most flexibility in dealing with the daily changes in the market including warehousing and that would allow staff and its advisors to determine what can be done and with such parameters as would protect the Authority's name.

In response to an inquiry from Mr. Catell, Mr. Connorton explained that one reason warehousing has not been done yet in New York State is that most public authorities are not conduit issuers and their enabling statutes prevent them from warehousing their own bonds. Similarly, the Authority's enabling statute prevents the Authority from warehousing its own bonds and could not do this with respect to its West Valley bonds. However, in the proposed situation, the utilities are buying Authority bonds and shelving them. The Authority's statutory provisions do not prohibit the transaction being discussed. Additionally, Mr. Connorton confirmed that there are proposals for warehousing taking place in other states, but that these proposals are being evaluated transaction by transaction. He also concurred with Mr. Coon that this marketplace is shifting every day and that his firm is seeing proposals like this in other states.

Mr. Betancourt indicated that the Company is also requesting flexibility because it has negotiated a 364-day revolving credit facility pursuant to which letters of credit may be issued. Under the terms of the overall letter of credit provisions, as soon as there is a borrowing against the revolving credit facility for one conversion, the 364 days start to run. If the bonds cannot be warehoused all at once, a different credit facility would have to be negotiated.

In response to an inquiry from Mr. Akel, Mr. Coon indicated that, if the bond insurers go out of business, with respect to letter of credit-wrapped transactions, the letter of credit bank will provide the credit. Mr. Betancourt added that, in a weekly interest rate mode, bondholders initially look to the letter of credit bank for payment and the letter of credit bank, in turn, looks to the bond insurer and the company for reimbursement. He said that he believed that, if the bond insurer does not exist, then the letter of credit controls the process and from the bondholders perspective this is positive, because letter of credit secured issues have the highest ratings in the marketplace. Regardless, the utilities are still liable for paying even if bond insurers were to go out of business.

Mr. Catell indicated that he believed that the Authority should provide utilities with as much flexibility as possible, while still protecting the Authority and the bondholders.

In response to an inquiry from Mr. Catell, Mr. Pitkin reported that staff have received calls from current bondholders who are experiencing failed auctions. These failed auctions trigger higher interest rates, but bondholders are unhappy with not being able to sell their bonds and get out of the market, even though they are getting the higher interest rates.

Mr. Betancourt concurred that the concern for many bondholders is that they have no ability to sell their bonds.

Mr. Pitkin added that there are considerations other than the amount of the interest payment. While the documents permit the bonds to be converted to multiple interest rates at a utility's option, it triggers a mandatory tender. In the context of participating in auctions, there would be full disclosure. If the company buys the bonds, the issue is whether a bondholder who is receiving the higher interest rate would be displeased when the utility takes those bonds back.

Mr. Betancourt responded that bondholders are advised through the offering document that there is a possibility the interest rate mode may change and added that weekly rate holders have no expectation of holding the bonds until maturity. Mr. Betancourt assured the Committee

members that the Company is not asking permission to do anything outside of what the bondholders know at the time of purchase. Additionally, the utilities have indemnified the Authority in connection with suits brought as a result of the utilities actions.

Mr. Coon added that if the company participated in auctions, that same bondholder would likely get a reduced rate and it would be similar in effect to the warehousing transaction.

Mr. Betancourt added that, while another option available to the utilities is to refund the bonds, this option is expensive and the increased expense could ultimately be passed on to ratepayers. If a utility refunds a series of bonds, any existing bond insurance is terminated under the terms of the policy, but the utility would have to incur other expenses such as underwriting and other fees. This cost of refunding is immense compared to effecting a conversion. Mr. Coon added that this is not an action that the utilities are considering at this time.

In response to an inquiry from Mr. Gottlieb, Mr. Pitkin indicated that the resolution previously approved by the Members do not authorize the process of “warehousing”.

Mr. Betancourt stated that Energy East is requesting a provision be added to permit the warehousing, because the next meeting of the Authority is in June and this delay would cost the utilities’ money.

In response to an inquiry from Mr. Catell, Mr. Pitkin stated that a resolution could be drafted to meet Energy East’s request for flexibility with respect to the warehousing. However, each of the transactions is different and staff would need to review each series of bonds to ensure warehousing is possible under the documents and what specifically needs to be changed. Ms. Jerry added that the documents will need to be changed for each series, but that unanswered questions include how much the documents will need to be changed and whether the Authority will have to receive authorization from the Public Authorities Control Board (“PACB”).

Mr. Catell suggested that the Members pass a resolution permitting warehousing, provided the Authority receives an opinion from Bond Counsel and any required PACB approvals.

Mr. Pitkin indicated that if a resolution is not approved by the Members, the only action the utilities may make prior to the June meeting would be to participate in the auction process, which Energy East believes is more administratively burdensome.

Mr. Betancourt assured the Committee that Energy East and Dewey & LeBoeuf will communicate on a weekly basis with the Authority, Authority Bond Counsel, and bond insurers.

Mr. Catell commented that any resolution might authorize the transaction, but would only go forward after appropriate review by staff, Bond Counsel, and others, as appropriate.

In response to an inquiry from Mr. Gottlieb, Mr. Pitkin indicated that, if a resolution is approved in accordance with this discussion, the Members would have exercised the appropriate level of governance in delegating the duties.

Mr. Brodie cautioned that staff had had limited time to review this and is not recommending action as this time. However, the Authority recognizes Energy East's position. If the Members are comfortable with providing the Officers with the ability to proceed with warehousing, when and if they do become comfortable, then the Officers will proceed in that direction.

Mr. DeIorio stated that the first resolution considered by the Committee was regular business. However, this resolution is more difficult, because the Members are being asked to approve a concept that both had to be sufficient and adequate to provide assistance to Energy East, but also must be done in a manner that protects the Authority.

Mr. Pitkin remarked that the Authority's role is to assist utilities with lower-cost financing on a tax-exempt basis. In the current market, the tax-exempt interest rates for auction interest rate bonds are high, in comparison to historical auction interest rates. The Authority is attempting to assist in this situation.

Mr. DeLorio added that what role the PACB should play in this transaction is not clear and their PACB concerns about a transaction that changes the bonds from tax-exempt to taxable might be an issue.

Mr. Connorton explained that the Authority's bonds are revenue bonds paid solely by the revenue of the utilities. On the cover of the offering statement provided to bondholders, it states that the bonds are not a debt of the State. Regardless of the decision of the Members, the Authority's issuance of bonds does not affect the credit of the State. Due to the current market conditions, the greatest problem is that in the long range, the market is going to be more concerned with the underlying credit of the borrowers, but concurred that any PACB concerns should be addressed.

Mr. Coon stated that the utilities are currently paying interest rates that are 50% higher than in the past. Ultimately, if the utilities are able to warehouse the bonds, Mr. Coon stated that they will pay interest on the bonds at a lower cost than if they continue to experience failed auctions.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members, the following resolution was adopted.

#### Resolution No. 333

RESOLVED, that the Audit and Finance Committee requests that staff draft a resolution authorizing warehousing of bonds subject to the appropriate review by staff, the issuance of an opinion by the Authority's Bond Counsel, and the approval of other relevant New York State entities.

Mr. Catell indicated that the last agenda item concerned other business. There being no further business, upon motion duly made and seconded, and by unanimous voice vote, the meeting was adjourned.

Respectfully submitted,

A handwritten signature in cursive script that reads "Jacquelyn L. Jerry".

Jacquelyn L. Jerry  
Secretary to the Committee