

\$319,970,000

Puerto Rico Electric Power Authority

\$136,105,000 Power Revenue Refunding Bonds, Series OO

\$88,595,000 Power Revenue Refunding Bonds, Series PP

\$95,270,000 Power Revenue Refunding Bonds, Series QQ (Forward Delivery)

The Power Revenue Refunding Bonds, Series OO (the “Series OO Bonds”), the Power Revenue Refunding Bonds, Series PP (the “Series PP Bonds”) and the Power Revenue Refunding Bonds, Series QQ (the “Series QQ Bonds”) and, together with the Series OO Bonds and the Series PP Bonds, the “Bonds”) of Puerto Rico Electric Power Authority (the “Authority”) are being issued pursuant to a Trust Agreement, dated as of January 1, 1974, as amended, with U.S. Bank Trust National Association, New York, New York, successor trustee (the “1974 Agreement”).

The Bonds, the outstanding bonds previously issued under the 1974 Agreement and any additional bonds that the Authority may from time to time issue under the 1974 Agreement are payable solely from the net revenues of the Authority’s electric generating, transmission and distribution system. The Bonds will have the following characteristics:

- The Bonds will be dated their date of delivery.
- The Bonds will be registered under the book-entry only system of The Depository Trust Company (“DTC”). Purchasers of the Bonds will not receive certificates evidencing the Bonds.
- Interest on the Series OO Bonds and the Series PP Bonds will be payable on January 1, 2005 and on each July 1 and January 1 thereafter. Interest on the Series QQ Bonds will be payable on July 1, 2005 and on each January 1 and July 1 thereafter.
- The Series OO Bonds and the Series PP Bonds will be subject to optional redemption, commencing on July 1, 2014, as described herein. The Series QQ Bonds will not be subject to optional redemption.
- The inside cover page contains information concerning the maturity schedule, interest rates and yields of the Bonds.
- The scheduled payment of principal of and interest on some of the Bonds will be insured by CDC IXIS Financial Guaranty North America, Inc., Financial Guaranty Insurance Company, or XL Capital Assurance Inc., as indicated on the inside cover page of this Official Statement.
- In the opinion of Squire, Sanders & Dempsey, L.L.P., Bond Counsel, under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, and, in the case of the Series QQ Bonds, assuming among other matters no change in law, as described in this Official Statement in “Delayed Delivery of the Series QQ Bonds” under *Plan of Financing*, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. Interest on the Bonds may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. For a more complete discussion of the tax aspects of the Bonds, see *Tax Matters* herein.
- The Authority expects that the Series OO Bonds and Series PP Bonds will be available for delivery to DTC on or about August 26, 2004. The Authority expects that the Series QQ Bonds will be available for delivery to DTC on or about April 4, 2005.

The issuance of the Bonds and the purchase of the Bonds by the Underwriters are subject to the approval of legality by Squire, Sanders & Dempsey L.L.P., Bond Counsel, and certain other conditions. O’Neill & Borges, San Juan, Puerto Rico, will pass upon certain legal matters for the Underwriters.

The Bonds are not a debt or obligation of the Commonwealth of Puerto Rico or any of its municipalities or other political subdivisions, other than the Authority, and neither the Commonwealth of Puerto Rico nor any such municipalities or other political subdivisions, other than the Authority, shall be liable for the payment of the principal of or interest on the Bonds.

**JPMorgan
Banc of America Securities LLC
Lehman Brothers
UBS Financial Services Inc.**

**Merrill Lynch & Co.
Citigroup
Raymond James & Associates, Inc.**

**Morgan Stanley
Goldman, Sachs & Co.
Samuel Ramírez & Co.
Wachovia Bank, National Association**

\$319,970,000

Puerto Rico Electric Power Authority

\$136,105,000 Power Revenue Refunding Bonds, Series OO

<u>Maturity (July 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>
2005	\$ 3,140,000	4.000%	1.480%
2006	\$ 1,325,000	4.000%	1.880%
2007	\$ 1,375,000	4.000%	2.240%
2008	\$ 1,435,000	4.000%	2.620%
2009	\$ 1,490,000	5.000%	2.920%
2010	\$ 3,535,000	5.000%	3.140%
2011**	\$ 1,625,000	5.000%	3.300%
2012**	\$ 1,710,000	5.000%	3.460%
2013**	\$57,625,000	5.000%	3.620%
2014**	\$23,345,000	5.000%	3.730%
2014 ⁺	\$36,685,000	5.000%	3.600%
2015 ⁺	\$ 2,815,000	5.000%	3.710%*

\$88,595,000 Power Revenue Refunding Bonds, Series PP

<u>Maturity (July 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>
2005	\$ 1,175,000	3.000%	1.480%
2006	\$ 200,000	4.000%	1.880%
2007	\$ 205,000	4.000%	2.240%
2008	\$ 215,000	4.000%	2.620%
2009	\$ 225,000	4.000%	2.920%
2010	\$ 235,000	4.000%	3.140%
2011**	\$ 240,000	3.200%	3.300%
2012**	\$ 250,000	3.375%	3.460%
2013**	\$ 260,000	3.500%	3.620%
2014**	\$ 265,000	3.600%	3.730%
2015**	\$ 275,000	3.750%	3.840%
2016 ⁺	\$ 285,000	3.700%	3.770%
2017 ⁺	\$ 300,000	3.750%	3.860%
2018 ⁺	\$ 310,000	3.800%	3.950%
2019 ⁺	\$ 320,000	3.900%	4.040%
2020 ⁺	\$ 335,000	4.000%	4.130%
2021 ⁺	\$ 345,000	4.125%	4.230%
2022 ⁺	\$19,290,000	5.000%	4.320%*
2023 ⁺	\$20,260,000	5.000%	4.400%*
2024 ⁺	\$21,270,000	5.000%	4.470%*
2025 ⁺	\$22,335,000	5.000%	4.530%*

\$95,270,000 Power Revenue Refunding Bonds, Series QQ (Forward Delivery)

<u>Maturity (July 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>
2013 ⁺⁺	\$13,500,000	5.250%	3.920%
2014 ⁺⁺	\$14,685,000	5.250%	4.030%
2015 ⁺⁺	\$15,450,000	5.500%	4.130%
2016 ⁺⁺	\$16,295,000	5.500%	4.210%
2017 ⁺⁺	\$17,195,000	5.500%	4.280%
2018 ⁺⁺	\$18,145,000	5.500%	4.350%

* Yield to July 1, 2014 call date.

** Insured by CDC IXIS Financial Guaranty North America, Inc.

⁺ Insured by Financial Guaranty Insurance Company.

⁺⁺ Insured by XL Capital Assurance Inc.

No dealer, broker, sales representative or other person has been authorized by the Authority or the Underwriters to give any information or to make any representations, other than those contained herein, and, if given or made, such other information or representations must not be relied upon as having been authorized by the Authority or any Underwriters. This Official Statement does not constitute an offer to sell, or the solicitation of an offer to buy, nor shall there be any sale of the Bonds offered hereby by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information set forth herein has been obtained from the Authority, the Commonwealth of Puerto Rico, and other official sources that are believed to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation by any Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority or the Commonwealth of Puerto Rico since the date hereof.

The Underwriters have provided the following sentence, as well as the following paragraph, for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of their respective responsibilities to investors under, the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS OFFERED HEREBY AND OF THE AUTHORITY'S OUTSTANDING POWER REVENUE BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CERTAIN STATEMENTS CONTAINED IN THIS OFFICIAL STATEMENT REFLECT NOT HISTORICAL FACTS BUT FORECASTS AND "FORWARD-LOOKING STATEMENTS." THESE STATEMENTS ARE BASED UPON A NUMBER OF ASSUMPTIONS AND ESTIMATES THAT ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES, MANY OF WHICH ARE BEYOND THE CONTROL OF THE AUTHORITY. IN THIS RESPECT, THE WORDS "ESTIMATE," "PROJECT," "ANTICIPATE," "EXPECT," "INTEND," "BELIEVE" AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. ALL PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINIONS, ESTIMATES AND OTHER FORWARD-LOOKING STATEMENTS ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY THESE FORWARD-LOOKING STATEMENTS.

Other than with respect to the information concerning CDC IXIS Financial Guaranty North America, Inc., ("CIFGNA"), Financial Guaranty Insurance Company ("FGIC") and XL Capital Assurance Inc. ("XLCA") contained under the caption "Bond Insurance" of this Official Statement, none of the information in this Official Statement has been supplied or verified by CIFGNA, FGIC or XLCA. CIFGNA, FGIC and XLCA make no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information, (ii) the validity of the Bonds, or (iii) the tax exempt status of the interest on the Bonds.

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INTRODUCTORY STATEMENT

The purpose of this Official Statement of Puerto Rico Electric Power Authority (the “Authority”), which includes the cover page, the Appendices hereto and the information incorporated by reference as set forth below, is to furnish information in connection with the issuance and sale by the Authority of its Power Revenue Refunding Bonds, Series OO (the “Series OO Bonds”), Power Revenue Refunding Bonds, Series PP (the “Series PP Bonds”) and the Power Revenue Refunding Bonds, Series QQ (the “Series QQ Bonds”). The Series OO Bonds, the Series PP Bonds and the Series QQ Bonds are hereinafter collectively referred to as the “Bonds.”

The Bonds will be issued under and secured by a Trust Agreement, dated as of January 1, 1974, as amended (the “1974 Agreement”), between the Authority and U.S. Bank Trust National Association, successor trustee (the “1974 Trustee”). The Bonds, the other Puerto Rico Electric Power Authority Power Revenue Bonds and Power Revenue Refunding Bonds to be outstanding after the issuance of the Bonds, and such additional bonds as may be issued from time to time under the 1974 Agreement, are hereinafter collectively referred to as the “Power Revenue Bonds.”

Payment of the principal of and interest on the Series OO Bonds maturing July 1, 2011 through July 1, 2013, \$23,345,000 principal amount of the Series OO Bonds maturing July 1, 2014, and on the Series PP Bonds maturing July 1, 2011 through July 1, 2015, as indicated on the inside cover page of this Official Statement (the “CIFGNA Insured Bonds”), when due, will be insured by a financial guaranty insurance policy to be issued by CDC IXIS Financial Guaranty North America, Inc. (“CIFGNA”) simultaneously with the delivery of CIFGNA Insured Bonds.

Payment of the principal of and interest on \$36,685,000 principal amount of the Series OO Bonds maturing July 1, 2014, on the Series OO Bonds maturing July 1, 2015, and on the Series PP Bonds maturing July 1, 2016 through July 1, 2025, as shown on the inside cover page of this Official Statement (the “FGIC Insured Bonds”), when due, will be insured by a financial guaranty insurance policy to be issued by Financial Guaranty Insurance Company (“FGIC”) simultaneously with the delivery of the FGIC Insured Bonds.

Payment of the principal of and interest on all of the Series QQ Bonds, as shown on the inside cover page of this Official Statement (the “XLCA Insured Bonds”), when due, will be insured by a municipal bond insurance policy to be issued by XL Capital Assurance Inc. (“XLCA”) simultaneously with the delivery of the XLCA Insured Bonds.

Capitalized terms used in this Official Statement and not defined shall have the meanings given to them in Appendix I, *Definitions of Certain Terms*.

In order to give potential purchasers of the Bonds general information on the Commonwealth of Puerto Rico (the “Commonwealth” or “Puerto Rico”), this Official Statement incorporates by reference the sections under the headings “Introduction” and “The Economy” of the Commonwealth of Puerto Rico Financial Information and Operating Data Report, dated April 1, 2004, which is attached as Appendix I to the Official Statement of the Commonwealth, dated April 30, 2004, relating to the issuance by the Commonwealth of its \$279,240,000 Public Improvement Refunding Bonds, Series 2004 A, and its \$447,875,000 Public Improvement Refunding Bonds, Series 2004 B (General Obligation Bonds), which has

been filed with each nationally recognized municipal securities information repository (“NRMSIR”). The Financial Information and Operating Data Report was not prepared by the Authority, and the Authority does not assume any responsibility for its accuracy or completeness. The Commonwealth does not guarantee the Bonds and is not otherwise responsible for their payment.

Any appendix of an Official Statement of the Commonwealth or any appendix of an Official Statement of any instrumentality of the Commonwealth containing the same information as the Financial Information and Operating Data Report that is filed with each NRMSIR and the Municipal Securities Rulemaking Board (“MSRB”) after the date hereof and prior to the termination of any offering of the Bonds shall be deemed to be incorporated by reference into this Official Statement to the extent set forth in the preceding paragraph and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above described documents or portions thereof incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

OVERVIEW

The Authority supplies virtually all of the electric power consumed in the Commonwealth and is one of the largest municipal utilities in the United States. The Authority was created in 1941 as a public corporation and governmental instrumentality of the Commonwealth. As of March 31, 2004, it served approximately 1.4 million clients and had utility plant totaling approximately \$8.0 billion, including \$2.2 billion of production plant in service and \$3.1 billion of transmission and distribution plant in service, all based on original cost. The Authority’s production facilities, together with two private co-generation facilities with long-term power purchase contracts with the Authority, have a dependable generating capacity of 5,359 megawatts (“MW”). As of March 31, 2004, the Authority had 2,338 circuit miles of transmission lines and 30,106 circuit miles of distribution lines. In September 2003, the Authority realized a historical peak load of 3,499 MW.

For the twelve months ended March 31, 2004, the average percentage of the Authority’s generating capacity available for service (“equivalent availability”), which includes the two co-generation facilities mentioned above, was 81%, up from 72% for fiscal year 1995. Improved availability, together with the Authority’s progress in implementing its capacity expansion plan and improving its transmission and distribution system, have led to gains in the reliability of the Authority’s electrical service to its clients.

Operating Results

During the period from fiscal year 1999 through fiscal year 2003, the number of clients served by the Authority increased at a compound annual rate of 1.4%, and electric energy sales in kilowatt hours (“kWh”) increased at a compound annual rate of 4.0%. During this period, Revenues and Current Expenses increased at a compound annual rate of 12.8% and 15.5%, respectively. Excluding the cost of fuel oil and purchased power, both of which costs are passed on to clients through a separate charge included in electric service rates, Revenues and Current Expenses increased during such period at a compound annual rate of 2.0% and 4.0%, respectively, primarily due to higher energy demand.

During the first nine months of fiscal year 2004, Revenues and Current Expenses increased by 3.5% and 5.3%, respectively, compared to the same period for the prior fiscal year. The increase in Revenues and Current Expenses was mainly due to an increase in energy sales in kWh of 1.8 % and an increase of \$0.0066 per kWh (or 10.4%) in the average price of purchased power by the Authority. Excluding the cost of fuel oil and purchased power, Revenues and Current Expenses increased by 1.1% and 3.7%, respectively, compared to the same period of the prior fiscal year.

Net Revenues increased at a compound annual rate of 6.8% during the period from fiscal year 1999 to fiscal year 2003. For the first nine months of fiscal year 2004, Net Revenues decreased by 1.3% compared to the same period in fiscal year 2003.

Demand for energy is related to the level of economic and business activity in the Commonwealth, energy costs and climatological factors. The Commonwealth Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2003 indicate that the economy registered an increase of 1.9% in real gross product. The Planning Board reports indicate that real gross product decreased by 0.3% during fiscal year 2002, and increased by 1.6% in fiscal year 2001, 3.0% in fiscal year 2000, and 4.1% in fiscal year 1999. For fiscal year 2004, the Planning Board is forecasting an increase in real gross product of 2.9%. Projections of future peak energy demand for the five fiscal year period ending June 30, 2008, prepared by the Authority, show an average annual increase of 3.1%.

The following table summarizes the operating results of the Authority for the five fiscal years ended June 30, 2003 and for the nine-month periods ended March 31, 2003 and 2004. This table presents Net Revenues of the Authority under the provisions of the 1974 Agreement. These calculations of Net Revenues differ in several important respects from the Authority's calculations of changes in net assets prepared in accordance with generally accepted accounting principles. See Schedule II to the Financial Statements for the fiscal years ended June 30, 2002 and 2003 in Appendix II for a reconciliation of the Authority's net income under generally accepted accounting principles with its Net Revenues under the 1974 Agreement.

	Operating Results (dollars in thousands)					Nine Months Ended	
	Fiscal Years Ended June 30,					March 31,	
	1999	2000	2001	2002	2003	2003	2004
Electric energy sales (in millions of kWh).....	16,989	18,145	18,723	19,130	19,887	14,926	15,199
Percentage change from year before	(2.7)	6.8	3.2	2.2	3.9	4.6	1.8
Peak load (in MW).....	3,057	3,133	3,202	3,297	3,376	3,376	3,499
Percentage change from year before	1.2	2.4	2.2	3.0	2.4	2.4	3.6
Total Revenues	\$ 1,563,953	\$ 2,025,284	\$ 2,373,077	\$ 2,193,681	\$ 2,536,250	\$ 1,884,983	\$ 1,951,466
Less: Current Expenses.....	<u>1,052,761</u>	<u>1,466,823</u>	<u>1,722,689</u>	<u>1,566,595</u>	<u>1,871,476</u>	<u>1,384,944</u>	<u>1,457,717</u>
Net Revenues.....	<u>\$ 511,192</u>	<u>\$ 558,461</u>	<u>\$ 650,388</u>	<u>\$ 627,086</u>	<u>\$ 664,774</u>	<u>\$ 500,039</u>	<u>\$ 493,749</u>
Principal and Interest Requirements.....	\$ 348,963	\$ 346,417	\$ 367,796	\$ 392,043	\$ 381,178	-	-
Ratio of Net Revenues to Principal and Interest Requirements.....	1.46	1.61	1.77	1.60	1.74	-	-

System Improvements and Additional Capacity

In order to meet the expected growth in demand, diversify its fuel sources to reduce its historic reliance on oil-fired generating units, and continue to improve the reliability of its service, the Authority has been investing in the improvement, rehabilitation and life extension of its generating, transmission and distribution facilities and has acquired additional capacity pursuant to long-term power purchase agreements with the operators of two privately owned cogeneration facilities.

The Authority entered into a long-term contract with EcoEléctrica, L.P. ("EcoEléctrica") to purchase 507 MW of dependable generating capacity from a natural gas-fired cogeneration plant built by EcoEléctrica and located in Peñuelas, Puerto Rico, which commenced commercial operation on March 21, 2000. The Authority also entered into a long-term contract with AES Puerto Rico, L.P. ("AES-PR") to purchase 454

MW of dependable generating capacity from a coal-fired cogeneration facility built by AES-PR and located in Guayama, Puerto Rico, which commenced commercial operation on November 29, 2002. These contracts allow the Authority to reduce its dependency on fuel oil while passing on to EcoEléctrica and AES-PR the risks of operating the cogeneration facilities. The contracts include these companies' commitment to provide a fixed capacity at a higher availability level than the Authority currently achieves.

The Authority recently obtained the permits required for replacing two 44 MW steam units in San Juan, removed from service in fiscal year 1997, with new generating units that are projected to provide a net total of 464 MW of combined cycle capacity. Construction is scheduled to start during the summer of 2004, and the project is expected to be operational during fiscal year 2006.

The Authority is also expanding its 230 kilovolt ("kV") transmission lines, which add to the stability of the electric system, improve reliability of service to clients, and reduce transmission losses. The Authority is constructing new 230 kV transmission lines to complete the transmission loop on the eastern part of the island. Construction is expected to be completed during fiscal year 2005. In addition, the Authority is constructing a new 230 kV transmission line between the South Coast Steam Plant and the transmission center in Aguas Buenas. The new transmission line is expected to be in service during fiscal year 2007.

Set forth below is a summary of the Authority's historical total capital improvement program and financing sources for the five fiscal years ended June 30, 2003 and the projected capital improvement program and financing sources for the five fiscal years ending June 30, 2008. See "Historical Capital Improvement and Financing Program" and "Projected Five-Year Capital Improvement and Financing Program" under *The System*.

**Capital Improvements
(dollars in thousands)**

Capital Improvements	Fiscal Years			
	1999-2003 Total	% of Total	2004-2008 Total	% of Total
Production Plant	\$ 679,526	33.8%	\$ 808,151	36.7%
Transmission facilities.....	377,291	18.7	520,496	23.6
Distribution facilities.....	623,782	31.0	504,015	22.9
Other ⁽¹⁾	331,717	16.5	369,243	16.8
	<u>\$2,012,316</u>	<u>100.0%</u>	<u>\$2,201,905</u>	<u>100.0%</u>
Financing Sources				
Internally generated funds	\$ 434,031	21.6%	\$ 396,106	18.0%
Borrowed funds	1,578,285	78.4	1,805,799	82.0
	<u>\$2,012,316</u>	<u>100.0%</u>	<u>\$2,201,905</u>	<u>100.0%</u>

(1) Includes land and buildings, general equipment, preliminary surveys and investigations.

PLAN OF FINANCING

Series OO Bonds and Series PP Bonds

The Authority is issuing the Series OO Bonds and the Series PP Bonds pursuant to Section 210 of the 1974 Agreement to refund the following Power Revenue Bonds (collectively, the “Series OO and Series PP Refunded Bonds”) on the redemption dates and at the redemption prices set forth below plus accrued interest to the redemption dates, provided that certain of the Series OO and Series PP Refunded Bonds are being paid at maturity as described below:

Refunded Bonds	Maturity Date	Principal Amount to be Refunded	Interest Rate	Redemption Date	Redemption Price (% of Par)
Series DD	07/01/2005	\$ 10,220,000	5.00%	At maturity	NA
Series HH	07/01/2005	11,335,000	4.25	At maturity	NA
Series S	07/01/2015	4,760,000	6.00	09/27/2004	102
Series U	07/01/2005	440,000	5.50	09/27/2004	102
	07/01/2006	465,000	5.60	09/27/2004	102
	07/01/2007	490,000	5.70	09/27/2004	102
	07/01/2008	520,000	5.75	09/27/2004	102
	07/01/2009	550,000	5.75	09/27/2004	102
	07/01/2014	117,815,000	6.00	09/27/2004	102
Series X	07/01/2005	7,195,000	5.10	At maturity	NA
	07/01/2025	82,205,000	5.50	07/01/2005	100

The refunding will permit the Authority to realize savings on its debt service requirements on Power Revenue Bonds outstanding under the 1974 Agreement. The Authority will deposit the net proceeds of the Bonds with the 1974 Trustee, as escrow agent, under the terms of an escrow deposit agreement for the Series OO Bonds and the Series PP Bonds. The net proceeds will be invested in Government Obligations, the principal of and interest on which when due will provide moneys sufficient to pay the principal or redemption price of the Series OO and Series PP Refunded Bonds, as applicable, and the interest coming due on the Series OO and Series PP Refunded Bonds through their maturity or redemption date, as applicable.

Series QQ Bonds

The Authority is issuing the Series QQ Bonds pursuant to Section 210 of the 1974 Agreement to refund the following Power Revenue Bonds (the “Series QQ Refunded Bonds” and, together with the Series OO and Series PP Refunded Bonds, the “Refunded Bonds”) on the redemption date and at the redemption prices set forth below plus accrued interest to the redemption date, provided that the Series QQ Refunded Bonds maturing on July 1, 2005 are being paid at maturity:

Refunded Bonds	Maturity Date	Principal Amount to be Refunded	Interest Rate	Redemption Date	Redemption Price (% of Par)
Series AA	07/01/2005	\$ 5,450,000 ⁽¹⁾	4.90%	At maturity	NA
Series Z	07/01/2005	1,460,000	5.00	At maturity	NA
	07/01/2013	13,945,000	5.50	07/01/2005	102
	07/01/2014	14,720,000	5.50	07/01/2005	102
	07/01/2016	31,900,000	5.50	07/01/2005	102
	07/01/2021	35,470,000 ⁽¹⁾	5.25	07/01/2005	100

(1) Partial refunding.

The refunding will permit the Authority to realize savings on its debt service requirements on Power Revenue Bonds outstanding under the 1974 Agreement. The Authority will deposit the net proceeds of the Bonds with the 1974 Trustee, as escrow agent, under the terms an escrow deposit agreement for the Series QQ Bonds. The net proceeds will be invested in Government Obligations, the principal of and interest on which when due will provide moneys sufficient to pay the principal or redemption price of the Series QQ Refunded Bonds, and the interest coming due on the Series QQ Refunded Bonds through their maturity or redemption date, as applicable. See “Delayed Delivery of the Series QQ Bonds” below.

Upon the deposit with the 1974 Trustee referred to above, the Refunded Bonds will, in the opinion of Bond Counsel, no longer be outstanding under the provisions of the 1974 Agreement and the Refunded Bonds will thereupon be defeased. In rendering the foregoing opinion, Bond Counsel will rely on the report of The Arbitrage Group, Inc., as the verification agent, dated the date of delivery of the Bonds, relating to the verification of certain mathematical computations with respect to the moneys and Government Obligations deposited with the escrow agent under the terms of the escrow deposit agreements described above.

Delayed Delivery of the Series QQ Bonds

The Series QQ Bonds are expected to be issued on or about April 4, 2005. The obligation of the Underwriters to purchase the Series QQ Bonds is subject to a number of conditions, including (i) receipt of the opinion of Bond Counsel described below, and certain opinions of counsel to the Authority and counsel to the Underwriters, (ii) receipt of a supplement to this Official Statement (the “2005 Supplement”), together with a certificate of the Authority as to the accuracy of this Official Statement as so supplemented and (iii) receipt of the XLCA insurance policy and the absence of any reduction in the rating classification of XLCA’s obligations after the date of this Official Statement, which reduction causes the rating classification of the Series QQ Bonds to be lower than the highest rating classification of the agencies rating such Bonds. The Underwriters have the right (but are not obligated) to waive any failure of the Authority to comply with the conditions described in clause (ii) or (iii) above.

The expected date of issue of the Series QQ Bonds may be postponed if on such date: (i) any extraordinary event shall have occurred or shall exist affecting current national or international economic,

financial or other conditions or affecting the Authority, which, in the reasonable opinion of the Underwriters, materially adversely affects the market for the Series QQ Bonds; (ii) there shall have occurred any outbreak of hostilities or other national or international calamity or crisis or escalation of any thereof, which, in the reasonable opinion of the Underwriters, materially adversely affects the market for the Series QQ Bonds; (iii) legislation shall be enacted or any action shall be taken by, or on behalf of, the Securities and Exchange Commission to the effect that the Series QQ Bonds or any securities of the Authority are not exempt from the registration, qualification and other requirements of the Securities Act of 1933, as amended, or to the effect that the 1974 Agreement must be qualified under the Trust Indenture Act of 1939, as amended, or to the effect that the Series QQ Bonds or any securities of the Authority would be in violation of any provision of the federal securities laws in the opinion of counsel to the Underwriters; (iv) a general banking moratorium shall have been established by Federal, New York or Commonwealth of Puerto Rico authorities or a major financial crisis or material disruption in commercial banking or securities settlement or clearances services shall have occurred that, in the reasonable opinion of the Underwriters, materially adversely affects the market for the Series QQ Bonds; (v) any legislation, ordinance, rule or regulation shall be introduced in, or be enacted by, any governmental body, department or agency in the Commonwealth, or a decision by any court of competent jurisdiction within the Commonwealth shall be rendered which, in the reasonable opinion of the Underwriters, materially adversely affects the market for the Series QQ Bonds; or (vi) legislation shall have been introduced or enacted by the Legislature of the Commonwealth or by the Congress of the United States, or legislation pending in the Legislature of the Commonwealth or the Congress of the United States shall have been amended, or legislation shall have been recommended to the Congress of the United States or otherwise endorsed for passage (by press release, other form of notice or otherwise) by the President of the United States, the Treasury Department of the United States, the Internal Revenue Service or the Chairman or ranking minority member of the Committee on Finance of the United States Senate or the Committee on Ways and Means of the United States House of Representatives, or legislation shall have been proposed for consideration by either such Committee, by the staff of such Committee or by the staff of the Joint Committee on Taxation of the Congress of the United States, or legislation shall have been favorably reported for passage to either House of Congress of the United States by any committee of such House to which legislation has been referred for consideration, or a decision by a court of the United States or the Tax Court of the United States shall be rendered or a ruling, regulation or official statement by or on behalf of the Treasury Department of the United States, the Internal Revenue Service or other governmental agency shall be made, with respect to Federal taxation upon interest received on securities of the general character of the Series QQ Bonds or which would have the effect of materially adversely changing, directly or indirectly, the Federal income tax consequences of receipt of interest on securities of the general character of the Series QQ Bonds in the hands of the holders thereof, which in the reasonable opinion of the majority of the Underwriters would materially adversely affect the market price of the Series QQ Bonds.

Such postponement shall continue for the period of time, which shall be determined reasonably and in good faith by the Underwriters, after consultation with the Authority and Government Development Bank, during which the event causing the postponement shall adversely affect the market for the Bonds. During the period of postponement, the obligations of the Underwriters to purchase the Series QQ Bonds shall be suspended. At such time as the Underwriters shall determine, reasonably and in good faith, and after consultation with the Authority and Government Development Bank, that the event no longer adversely affects the market for the Series QQ Bonds, the Underwriters shall notify the Authority of a new proposed closing date for the Series QQ Bonds, which if agreed by the Authority shall be the new closing date for the Series QQ Bonds.

ADVERSE CHANGES (FINANCIAL OR OTHER) IN THE AFFAIRS OF THE AUTHORITY WILL NOT EXCUSE THE UNDERWRITERS FROM PAYING FOR AND TAKING DELIVERY OF THE SERIES QQ BONDS UNLESS ANY SUCH ADVERSE CHANGE HAS NOT BEEN ACCURATELY AND COMPLETELY DESCRIBED IN OR INCORPORATED BY REFERENCE IN THE 2005 SUPPLEMENT.

It is a condition of the issuance of the Series QQ Bonds that Bond Counsel deliver its approving opinion substantially in the form set forth in Appendix IV. Bond Counsel's ability to deliver this opinion is

subject to its review and analysis at the time the Series QQ Bonds are issued of, among other things, (1) the application of the proceeds of the Series QQ Bonds, (2) pertinent provisions of Puerto Rico law and federal income tax and securities laws then in effect or proposed to be in effect and (3) certifications and representations delivered or made by the Authority and the Underwriters at that time. Bond Counsel has advised the Authority and the Underwriters that, (A) if the Authority and the Underwriters satisfy their respective obligations set forth in the Contract of Purchase for the Series QQ Bonds and (B) if there is no change in any applicable law, or in any other facts or circumstances (tax or otherwise) that, in Bond Counsel's view, affect or are material to its opinion, and (C) if such certifications and representations are delivered or made to Bond Counsel's satisfaction, Bond Counsel expects to be able to deliver an approving opinion for the Series QQ Bonds substantially in the form attached hereto as Appendix IV. No assurances can be given that there will be no change in applicable law prior to the time the Series QQ Bonds are to be issued, that the facts and circumstances that are material to such opinion will not differ at the time the Series QQ Bonds are to be issued from those currently expected, or that such certifications and representations will be delivered and made. As a consequence, no assurance can be made that an approving opinion will be delivered by Bond Counsel.

FAILURE TO DELIVER THE 2005 SUPPLEMENT OR THE OPINIONS AND CERTIFICATES IN THE FORM AND SUBSTANCE PROVIDED FOR IN THE CONTRACT OF PURCHASE FOR THE SERIES QQ BONDS (UNLESS SUCH FAILURE IS WAIVED BY THE UNDERWRITERS) WILL MEAN THAT THE SERIES QQ BONDS WILL NOT BE ISSUED AND DELIVERED. THE UNDERWRITERS HAVE THE RIGHT, BUT ARE UNDER NO OBLIGATION, TO WAIVE ANY SUCH FAILURE.

The Underwriters are not required to purchase the Series QQ Bonds if, at any time on or prior to the date the Series QQ Bonds are to be issued, as a result of a Change in Law, the Underwriters are or would be prohibited from lawfully purchasing the Series QQ Bonds or lawfully selling the Series QQ Bonds to the public.

As defined in the Contract of Purchase, "Change in Law" means (i) any change in federal, Commonwealth or state law or any changes in regulations or other pronouncements or interpretations by federal, Commonwealth or state agencies, (ii) the enactment, introduction or proposal of any federal legislation (if it has a proposed effective date that is on or before the date the Series QQ Bonds are to be issued), (iii) the enactment, introduction or proposal of any law, rule or regulation of any other governmental body, department or agency (federal, Commonwealth or state) (if it has a proposed effective date that is on or before the date the Series QQ Bonds are to be issued) or (iv) the handing down of a judgment, ruling or order issued by any court or administrative body, which in each case would prohibit (or have the retroactive effect of prohibiting, if enacted, adopted, passed or finalized) the Underwriters from purchasing or selling the Series QQ Bonds to the public or would make the Authority's issuance, sale or delivery of the Series QQ Bonds illegal (or have the retroactive effect of making such issuance, sale or delivery illegal, if enacted, adopted, passed or finalized); provided, however, that such change in law, rule or regulation or judgment, ruling or order shall have become effective or been enacted, introduced, proposed or issued, as the case may be, after the date of this Official Statement.

Events that may occur prior to the issuance of the Series QQ Bonds may have significant consequences to persons who have agreed to purchase the Series QQ Bonds. The market prices of the Series QQ Bonds on the date the Series QQ Bonds are issued are unlikely to be the same as the purchase prices therefor, and such differences may be substantial. Several factors may adversely affect the market prices of the Series QQ Bonds, including (but not limited to) a general increase or decrease in market interest rates, any threatened or adopted change in the federal income tax laws affecting the relative benefits of owning tax-exempt securities versus other types of investments, or any adverse development with respect to the Authority. In addition, although the delivery of the approving opinion of Bond Counsel is a condition to the issuance and delivery of the Series QQ Bonds and is subject to a number of conditions to be fulfilled at the time of such delivery as described above, changes or proposed changes in federal income tax laws or

regulations or interpretations thereof could affect the market value of tax-exempt securities, including the Series QQ Bonds, without preventing the delivery of such opinion or the delivery of the Series QQ Bonds.

Estimated Sources and Uses of Funds

Series OO Bonds and Series PP Bonds

Sources:	
Principal amount of the Series OO Bonds and Series PP Bonds	\$ 224,700,000.00
Net original issue premium or discount	17,754,262.45
Other available moneys ⁽¹⁾	<u>7,094,192.08</u>
Total Sources	<u>\$ 249,548,454.53</u>
Uses:	
Deposit to Escrow Funds for the Series OO and Series PP Refunded Bonds..	\$ 244,224,171.48
Underwriting discount, bond insurance premiums and estimated legal, printing and other financing expenses.....	<u>5,324,283.05</u>
Total Uses	<u>\$ 249,548,454.53</u>

Series QQ Bonds

Sources:	
Principal amount of the Series QQ Bonds	\$ 95,270,000.00
Net original issue premium or discount	10,304,839.15
Other available moneys ⁽²⁾	<u>3,110,825.00</u>
Total Sources	<u>\$ 108,685,664.15</u>
Uses:	
Deposit to Escrow Funds for the Series QQ Refunded Bonds.....	\$ 106,375,977.53
Underwriting discount, bond insurance premiums and estimated legal, printing and other financing expenses.....	<u>2,309,686.62</u>
Total Uses.....	<u>\$ 108,685,664.15</u>

(1) Derived from moneys on deposit in the Bond Service Account and Redemption Account of the 1974 Sinking Fund to pay debt service on the Series OO and Series PP Refunded Bonds.

(2) Derived from certain moneys on deposit in the Bond Service Account and Redemption Account of the 1974 Sinking Fund to pay debt service on the Series QQ Refunded Bonds.

SECURITY

The Bonds are not a debt or obligation of the Commonwealth or any of its municipalities or other political subdivisions, other than the Authority, and neither the Commonwealth nor any such municipalities or other political subdivisions, other than the Authority, are liable thereon, nor shall the Bonds be payable out of any funds other than those of the Authority as further described herein.

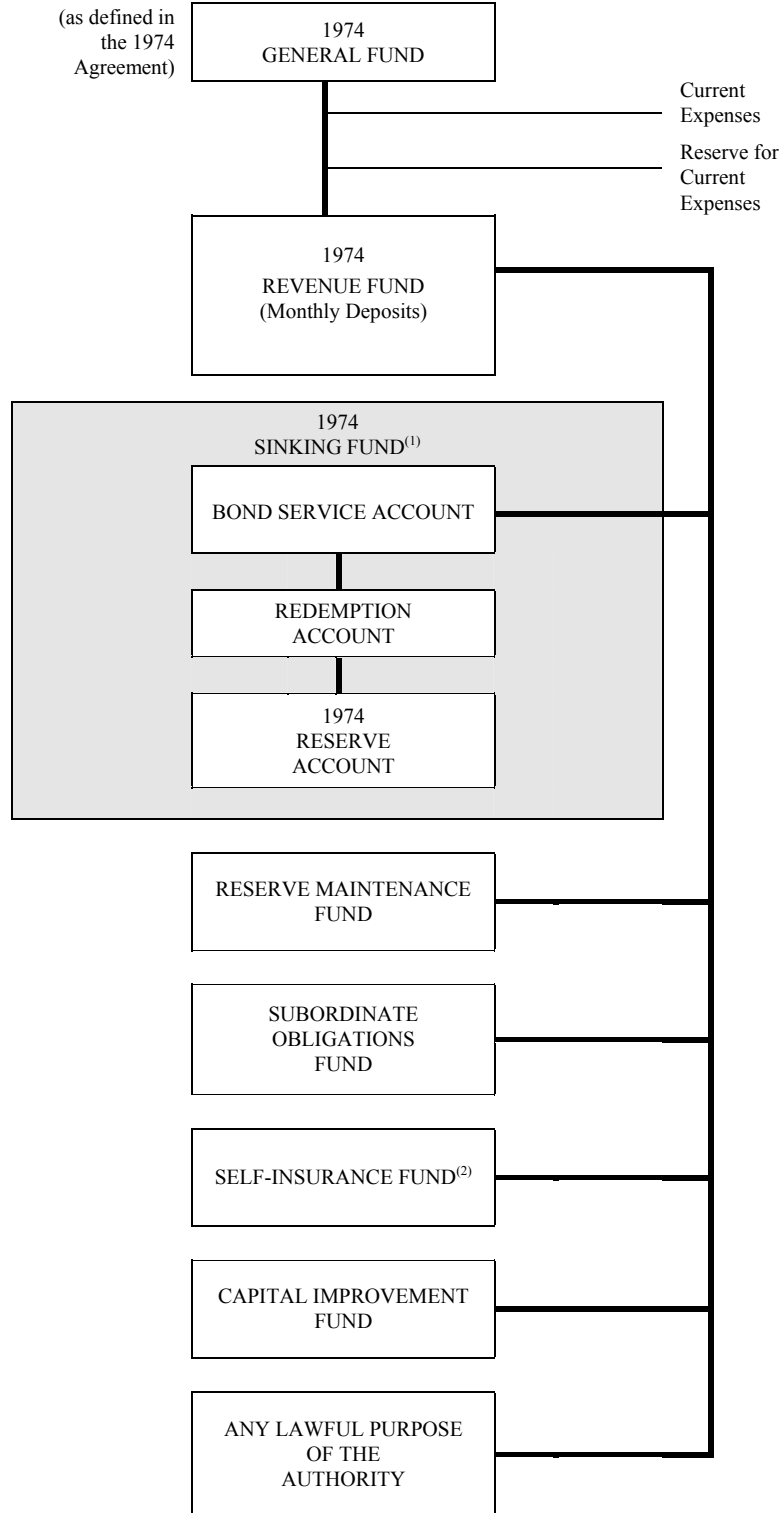
Source of Payment

The Power Revenue Bonds are payable solely from the Revenues of the System after payment of the Current Expenses of the Authority and any reserve therefor. For purposes of the 1974 Agreement and this Official Statement, the “System” means all the properties owned and operated by the Authority as a single integrated system in connection with the production, distribution or sale of electric energy, the acquisition or construction of which was financed in whole or in part from the proceeds of Power Revenue Bonds or from the proceeds of bonds issued under a previous indenture, or from moneys deposited to certain accounts established under the 1974 Agreement, or (to the extent specified by the Authority) from certain subordinated obligations; “Revenues” means all moneys received by the Authority as a result of the ownership or operation of the System, proceeds of certain insurance, and certain investment income; and “Current Expenses” means the Authority’s reasonable and necessary current expenses of maintaining, repairing and operating the System. The Authority has covenanted to deposit in the 1974 Sinking Fund a sufficient amount of such Revenues (after payment of Current Expenses) to pay the principal of and the interest on all the Power Revenue Bonds and to provide a reserve therefor. See Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*, which should be read in conjunction herewith.

Flow of Funds under 1974 Agreement

The following schematic representation is provided only to guide readers and does not purport to be complete.

REVENUES



(1) Monthly deposits to the Bond Service Account and the Redemption Account for all Power Revenue Bonds are capped at 1/6 of the interest due on the next interest payment date and 1/12 of the principal due on the next principal payment date and 1/12 of Amortization Requirements for the current fiscal year.

(2) Subject to replenishment at the option of the Authority.

Rate Covenant

The Authority has covenanted in the 1974 Agreement to fix, charge and collect reasonable rates and charges so that Revenues of the System will be sufficient to pay Current Expenses and to provide an amount at least equal to 120% of the aggregate Principal and Interest Requirements for the next fiscal year on account of all outstanding Power Revenue Bonds, reduced by any accrued interest thereon for such fiscal year. For purposes of calculating Principal and Interest Requirements under the rate covenant and the additional bonds tests described below, the Accreted Value of any capital appreciation bonds of the Authority on their maturity dates shall be included as principal due and payable on said maturity dates. The Accreted Value at any date of a capital appreciation bond currently outstanding equals the original principal amount of such capital appreciation bond plus the interest accrued from its date of issuance to such date, based upon the interest rate used to calculate the yields thereof, compounded in the manner provided in the 1974 Agreement, and for future issues of capital appreciation bonds will be determined as provided in the respective resolutions of the Authority authorizing such issues. See “Rate Covenant” in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

Reserve Account

The Authority has covenanted in the 1974 Agreement to accumulate in the 1974 Reserve Account an amount equal to the interest payable on all outstanding Power Revenue Bonds within the next 12 months, provided that for Power Revenue Bonds issued for other than refunding purposes, the amount to be so deposited in any month, as set forth in “Disposition of Revenues” in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*, need not exceed one-sixtieth of the amount of the increase in the interest payable within the next 12 months resulting from the issuance of such Power Revenue Bonds. In connection with the capital appreciation bonds of the Authority, the minimum amount required to be on deposit in the 1974 Reserve Account with respect to the interest accrued thereon is to be derived from the interest rate used to calculate the assumed yields through their maturity times the Accreted Value of such Power Revenue Bonds determined in the manner provided in the 1974 Agreement on the valuation date therefor occurring on or after the first day of the twelfth month succeeding the date of calculation.

As of July 2, 2004, approximately \$243.6 million was on deposit to the credit of the 1974 Reserve Account. The amount required to be accumulated in the 1974 Reserve Account will be approximately \$256.7 million after giving effect to (i) the issuance of Power Revenue Bonds issued for non-refunding purposes within the previous 60 months and (ii) the issuance of the Bonds and the refunding of the Refunded Bonds. The difference between the current balance in the 1974 Reserve Account and the amount required to be accumulated therein will be covered by monthly deposits by the Authority in the required monthly amounts as described above.

Reserve Maintenance Fund, Self-insurance Fund and Capital Improvement Fund

The 1974 Agreement establishes the Reserve Maintenance Fund, the Self-insurance Fund and the Capital Improvement Fund. Revenues are deposited monthly into each of such Funds after the required deposits into the 1974 Sinking Fund as set forth in the schematic representation above for purposes of (a) paying the cost of unusual or extraordinary maintenance or repairs, maintenance or repairs not recurring annually and renewals and replacements, including major items of equipment, in the case of the Reserve Maintenance Fund, (b) paying the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of, a cause which is not covered by insurance required by the 1974 Agreement, in the case of the Self-insurance Fund, and (c) paying the cost of anticipated extensions and improvements which cost has not otherwise been provided for from the proceeds of the Power Revenue Bonds, in the case of the Capital Improvement Fund. Each of these Funds serves as an additional reserve for the payment of principal of and interest on Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the 1974 Sinking Fund (including the 1974 Reserve Account) are

insufficient for such purpose. As of March 31, 2004, the balances of the Reserve Maintenance Fund and the Self-insurance Fund were \$52.7 million and \$81.6 million, respectively. In addition, as of such date, the Authority had set aside \$59.1 million for the Capital Improvement Fund. See “Disposition of Revenues” in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

Additional Bonds

Additional Power Revenue Bonds may be issued under the 1974 Agreement for the purpose of paying all or any part of the cost of any improvements to the System or for any other proper corporate purpose of the Authority; provided that, among other requirements, Net Revenues (as defined in the 1974 Agreement) of the Authority for 12 consecutive months out of the preceding 18 months, adjusted to reflect rates in effect on the date of issuance of such bonds, shall be not less than 120% of maximum aggregate annual Principal and Interest Requirements for all Power Revenue Bonds then outstanding, and that the average annual Net Revenues for the five fiscal years succeeding the issuance of such bonds, adjusted to reflect any rate schedule the Authority has covenanted to put in effect during such five fiscal years, as estimated by the Authority and approved by its Consulting Engineers, shall be not less than 120% of the maximum aggregate annual Principal and Interest Requirements for all Power Revenue Bonds then outstanding and the Power Revenue Bonds then to be issued.

Power Revenue Refunding Bonds may also be issued under the 1974 Agreement for the purpose of refunding all or any part of the outstanding Power Revenue Bonds of any series, provided that, among other requirements, either (i) the earnings tests described above for the issuance of additional Power Revenue Bonds are satisfied (except that effect is given to the retirement of the bonds to be refunded) or (ii) the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and the bonds then to be issued (after giving effect to the retirement of the bonds to be refunded) shall be less than the maximum aggregate Principal and Interest Requirements on account of all outstanding Power Revenue Bonds (excluding the bonds then to be issued). See “Issuance of Power Revenue Bonds -Sections 208, 209 and 210 of the 1974 Agreement” in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

Subordinate Obligations

The Authority may incur or issue obligations for any proper corporate purpose secured by a pledge of moneys in the Subordinate Obligations Fund. If the Authority incurs any such obligations, Net Revenues of the Authority must be deposited monthly to the credit of the Subordinate Obligations Fund (after the required deposits have been made to the 1974 Sinking Fund and the Reserve Maintenance Fund) in amounts sufficient to pay such obligations as they become due.

The Authority may, in connection with the incurrence of any such obligations, limit the deposit to the Reserve Maintenance Fund as described above to not more than \$400,000 per month, notwithstanding any higher amounts recommended by the Authority’s Consulting Engineers. If such deposit is so limited, the Authority will be required, immediately after each monthly deposit to the Subordinate Obligations Fund, to deposit to the Reserve Maintenance Fund (and prior to any deposits to the Self-insurance Fund and the Capital Improvement Fund) the lesser of the amount remaining in the 1974 Revenue Fund and the amount of any such deficiency.

Unless a particular project financed with any such obligations is specified by the Authority as being part of the System, any revenues attributable to such project will not be pledged to the payment of Power Revenue Bonds and any expenses associated with such project will not be payable from Revenues as Current Expenses of the System. See “Disposition of Revenues” in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

BOND INSURANCE

The CIFGNA Bond Insurance Policy

The following information has been furnished by CIFGNA for use in this Official Statement. Reference is made to Appendix V for a specimen of CIFGNA's policy.

The Insurer and the Financial Guaranty Insurance Policy. CIFGNA is a monoline financial guaranty insurance company incorporated under the laws of the State of New York, with its principal place of business in New York City.

The claims-paying ability (also referred to as its financial strength) of CIFGNA is rated "AAA" by Fitch, "Aaa" by Moody's, and "AAA" by Standard and Poor's, the highest rating assigned by each such rating agency. Each rating of CIFGNA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of CIFGNA and its ability to pay claims on its policies of insurance based upon, among other factors, the adequacy of the net worth maintenance and reinsurance agreements provided by CIFG described below under "Capitalization." Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold the CIFGNA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the CIFGNA Insured Bonds. CIFGNA does not guaranty the market price of the CIFGNA Insured Bonds nor does it guaranty that the ratings on the CIFGNA Insured Bonds will not be revised or withdrawn.

CIFGNA is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York, its state of domicile, and is licensed to do business in over 40 jurisdictions. CIFGNA is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that each such insurer maintain a minimum surplus to policyholders, establishes contingency, loss and unearned premium reserve requirements for each such insurer, and limits the size of individual transactions ("single risks") and the volume of transactions ("aggregate risks") that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as CIFGNA regulate, among other things, permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings. CIFGNA is required to file quarterly and annual statutory financial statements with the New York State Insurance Department ("NYSID"), and is subject to statutory restrictions concerning the types and quality of its investments and the filing and use of policy forms and premium rates. Additionally, CIFGNA's accounts and operations are subject to periodic examination by the NYSID.

THE INSURANCE PROVIDED BY THE CIFGNA FINANCIAL GUARANTY INSURANCE POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED BY THE INSURANCE LAWS OF THE STATE OF NEW YORK.

Capitalization. In addition to its capital and surplus as set forth below, CIFGNA is supported by a net worth maintenance agreement from its indirect parent, CDC IXIS Financial Guaranty, a French reinsurance corporation ("CIFG"). The net worth maintenance agreement provides that CIFG will maintain CIFGNA's U.S. statutory capital and surplus at no less than \$80 million. In addition, through a facultative reinsurance agreement, CIFGNA may cede up to 90% of its exposure on each transaction to CIFG; however, the facultative reinsurance agreement does not require that CIFG reinsure its exposure under any transaction. CIFG's claims paying ability is rated "Aaa" by Moody's, "AAA" by Standard & Poor's and "AAA" by Fitch, the highest rating assigned by each such rating agency. *Notwithstanding these net worth maintenance and reinsurance agreements, the holders of the CIFGNA Insured Bonds will have direct recourse against*

CIFGNA only, and neither CIFG nor any other affiliate of CIFGNA will be directly liable to the holders of the CIFGNA Insured Bonds.

The following table sets forth the capitalization of CIFGNA as of June 30, 2004, on the basis of accounting principles prescribed or permitted by the NYSID (in thousands):

Common capital stock	\$ 19,700
Gross paid in and contributed surplus	110,925
Unassigned funds (retained deficit)	<u>(32,894)</u>
Surplus as regards policyholders	<u>\$ 97,731</u>

There has been no material adverse change in the capitalization of CIFGNA from June 30, 2004 to the date of this Official Statement.

Audited financial statements of CIFGNA as of December 31, 2003, prepared in accordance with statutory accounting principles applicable to insurance companies, may be obtained by writing to CIFGNA at 825 Third Avenue, 6th Floor, New York, New York 10022, Attention: Finance Department. The toll-free telephone number of CIFGNA is (866) CIFG-212.

The Financial Guaranty Insurance Policy does not protect investors against changes in market value of the CIFGNA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. CIFGNA makes no representation regarding the CIFGNA Insured Bonds or the advisability of investing in the CIFGNA Insured Bonds. CIFGNA makes no representation regarding this Official Statement, nor has it participated in the preparation thereof, except that CIFGNA has provided to the Authority the information presented under this caption for inclusion in this Official Statement.

The FGIC Bond Insurance Policy

The following information has been supplied by FGIC for inclusion in this Official Statement. No representation is made by the Authority or the Underwriters as to the accuracy or completeness of this information. Reference is made to Appendix VI for a specimen of FGIC's policy.

Payments Under the Policy. Concurrently with the issuance of the FGIC Insured Bonds, FGIC will issue its FGIC Insurance Policy for the FGIC Insured Bonds (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal or accreted value (if applicable) of and interest on the FGIC Insured Bonds, which has become due for payment, but shall be unpaid by reason of nonpayment by the Authority. FGIC will make such payments to U.S. Bank Trust National Association, or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal, accreted value or interest (as applicable) is due or on the business day next following the day on which FGIC shall have received notice (in accordance with the terms of the Policy) from an owner of FGIC Insured Bonds or the Trustee or paying agent (if any) of the nonpayment of such amount by the Authority. The Fiscal Agent will disburse such amount due on any FGIC insured bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal, accreted value or interest (as applicable) due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal, accreted value or interest (as applicable) shall be vested in FGIC. The term "nonpayment" in respect of a FGIC insured bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a FGIC insured bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, non-appealable order of a court having competent jurisdiction.

Once issued, the Policy is non-cancelable by FGIC. The Policy covers failure to pay principal (or accreted value, if applicable) of the FGIC Insured Bonds on their stated maturity dates and their mandatory sinking fund redemption dates, and not on any other date on which the FGIC Insured Bonds may have been otherwise called for redemption, accelerated or advanced in maturity. The Policy also covers the failure to pay interest on the stated date for its payment. If the FGIC Insured Bonds are accelerated or become subject to mandatory redemption, FGIC will be obligated to pay principal (or accreted value, if applicable) and interest on the originally scheduled principal (including mandatory sinking fund redemption) and interest payment dates. Upon such payment, FGIC will become the owner of the FGIC insured bond, appurtenant coupon or right to payment of principal or interest on such FGIC insured bond and will be fully subrogated to all of the Bondholder's rights thereunder.

The Policy does not insure any risk other than Nonpayment by the Authority, as defined in the Policy. Specifically, the Policy does not cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity; (ii) payment of any redemption, prepayment or acceleration premium; or (iii) nonpayment of principal (or accreted value, if applicable) or interest caused by the insolvency or negligence or any other act or omission of the Trustee, paying agent or registrar, if any.

As a condition of its commitment to insure FGIC Insured Bonds, FGIC may be granted certain rights under the 1974 Agreement. The specific rights, if any, granted to FGIC in connection with its insurance of the FGIC Insured Bonds may be set forth in the description of the principal legal documents appearing elsewhere in this Official Statement, and reference is made thereto.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty Insurance Company. FGIC, a New York stock insurance corporation, is a direct, wholly-owned subsidiary of FGIC Corporation, and provides financial guaranty insurance for public finance and structured finance obligations. FGIC is licensed to engage in financial guaranty insurance in all 50 states, the District of Columbia and the Commonwealth of Puerto Rico and, through a branch, in the United Kingdom. FGIC is a wholly-owned subsidiary of FGIC Corporation, a Delaware corporation.

On December 18, 2003, an investor group consisting of The PMI Group, Inc. ("PMI"), affiliates of The Blackstone Group L.P. ("Blackstone"), affiliates of The Cypress Group L.L.C. ("Cypress") and affiliates of CIVC Partners L.P. ("CIVC") acquired FGIC Corporation (the "FGIC Acquisition") from a subsidiary of General Electric Capital Corporation ("GE Capital"). PMI, Blackstone, Cypress and CIVC acquired approximately 42%, 23%, 23% and 7%, respectively, of FGIC Corporation's common stock. GE Capital retained approximately \$234.6 million in liquidation preference of FGIC Corporation's convertible participating preferred stock and approximately 5% of FGIC Corporation's common stock. Neither FGIC Corporation nor any of its shareholders is obligated to pay any debts of FGIC or any claims under any insurance policy, including the Policy, issued by FGIC.

FGIC is subject to the insurance laws and regulations of the State of New York, where it is domiciled, including Article 69 of the New York Insurance Law ("Article 69"), a comprehensive financial guaranty insurance statute. FGIC is also subject to the insurance laws and regulations of all other jurisdictions in which it is licensed to transact insurance business. The insurance laws and regulations, as well as the level of supervisory authority that may be exercised by the various insurance regulators, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, to meet certain financial tests, to comply with requirements concerning permitted investments and the use of policy forms and premium rates and to file quarterly and annual financial statements on the basis of statutory accounting principles ("SAP") and other reports. In addition, Article 69, among other things, limits the

business of each financial guaranty insurer, including FGIC, to financial guaranty insurance and certain related lines.

For the six months ended June 30, 2004, and the years ended December 31, 2003 and December 31, 2002, FGIC had written directly or assumed through reinsurance, guaranties of approximately \$27.1 billion, \$42.4 billion and \$47.9 billion par value of securities, respectively (of which approximately 60%, 79% and 81%, respectively, constituted guaranties of municipal bonds), for which it had collected gross premiums of approximately \$162.9 million, \$260.3 million and \$232.6 million, respectively. For the six months ended June 30, 2004, FGIC had reinsured, through facultative arrangements, approximately 0.1% of the risks it had written.

As of June 30, 2004, FGIC had net admitted assets of approximately \$2.935 billion, total liabilities of approximately \$1.793 billion, and total capital and policyholders' surplus of approximately \$1.142 billion, determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

The unaudited financial statements of FGIC as of June 30, 2004, and the audited financial statements of FGIC as of December 31, 2003 and December 31, 2002, which have been filed with the NRMSIRs, are hereby included by specific reference in this Official Statement. Any statement contained herein under the heading "*The FGIC Bond Insurance Policy*" or in any documents included by specific reference herein, shall be modified or superseded to the extent required by any statement in any document subsequently filed by FGIC with such NRMSIRs, and shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement. All financial statements of FGIC (if any) included in documents filed by the Authority with the NRMSIRs subsequent to the date of this Official Statement and prior to the termination of the offering of the Bonds shall be deemed to be included by specific reference into this Official Statement and to be a part hereof from the respective dates of filing of such documents.

FGIC also prepares quarterly and annual financial statements on the basis of generally accepted accounting principles. Copies of FGIC's most recent GAAP and SAP financial statements are available upon request to: Financial Guaranty Insurance Company, 125 Park Avenue, New York, NY 10017, Attention: Corporate Communications Department. FGIC's telephone number is (212) 312-3000.

Financial Guaranty's Credit Ratings. The financial strength of FGIC is rated "AAA" by Standard & Poor's, "Aaa" by Moody's, and "AAA" by Fitch. Each rating of FGIC should be evaluated independently. The ratings reflect the respective ratings agencies' current assessments of the insurance financial strength of FGIC. Any further explanation of any rating may be obtained only from the applicable rating agency. These ratings are not recommendations to buy, sell or hold the FGIC Insured Bonds, and are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the FGIC Insured Bonds. FGIC does not guarantee the market price or investment value of the FGIC Insured Bonds nor does it guarantee that the ratings on the FGIC Insured Bonds will not be revised or withdrawn.

Neither FGIC nor any of its affiliates accepts any responsibility for the accuracy or completeness of the Official Statement or any information or disclosure that is provided to potential purchasers of the FGIC Insured Bonds, or omitted from such disclosure, other than with respect to the accuracy of information with respect to FGIC or the Policy under "*The FGIC Bond Insurance Policy*." In addition, FGIC makes no representation regarding the FGIC Insured Bonds or the advisability of investing in the FGIC Insured Bonds.

The XLCA Bond Insurance Policy

The following information has been supplied by XLCA for inclusion in this Official Statement. No representation is made by the Authority or the Underwriters as to the accuracy or completeness of the information.

XLCA accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding XLCA and its affiliates set forth under this heading. In addition, XLCA makes no representation regarding the Bonds or the advisability of investing in the Bonds.

General. XLCA is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. XLCA is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, the State of New York, forty-eight other states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Singapore. XLCA has a license application pending with the State of Wyoming, the only state in which it is not currently licensed.

XLCA is an indirect wholly owned subsidiary of XL Capital Ltd, a Cayman Islands corporation (“XL Capital Ltd”). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance and reinsurance coverages and financial products to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The common stock of XL Capital Ltd is publicly traded in the United States and listed on the New York Stock Exchange (NYSE: XL). **XL Capital Ltd is not obligated to pay the debts of or claims against XLCA.**

XLCA was formerly known as The London Assurance of America Inc. (“London”), which was incorporated on July 25, 1991 under the laws of the State of New York. On February 22, 2001, XL Reinsurance America Inc. (“XL Re”) acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

Reinsurance. XLCA has entered into a facultative quota share reinsurance agreement with XL Financial Assurance Ltd (“XLFA”), an insurance company organized under the laws of Bermuda, and an affiliate of XLCA. Pursuant to this reinsurance agreement, XLCA expects to cede up to 90% of its business to XLFA. XLCA may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by XLCA as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit XLCA’s obligations under any financial guaranty insurance policy. With respect to any transaction insured by XLCA, the percentage of risk ceded to XLFA may be less than 90% depending on certain factors including, without limitation, whether XLCA has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XLCA, including policy for the XLCA Insured Bonds.

Based on the audited financials of XLFA, as of December 31, 2003, XLFA had total assets, liabilities, redeemable preferred shares and shareholders’ equity of \$831,762,000, \$401,123,000, \$39,000,000 and \$391,639,000, respectively, determined in accordance with generally accepted accounting principles in the United States. XLFA’s insurance financial strength is rated “Aaa” by Moody’s and “AAA” by S&P and Fitch Inc. In addition, XLFA has obtained a financial enhancement rating of “AAA” from S&P.

The obligations of XLFA to XLCA under the reinsurance agreement described above are unconditionally guaranteed by XL Insurance (Bermuda) Ltd (“XLI”), a Bermuda company and one of the world's leading excess commercial insurers. XLI is a wholly owned indirect subsidiary of XL Capital Ltd. In

addition to A.M. Best's rating of "A+" (Negative Outlook), XLI's insurance financial strength rating is "Aa2" by Moody's, "AA-" by Standard & Poor's and "AA" by Fitch. The ratings of XLFA and XLI are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody's, Standard & Poor's or Fitch.

Notwithstanding the capital support provided to XLCA described in this section, the bondholders will have direct recourse against XLCA only, and neither XLFA nor XLI will be directly liable to the bondholders.

Financial Strength and Financial Enhancement Ratings of XLCA. XLCA's insurance financial strength is rated "Aaa" by Moody's and "AAA" by Standard & Poor's and Fitch, Inc. ("Fitch"). In addition, XLCA has obtained a financial enhancement rating of "AAA" from Standard & Poor's. These ratings reflect Moody's, Standard & Poor's and Fitch's current assessment of XLCA's creditworthiness and claims-paying ability as well as the reinsurance arrangement with XLFA described under "Reinsurance" above.

The above ratings are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody's, Standard & Poor's or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the Bonds. XLCA does not guaranty the market price of the Bonds nor does it guaranty that the ratings on the Bonds will not be revised or withdrawn.

Capitalization of XLCA. Based on the audited statutory financial statements for XLCA as of December 31, 2002 filed with the State of New York Insurance Department, XLCA has total admitted assets of \$180,993,189, total liabilities of \$58,685,217 and total capital and surplus of \$122,307,972 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities ("SAP"). Based on the audited statutory financial statements for XLCA as of December 31, 2003 filed with the State of New York Insurance Department, XLCA has total admitted assets of \$329,701,823, total liabilities of \$121,635,535 and total capital and surplus of \$208,066,288 determined in accordance with SAP.

For further information concerning XLCA and XLFA, see the financial statements of XLCA and XLFA, and the notes thereto, incorporated by reference to this Official Statement. The financial statements of XLCA and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the "Commission") by XL Capital Ltd and may be reviewed at the EDGAR website maintained by the Commission. All financial statements of XLCA and XLFA included in, or as exhibits to, documents filed by XL Capital Ltd pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 on or prior to the date of this Official Statement, or after the date of this Official Statement but prior to termination of the offering of the Bonds, shall be deemed incorporated by reference in this Official Statement.

Except for the financial statements of XLCA and XLFA, no other information contained in XL Capital Ltd's reports filed with the Commission is incorporated by reference. Copies of the statutory quarterly and annual statements filed with the State of New York Insurance Department by XLCA are available upon request to the State of New York Insurance Department.

Regulation of XLCA. XLCA is regulated by the Superintendent of Insurance of the State of New York. In addition, XLCA is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, XLCA is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. XLCA is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York and most other jurisdictions have laws and regulations prescribing permitted investments and governing the payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

THE FINANCIAL GUARANTY INSURANCE POLICIES ISSUED BY XLCA, INCLUDING THE POLICY OF THE XLCA INSURED BONDS, ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

The principal executive offices of XLCA are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478-3400.

Certain Rights of the Bond Insurers

As provided in the insurance agreements to be entered into by the Authority with each of CIFGNA, FGIC and XLCA concurrently with the delivery of their respective municipal bond insurance policies, as long as CIFGNA, FGIC and XLCA shall not be in default on their respective obligations under the municipal bond insurance policies, CIFGNA, FGIC and XLCA shall be deemed to be the owner of the Insured Bonds insured by each of them for purposes of, among other things, (1) taking remedial actions under the 1974 Agreement and (2) the giving of consents to the execution of any supplemental agreement to the 1974 Agreement.

PROPOSED SUPPLEMENTAL AGREEMENT

The Authority has proposed to execute a supplemental agreement (the “Supplemental Agreement”) to the 1974 Agreement. Purchasers of the Bonds will have consented by their purchase to the terms of the Supplemental Agreement.

The Supplemental Agreement, which was initially proposed in 1985, will permit the Authority to secure its obligations to providers of credit or liquidity facilities securing Power Revenue Bonds by granting liens on Revenues on a parity with Power Revenue Bonds. The Supplemental Agreement will be executed when owners of 100% of the outstanding Power Revenue Bonds consent thereto. Upon the issuance of the Bonds (and the refunding of the Refunded Bonds), the owners of approximately 99% of the outstanding Power Revenue Bonds will have consented to the execution of the Supplemental Agreement. See Appendix I, *Summary of Certain Provisions of Proposed Supplemental Agreement*, for additional information respecting the provisions of the Supplemental Agreement.

Copies of the proposed Supplemental Agreement are on file for inspection with the 1974 Trustee.

DESCRIPTION OF THE BONDS

General

The Bonds will bear interest at such rates and will mature on the dates and in the principal amounts set forth on the inside cover page of this Official Statement. The Bonds will be dated their date of delivery. Interest on the Series OO Bonds and the Series PP Bonds will be payable on each January 1 and July 1, commencing on January 1, 2005. Interest on the Series QQ Bonds will be payable on each July 1 and January 1, commencing on July 1, 2005. Principal of and premium, if any, and interest on the Bonds will be payable in the manner described below under “Book-Entry Only System.” The Bonds are being issued in fully registered form and, when issued, are to be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC is to act as securities depository for the Bonds. Individual purchases of interests in the Bonds will be made in book-entry form only, in denominations of \$5,000 or any multiple thereof. Purchasers of such interests will not receive definitive Bonds. Principal, redemption premium, if any, and interest are payable directly to DTC by the 1974 Trustee. Upon receipt of such payments, DTC will remit such principal and interest to the DTC Participants (as such term is hereinafter defined) for subsequent disbursement to the purchasers of beneficial interests in the Bonds.

Book-Entry Only System

The information in this section concerning DTC and DTC’s book-entry system has been obtained from DTC. The Authority, the 1974 Trustee and the Underwriters assume no responsibility for the accuracy of such information.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered bonds registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered bond will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity of the Bonds and will be deposited with DTC. So long as the nominee of DTC is the registered owner of the Bonds, such nominee will, subject to the limitations set forth under *Bond Insurance* above, be considered the sole owner or holder of the Bonds for all purposes under the 1974 Agreement and any applicable laws. Except as otherwise provided below, a Beneficial Owner (as hereinafter defined) of interests in the Bonds will not be entitled to have the Bonds registered in such owner’s name, will not be entitled to definitive Bonds and will not be considered an owner or holder of the Bonds under the 1974 Agreement.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over two million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges in Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of its Direct Participants, by members of the National Securities Clearing Corporation, the Government Securities Clearing Corporation, the MBS Clearing Corporation, and Emerging Markets Clearing Corporation (all subsidiaries of DTCC), by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others, such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (the “Indirect Participants” and together

with the Direct Participants, the “Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds in DTC’s records. The ownership interest of each actual purchaser of each Bond (a “Beneficial Owner”) will in turn be recorded in the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchases. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds will be accomplished by entries made in the books of Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interest in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the documents governing the Bonds. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the trustee and request that copies of the notices are provided directly to them.

Redemption notices will be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct Participant in the Bonds of that maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC’s procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC’s practice is to credit Direct Participants’ accounts upon DTC’s receipt of funds and corresponding detail information from the Authority or the 1974 Trustee on the payable date in accordance with their respective holdings shown on DTC’s records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in “street name,” and will be the responsibility of such Participant and not of DTC, the 1974 Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of the principal, redemption premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the 1974 Trustee. Disbursement of such payments to Direct Participants will be the responsibility of DTC,

and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

Each person for which a DTC Participant acquires an interest in the Bonds, as nominee, may desire to make arrangements with such DTC Participant to receive a credit balance in the records of such DTC Participant, to have all communications to DTC which may affect such persons forwarded in writing by such DTC Participant, and to have notification made of all interest payments.

The Authority, the 1974 Trustee and the Underwriters will have no responsibility or obligation to DTC, Participants, Beneficial Owners or other nominees of such Beneficial Owners for: (i) sending transaction statements; (ii) maintaining, supervising or reviewing the accuracy of any records maintained by DTC or any DTC Participant or other nominees of such Beneficial Owners; (iii) payment or the timeliness of payment by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owner, of any amount due with respect to the principal of or interest on the Bonds; (iv) delivery or timely delivery by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owners, of any notice or other communication which is required or permitted under the terms of the 1974 Agreement to be given to the registered owners of the Bonds; or (v) any consent given or any action taken by DTC or its nominee as the registered owner of the Bonds.

Discontinuance of the Book-Entry Only System

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Authority or the 1974 Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, certificates representing ownership interests in the Bonds will be printed and delivered.

The Authority, in its sole discretion and without the consent of any other person, may terminate the services of DTC as securities depository with respect to the Bonds. In such event, certificates representing ownership interests in the Bonds will be printed and delivered.

In the event that such book-entry only system is discontinued or terminated, the following provisions will apply: (i) payment of the principal of and the interests on the Bonds will be made in lawful money of the United States of America; (ii) payment of the principal will be made at the corporate trust office of the 1974 Trustee in New York, New York; (iii) interest on the Bonds will be paid by check mailed to the respective addresses of the registered owners thereof as of the fifteen day of the month immediately preceding the interest payment date as shown on the registration books of the Authority maintained by the 1974 Trustee; (iv) the Bonds will be issued only as registered bonds without coupons in authorized denominations; and (v) the transfer of the Bonds will be registrable and the Bonds may be exchanged at the principal corporate trust office of the 1974 Trustee in New York, New York upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Optional Redemption

The Series OO Bonds and the Series PP Bonds that mature on or after July 1, 2015, may be redeemed at the option of the Authority prior to maturity, from any available moneys, upon not less than 30 days' prior notice by mail, either in whole or in part (if in part, in such order of maturity as directed by the Authority), on any date not earlier than July 1, 2014, at par plus accrued interest to the redemption date.

The Series QQ Bonds are not subject to optional redemption.

THE AUTHORITY

The Authority was created a body corporate and politic constituting a public corporation and governmental instrumentality of the Commonwealth by the Puerto Rico Electric Power Authority Act, Act No. 83 of the Legislature of Puerto Rico, approved May 2, 1941, as amended (the “Act”).

The Authority was created for the purpose of conserving, developing and utilizing the water and power resources of the Commonwealth in order to promote the general welfare of the Commonwealth. It supplies virtually all the electricity consumed in Puerto Rico and is one of the largest municipal utilities in the United States.

The executive offices of the Authority are located at 1110 Ponce de León Avenue, San Juan, Puerto Rico 00907, telephone number (787) 289-4666.

Powers

The Authority has broad powers under the Act, including, among others: to make contracts; to acquire properties by eminent domain or otherwise; to borrow money and to issue bonds for any of its corporate purposes; to secure the payment of its bonds and all other obligations by pledge of its revenues; to determine, fix, alter, charge and collect reasonable rates, fees, rentals and other charges for use of its facilities; and to have complete control and supervision of its properties and activities. In addition, the Authority has the power to create, acquire and maintain corporations, partnerships or subsidiary corporations.

Management

The Act provides that the Governing Board of the Authority (the “Board”) shall be composed of nine members. The Secretary of Transportation and Public Works of the Commonwealth serves *ex officio* as a member of the Board, and six other members are appointed by the Governor with the advice and consent of the Senate of Puerto Rico. The remaining two members are client representatives elected directly by the Authority’s clients. Members of the Board serve for a term of four years and members who are not *ex officio* can be reappointed or reelected. There is currently one vacancy on the Board. The members of the Board are set forth below.

<u>Name</u>	<u>Principal Occupation</u>	<u>Term Ends</u>
José A. Del Valle-Vázquez, Chairman	Certified Public Accountant	July 2005
Fernando E. Fagundo	Secretary of Transportation and Public Works	<i>Ex Officio</i>
José A. Bechara-Bravo	Lawyer and Businessman	February 2007
José A. Fernández-Polo, P.E.	Civil Engineer and General Contractor	February 2007
José Luis Rodríguez-Homs, P.E.	Engineer	February 2007
Eliezel Rodríguez-Seda, P.E.	Engineer and Consultant	February 2006
Miguel Nazario-Franco	Consultant	February 2007
Zoilo López-Nieves*	Medical Doctor	Holding Over*

* Client representative who will serve as a member of the Governing Board until his successor is appointed.

The Board appoints an Executive Director who is the chief executive officer of the Authority and is responsible for the general operation of the Authority. The Board also appoints a Vice Executive Director who has the administrative power delegated unto him by the Executive Director and has the administrative supervision over all functions of the Authority, unless expressly reserved for himself by the Executive Director.

Héctor R. Rosario was appointed Executive Director effective January 21, 2001. Mr. Rosario is a Certified Public Accountant and holds a Master’s Degree in Business Administration. During his 33 years of service with the Authority, he has occupied various supervisory level positions, such as Supervisor-Customer Service; Supervisor-Bank Reconciliations Unit; Supervisor-Disbursements Section; Assistant Treasurer; and Treasurer.

Héctor M. Alejandro Narváez was appointed Vice Executive Director effective September 14, 2003. Mr. Alejandro is a licensed Professional Chemical Engineer and holds a Juris Doctor degree. During his 32 years of service with the Authority, he has performed various supervisory level positions, such as Director of Planning and Environmental Protection, Director of the Environmental Protection and Quality Assurance Division, and Technical Advisor in Environmental Protection, among others positions.

Other principal officers of the Authority include the following:

Edwin Rivera, Director of Electric System, is a licensed Professional Electrical Engineer with 29 years of service at the Authority. During that time, he has occupied various positions, including Director of Engineering, Superintendent-Electric System; Assistant Head-Electric Conservation Division; and Administrator at the Project Administration Office in the Engineering Division.

Valeriano Otero, Director of Transmission and Distribution, is a licensed Professional Electrical Engineer with 25 years of service with the Authority. He has occupied the positions of Line Supervisor III and District Engineer.

Lourdes Alfonso, Director of Customer Service, holds a Juris Doctor and a Bachelor's Degree in Business Administration, and has approximately 34 years of service with the Authority. Among the positions she has held are: Assistant Supervisor-Special Legal Services Department; Attorney at the Litigation Division; Head-Customer Service Division; and Attorney III at the Legal Division. She is also a Member of the Employees Retirement System's Board of Trustees.

Luis Figueroa, Director of Finance, is a Certified Public Accountant with 15 years of service at the Authority. During his tenure, he has occupied positions of Technical Advisor to the Director of Finance; Assistant Comptroller-General Accounting; and Assistant Comptroller-Payroll and Budget.

Juan F. Alicea Flores, Director of Planning and Environmental Protection is a licensed Professional Mechanical Engineer with 21 years of service with the Authority. Among other positions, he has performed as Head-Palo Seco Steam Plant Division, Operator Head at Aguirre Steam Plant, and Maintenance Head at Aguirre Steam Plant.

Wilfredo Pantojas, Director of Administrative Services, holds a Juris Doctor and a Master's Degree in Public Administration and has 19 years of service with the Authority. Among the positions he has held are: Office Supervisor I-Electric System Division; Local Purchase Orders Manager; Office Supervisor II; and Assistant Head-Material Management Division.

Milagros Calixto, Director of Engineering, holds a Bachelor of Science in Electrical Engineering and has 21 years of service with the Authority. Among the positions she has held are: Supervisor of Specification and Procurement Electrical Distribution Division; Special Assistant to the Electrical Distribution Division Director; Norms and Procedure Engineer; Supervising Engineer II; Superintendent of Norms and Procedures Office.

María M. Méndez, General Counsel, holds a Juris Doctor and a Bachelor's Degree in Business Administration, with a concentration in Marketing, and has 16 years of service with the Legal Division of the Authority. She has occupied the positions of: Attorney at the Opinion, Legislation and Contract Division; Acting Assistant General Counsel; and Acting General Counsel.

María E. Hernández Torrales, Human Resources Director, holds a Juris Doctor Degree and a Master in Arts. During her 29 years of service with the Authority, among other positions, she has performed as Personnel General Administrator, Personnel Services Administrator, and Labor Lawyer.

The Authority retains the firm of Washington Group International, Inc. as Consulting Engineers (the “Consulting Engineers”) to perform certain responsibilities under the 1974 Agreement. The Consulting Engineers’ responsibilities include submitting an annual report to the 1974 Trustee setting forth their recommendations: (a) as to any necessary or advisable revisions of the Authority’s rates and charges, (b) as to the amount that should be deposited monthly by the Authority during the ensuing fiscal year to the credit of various funds established under the 1974 Agreement for the purposes specified in the 1974 Agreement, and (c) as to any advice and recommendations as they deem advisable.

Ernst & Young LLP currently acts as the Authority’s independent accountants responsible for auditing the Authority’s financial statements for fiscal year 2004.

THE SYSTEM

The Authority is the supplier of virtually all of the electric power consumed in the Commonwealth. As of March 31, 2004, the Authority served approximately 1.4 million clients.

Generating Facilities

As of March 31, 2004, investment in Authority-owned production plant in service totaled approximately \$2.2 billion based on original cost, the total nameplate rating of the Authority-owned generating facilities of the System was 4,421 MW and their total dependable generating capacity was 4,398 MW. In addition, the Authority purchases power under long-term power purchase agreements from two cogeneration facilities. Under its agreement with EcoEléctrica, it has the right to purchase 507 MW of net dependable generating capacity. Under its agreement with AES-PR, it has the right to purchase 454 MW of net dependable generating capacity. The Authority has dispatch control over both facilities, and their output is fully integrated into the System.

Existing Generating Facilities (in MW)

<u>Generating Plants</u>	<u>Nameplate Rating (82 Units)</u>	<u>Dependable Generating Capacity</u>					
		<u>Total (82 Units)</u>	<u>Steam (18 Units)</u>	<u>Combined Cycle Power Blocks (13 Units)</u>	<u>Combustion Turbine (25 Units)</u>	<u>Hydro (21 Units)</u>	<u>Other⁽¹⁾ (5 Units)</u>
Aguirre.....	1,554	1,534	900 ⁽²⁾	592 ⁽³⁾	42 ⁽⁴⁾	—	—
Costa Sur.....	1,118	1,132	1,090	—	42 ⁽⁴⁾	—	—
Palo Seco.....	731	728	602	—	126 ⁽⁵⁾	—	—
San Juan.....	400	400	400	—	—	—	—
Mayagüez.....	90	84	—	—	84 ⁽⁶⁾	—	—
Arecibo.....	249	249	—	—	249 ⁽⁷⁾	—	—
Other Locations.....	279	271	—	—	168 ⁽⁸⁾	100	3
Subtotal.....	4,421	4,398	2,992	592	711	100	3
Peñuelas – EcoEléctrica.....	507	507	—	507 ⁽⁹⁾	—	—	—
Guayama – AES-PR.....	454	454	454 ⁽¹⁰⁾	—	—	—	—
Total.....	5,382	5,359	3,446	1,099	711	100	3

(1) Consists of four diesel units in the Municipality of Culebra and one in the Municipality of Vieques with an aggregate dependable capacity of approximately 3 MW held on standby reserve.

(2) Consists of the Authority’s two largest units, Aguirre Units 1 and 2, each with a dependable generating capacity of 450 MW.

(3) Consists of two combined-cycle power blocks, each made up of four 50 MW combustion turbine units and one 96 MW steam-turbine unit.

(4) Consists of two 21 MW units.

(5) Consists of six 21 MW units.

(6) Consists of four 21 MW units.

(7) Consists of three 83 MW units.

(8) Consists of eight 21 MW units.

(9) Consists of one combined cycle power block, made up of two 165 MW combustion turbine units and a 177 MW steam turbine unit.

(10) Consists of two 227 MW units.

The EcoEléctrica plant is a cogeneration facility located in the Municipality of Peñuelas. The facility includes a combined cycle power block, consisting of one steam and two combustion turbine units, and a liquefied natural gas terminal. The Authority began purchasing power from EcoEléctrica in September 1999 during the testing and start-up phase of the facility. Commercial operation began on March 21, 2000. The Authority has entered into an agreement with EcoEléctrica to purchase all of the power produced by the facility for a term of 22 years. The agreement requires EcoEléctrica to provide 507 MW of dependable generating capacity to the Authority. The Authority may purchase any energy produced by the facility in excess of 507 MW, if made available, by paying an energy charge only. No capacity charge would be imposed on the Authority for this “excess” power. EcoEléctrica has entered into a long-term supply agreement to meet its expected needs for natural gas at the facility. Deliveries of natural gas to the facility commenced on July 10, 2000.

The power purchase agreement with EcoEléctrica includes monthly capacity and energy charges to be paid by the Authority for the 507 MW of capacity, which EcoEléctrica is committed to provide. The capacity charge is subject to reduction, progressively to zero, if the facility does not achieve certain availability guarantees determined on a 12-month rolling average basis. The energy charges for power purchases are based on a number of factors including a natural gas related charge on a per kWh of energy basis and inflation indices. The EcoEléctrica purchased power costs incorporate a minimum monthly power or fuel purchase requirement based on an average capacity utilization factor on the part of the Authority. After paying this minimum requirement, the Authority only pays for energy actually received (including energy in excess of the 507 MW guaranteed by EcoEléctrica). This element of the agreement, when combined with the possible reduction in the capacity charge described above, effectively transfers substantially all of the economic risk of operating the facility to EcoEléctrica.

Until October of 2003, EcoEléctrica was a joint venture between subsidiaries of Edison International and Enron Corp. On December 3, 2001, Enron filed for bankruptcy. In October of 2003, after obtaining bankruptcy court approval, Enron sold its equity interest in EcoEléctrica to Gas Natural Extremadura, a Spanish company. Neither Enron’s bankruptcy proceedings nor the sale of Enron’s equity interest in EcoEléctrica to Gas Natural Extremadura have materially affected EcoEléctrica’s operations, generation capacity and fuel supply. EcoEléctrica’s liquefied natural gas requirements are being supplied pursuant to an agreement expiring in 2019 with an entity unrelated to Enron. In July of 2004, Edison International signed an agreement to sell several of its power generation assets, including its interest in EcoEléctrica, to International Power PLC and Mitsui & Co. The sale is subject to a number of conditions. The sale is not expected to have any material adverse effects on EcoEléctrica’s operations.

The AES-PR plant is a co-generation facility located in the Municipality of Guayama. The plant commenced commercial operation in November 2002. This clean burning coal technology facility consists of two identical fluidized bed boilers and two steam turbines with 454 MW of dependable generating capacity. The Authority has entered into an agreement with AES-PR to purchase all of the power produced by this facility for a term of 25 years from the date of commencement of commercial operation. The contract with AES-PR is substantially similar to the EcoEléctrica contract described above. Above a certain minimum amount, the Authority is only obligated to purchase energy actually produced by the facility. AES-PR is an affiliate of the AES Corporation.

The AES-PR and EcoEléctrica projects contribute to the Authority’s efforts towards fuel diversification and improved reliability of service. In the past, oil-fired units produced approximately 99% of the Authority’s energy. After the incorporation of the EcoEléctrica and AES-PR facilities to the System, approximately 26% of the Authority’s annual energy requirements are being provided by non-oil-fired generating facilities. This percentage is expected to increase to 33% upon EcoEléctrica and AES-PR reaching full contracted availability.

Among other benefits, the integration of the EcoEléctrica and AES-PR cogeneration facilities into the Authority’s System reduces the impact of changes in energy costs to the Authority’s clients resulting from

short-term changes in fuel costs due to the manner of calculation of the energy charges under the EcoEléctrica and AES-PR agreements. While the agreements provide that energy charges will change based on different formulas relating to the prior year, each agreement fixes the energy price for each year of the contract at the beginning of such year. Fixing the energy component of the price for the whole year reduces the impact of seasonal or short duration variations in the market price of electricity. Because the energy price is fixed and known for the entire year, the Authority is able to achieve better economic dispatching and scheduling of maintenance outages of all of its generating units. In addition, the year delay in the effect of energy price changes for these two facilities on the Authority's energy costs reduces variations of the fuel and purchased power components in the price of electricity sold by the Authority by postponing the impact of the price changes and bringing these changes out of step with price changes in the other components of the Authority's fuel mix.

All of the Authority's purchased power costs under the EcoEléctrica and AES-PR power purchase agreements are accounted for as operating expenses on the Authority's financial statements, are treated as a Current Expense under the 1974 Agreement, and are being recovered by the Authority pursuant to the purchased power charge under its current rate structure.

Transmission and Distribution Facilities

The Authority's transmission and distribution system interconnects its power plants with major switching and load centers throughout Puerto Rico in order to allow the flow of power to and between these locations. The System is integrated and each generating unit is able to provide electric power to the transmission and distribution system. During the period from fiscal year 1999 to fiscal year 2003, the Authority invested \$1.0 billion (or 49.7% of its capital improvement program) in its transmission and distribution system. The capital improvement program for the five fiscal years ending June 30, 2008 includes \$1.0 billion (or 46.5% of such program) for transmission and distribution facilities.

Transmission plant in service as of March 31, 2004 totaled \$1.0 billion based on original installed cost. As of that date, there were 2,338 circuit miles of transmission lines and 162 transmission switchyards. Transmission lines include 331 circuit miles of 230 kV lines, 676 circuit miles of 115 kV lines and 1,331 circuit miles of 38 kV lines. There are also 33 miles of underground 38 kV cable and 55 miles of 38 kV submarine cable. Seventy-one transmission substations located at generating sites and at other sites throughout the island have a total transformer capacity of 16,687,250 kilovolt amperes ("kVA").

After completing construction of the transmission loop on the western part of Puerto Rico in fiscal year 2002, the Authority is now constructing new 230 kV transmission lines to complete the transmission loop on the eastern part of the island. This eastern loop will connect major switching and load centers on the eastern part of the island, and boost electric system capacity in Puerto Rico's eastern region. The eastern loop is expected to be operating during fiscal year 2005.

The Authority is also constructing a new 50-mile long 230 kV transmission line between its South Coast steam plant and the transmission center in Aguas Buenas. The construction of this new transmission line was commenced in March of 2003 and is expected to be completed in fiscal year 2007. Once in operation, this major infrastructure project will enhance the reliability of the transmission system, and will permit the increase of power transfers from the south coast of Puerto Rico to the northern and central regions. The Authority is constructing an underground 115 kV transmission circuit line around the San Juan metropolitan area in order to reduce the incidents of loss of power in the aftermath of hurricanes and other major storms which strike Puerto Rico from time to time. The estimated cost for this project, which is expected to be completed in fiscal year 2006, is \$135 million. The Federal Emergency Management Agency has committed to provide \$75 million for the investment in construction for this project through grants to the Authority. In cooperation with several municipalities, the Authority is currently designing and building major underground systems located in high-density metropolitan areas. These underground systems will permit the replacement of overhead sub-transmission and distribution lines, thereby improving reliability and assisting municipalities undertaking urban renewal projects by removing unsightly poles, lines and transformers.

An aggressive program to improve the 38 kV sub-transmission system is in effect which includes construction of underground 38 kV lines in Mayagüez, Vega Baja, Viaducto and San Fernando in San Juan. In addition, most of the 38 kV lines in the central part of the island are being replaced. These projects will improve the reliability of the sub-transmission system.

Other relevant projects related to the load growth forecast of the San Juan metropolitan area are the recently energized 90,000 kVA Covadonga gas insulated substation and the new gas insulated 115/38 kV transmission centers and distribution substations of Martín Peña and Isla Grande, which are expected to be operational in fiscal year 2005. A new 115/38 kV transmission center in the municipality of Comerío started operating in fiscal year 2004. In addition, two new 115/38 kV transmission centers under construction in the municipalities of Juana Díaz and Hatillo will increase the load flow capability and improve the voltage regulation of the 38 kV system under emergency conditions. To improve the system power factor and to reduce the reactive power losses at the transmission level, two new 115 kV capacitor banks are under design for construction during fiscal year 2005 in the transmission center of Dorado and Sabana Llana.

Investment in distribution plant in service as of March 31, 2004 totaled \$2.1 billion based on original cost. The capital improvement program for the five fiscal years ending June 30, 2008 includes \$504 million (or 22.9% of the total) for extensions and improvements to existing distribution lines to serve new clients and substations for accommodating new load growth areas. As of March 31, 2004, the electric distribution system included approximately 30,106 circuit miles of distribution lines and 1,029 distribution substations (717 are client-owned) with a total installed transformer capacity of 6,793,100 kVA.

The Authority has a continuing program to digitize all the transmission and distribution facilities into a geographic information system. This will allow the Authority to create a common database for all its transmission and distribution facilities. Approximately 70% of the distribution facilities and all of the 230 kV and 115 kV transmission facilities have been digitized. The program is scheduled to be completed in fiscal year 2005.

The Authority's field operations are being computerized at the district level through the implementation of a work management system that has been in operation since December 1999. The Authority has completed communications facilities to link all the regions and district offices. Integration between the geographic information system and the work management system has been completed. This integration enables the Authority to track all work from initiation to completion through the same system, while keeping all geographic information (such as maps) updated with necessary additions and modifications. The Authority has also upgraded its computer technology relating to this integration, achieving greater service reliability for its clients.

With the implementation of these systems, real time data of transmission and distribution activities are now available. This has produced further automation of the reporting and analysis pertaining to the operations of these systems, and has helped improve productivity and reduce costs.

The Authority regularly reviews and upgrades its operating and maintenance practices, with an emphasis on improving the reliability of its transmission and distribution system. In order to improve the productivity of its transmission and distribution employees, the Authority has instituted programs to assist them in both technical and supervisory training. Also, as part of its continuous effort to improve service quality, the Authority has acquired new software applications and trained its personnel for the analysis and monitoring of power quality.

The Authority has developed a 441-mile fiber optic telecommunications network. This network was designed and installed on the Authority's rights-of-way (mainly its transmission lines). It has allowed the Authority to modernize its internal communication systems, which provide operations, load management, system protection and security, and other controls. The Authority is also developing strategies for commercializing the surplus capacity of the installed fiber, adding flexibility and diversification to its operations.

The Consulting Engineers are of the opinion that the Authority’s production plant and transmission and distribution system are in good repair and sound operating condition. See Appendix III, *Letter of the Consulting Engineers*.

Adequacy of Capacity

General

Electric utilities provide reliable service by establishing a level of dependable generating capacity that is at least equal to their load plus a reserve sufficient to allow for scheduled maintenance, forced or unscheduled outages (defined below), reductions in generating capacity due to partial outages, and other unforeseen events. Unlike most electric utilities in the United States, which are able to purchase power from neighboring systems in the event of unscheduled outages of generating units or temporary surges in demand, the Authority, as an island utility, is not able to do so. In addition, the absence of significant seasonal variations in demand results in a relatively high load factor (approximately 78.1% in fiscal year 2002, 80.2% in fiscal year 2003 and 78.0% for the nine months ended March 31, 2004), which affords the Authority less flexibility to schedule maintenance. Therefore, the Authority must have greater total reserve capacity than other utilities in the United States to cover instances of generating unit outages (scheduled and unscheduled, partial or total).

Improvements to the Authority’s generating units since the early 1990s have extended their life and increased their availability, thereby substantially improving the System’s equivalent availability. This has enabled the Authority to improve the quality of service to its clients. When coupled with the additional generating capacity included in the capacity expansion plan described below, maintaining the level of equivalent availability at current levels should allow the Authority to provide a better quality of service to its clients and meet forecasted increases in demand.

The Authority’s program to extend the life and increase the availability of its generating units is composed of two parts. The first is a comprehensive preventive maintenance program pursuant to which the Authority continuously trains its maintenance employees and adheres to a schedule designed to ensure proper operating levels of all major generating units by removing units from service at regular intervals for necessary maintenance (“scheduled outages”). The second part of this program is a design modification program which includes a commitment by the Authority to improve the operation of generating units and the ability of units to operate at design capability, and in some cases at increased capability, and to reduce the risk of units being forced out of service or being forced to operate at partial output (“forced or unscheduled outages”). About one-third of the \$679.5 million in capital expenditures for the five fiscal years ended June 30, 2003 for production plant was spent for such design modification program.

The table below shows annualized equivalent availability and the equivalent forced outage rate (an indication of the average percentage of total dependable generating capacity which is unavailable throughout the year due to forced outages or partial generating capacity outages) for fiscal years 1999 through 2003 and for the twelve months ended March 31, 2004.

Electric Generation Equivalent Availability and Reliability

	Years Ended June 30,					Twelve Months Ended March 31,
	1999	2000	2001	2002	2003	2004
Equivalent availability.....	79%	78%	80%	80%	81%	81%
Equivalent forced outage rate.....	8%	9%	8%	7%	9%	9%

For planning purposes, the Authority determines adequacy of capacity using probabilistic analytic methods widely used throughout the electric utility industry. The use of these methods takes into account the unique operational aspects of the Authority.

By more effectively utilizing scheduled outages, and by implementing major design modifications, the Authority has reduced the need for extended maintenance downtime and increased the overall reliability of all of its generating facilities. In addition, the Authority anticipates that by including the EcoEléctrica and AES-PR facilities in the Authority's equivalent availability statistics, the Authority's total system equivalent availability will improve even further over time. The additional reserve capacity represented by these two cogeneration facilities gives the Authority more flexibility in scheduling maintenance periods on its own generation facilities and favorably affect the System's equivalent availability. As a result, total production plant availability increased from an average of 72% in fiscal year 1995, to an average of 81% in fiscal year 2003, and for the twelve months ended March 31, 2004. The Authority calculates that each percentage point increase of System availability is equivalent to adding approximately 90 MW of available capacity to the System.

Projected Load Growth

Projections of future load growth are a key component in the Authority's capacity planning. In its financial and capacity planning, the Authority receives information from three sources relating to economic activity: Econométrica Inc., Inter-American University, and the Commonwealth Planning Board. The Inter-American University uses a macroeconomic model developed in conjunction with Global Insight. Econométrica and the Commonwealth Planning Board use data provided by Government Development Bank in association with Global Insight. The Authority's forecasts of electric energy sales and income are based in part on the correlations between the consumption of electricity and various economic and financial activities in the Commonwealth as represented in the above-mentioned models. The Authority continuously monitors actual performance relative to its forecasts and prepares new forecasts at least once a year.

The Authority incorporates the highest of the three forecasts as its base case for planning the additional generating capacity required by the System. Recognizing the inherent uncertainty of forecasting growth, the Authority ordinarily uses the lowest of the three forecasts in preparing its base case revenue forecast.

The Consulting Engineers have reviewed the Authority's projections of future load growth and estimates of peak load and have found them to provide a reasonable basis for planning purposes. See Appendix III, *Letter of the Consulting Engineers*.

Additional Generating Facilities

The Authority recently obtained the licenses required for replacing two 44 MW steam-generating units of the San Juan Steam Plant (Units 5 and 6), removed from service in fiscal year 1997, with new generating units that are projected to provide a total of 464 MW of combined cycle dependable generating capacity. After a first Prevention of Significant Deterioration ("PSD") permit for the project expired in 2002, a new PSD was obtained by the Authority on April 1, 2004. All other permits for the commencement of the project have been obtained. The new generating units are projected to be in service by the end of fiscal year 2006.

Based on the Authority's current projections of peak load and the continued level of production plant equivalent availabilities of its generating units, the Authority and the Consulting Engineers believe that completion of this project will provide the additional generating capacity needed to continue to provide reliable service to its clients through fiscal year 2009. Although the Authority believes that this project can be in operation by the end of fiscal year 2006, permitting or construction delays could delay the completion date. However, based on the Authority's projections of peak load, the System's capacity, and the maintenance by the Authority of the System's equivalent availability at its current level, the Authority believes that a delay in the completion of this project will not materially affect its ability to furnish reliable service.

The following table summarizes the Authority's projected peak load, dependable capacity, reserve margin and dependable reserve margin through fiscal year 2008 under the peak load projections shown below

and incorporating the assumptions for 464 MW of additional capacity from the repowering of San Juan Steam Plant units 5 and 6, described above. Projections of future peak load (for capacity planning purposes) from fiscal year 2004 to fiscal year 2008 prepared by the Authority show an average annual increase of 3.1%.

Fiscal Years	Peak	Dependable	Reserve	Dependable
Ending	Load	Capacity	Margin	Reserve
June 30,				Margin (%)
	(in MW, except percentages)			
2004	3,499	5,359	1,860	53
2005	3,624	5,359	1,735	48
2006	3,727	5,823	2,096	56
2007	3,845	5,823	1,978	51
2008	3,952	5,823	1,871	47

The Authority has projected a need for additional capacity by fiscal year 2009. Accordingly, the Authority’s Governing Board has approved a project that contemplates the construction by a private company of a co-generation plant on the western part of the island that will add approximately 474 MW of generating capacity in fiscal year 2009.

The Consulting Engineers have examined in detail the Authority’s proposed long-term capacity expansion plan (and the methodologies and assumptions upon which it is based) and have found its development to be reasonable and generally consistent with utility industry practice and appropriate for the Authority. See Appendix III, *Letter of the Consulting Engineers*.

Statistical Information

The following table sets forth certain statistical information regarding the System for the five fiscal years ended June 30, 2003 and for the nine-month periods ended March 31, 2003 and 2004. For the fiscal years ended June 30, 2000 and thereafter, the information below reflects the inclusion of 507 MW of capacity provided pursuant to the EcoEléctrica contract. For fiscal year 2003 and for the nine-month periods ended March 31, 2003 and 2004, the information below reflects the inclusion of 454 MW of capacity provided pursuant to the AES-PR contract.

Statistical Information

Years Ended June 30,

Nine Months
Ended March 31,

	Years Ended June 30,					Nine Months Ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
Nameplate rating at end of period (in MW)	4,421	4,421	4,421	4,421	4,421	4,421	4,421
Dependable generating capacity at end of period (in MW)	4,398	4,905 ⁽¹⁾	4,905 ⁽¹⁾	4,905 ⁽¹⁾	5,359 ⁽²⁾	5,359 ⁽²⁾	5,359 ⁽²⁾
Peak load, 60-minute (in MW)	3,057	3,133	3,202	3,297	3,376	3,376	3,499
Reserve Margin (%)	43.9	56.6	53.2	48.8	58.7	58.7	53.2
Average load (in MW)	2,299	2,443	2,526	2,576	2,707	2,702	2,728
Load factor (%)	75.2	78.0	78.9	78.1	80.2	80.0	78.0
Energy generated, purchased and sold (in millions of kWh):							
Electric energy generated and purchased	20,141	20,306 ⁽³⁾	22,132 ⁽³⁾	22,562 ⁽³⁾	23,717 ⁽⁴⁾	17,766 ⁽⁴⁾	18,004 ⁽⁴⁾
Auxiliary equipment use	<u>(1,122)</u>	<u>(1,064)</u>	<u>(1,124)</u>	<u>(1,076)</u>	<u>(1,076)</u>	<u>(826)</u>	<u>(816)</u>
Net electric energy generated and purchased	19,019	19,242	21,008	21,486	22,641	16,940	17,188
Losses and unaccounted for	<u>(2,030)</u>	<u>(1,097)</u>	<u>(2,285)</u>	<u>(2,356)</u>	<u>(2,754)</u>	<u>(2,014)</u>	<u>(1,989)</u>
Electric Energy Sold	<u>16,989</u>	<u>18,145</u>	<u>18,723</u>	<u>19,130</u>	<u>19,887</u>	<u>14,926</u>	<u>15,199</u>
Electric Energy Sales:							
Residential	5,939	6,385	6,631	6,910	7,280	5,488	5,534
Commercial	6,721	7,206	7,583	7,865	8,167	6,091	6,297
Industrial	3,881	4,091	4,019	3,876	3,963	2,986	3,037
Other	<u>448</u>	<u>463</u>	<u>490</u>	<u>479</u>	<u>477</u>	<u>361</u>	<u>331</u>
Total	<u>16,989</u>	<u>18,145</u>	<u>18,723</u>	<u>19,130</u>	<u>19,887</u>	<u>14,926</u>	<u>15,199</u>
Electric Energy Revenues (in thousands):							
Residential	\$ 471,070	\$ 633,151	\$ 779,682	\$ 725,797	\$ 867,684	\$ 645,340	\$ 667,594
Commercial	688,526	878,697	1,026,219	969,182	1,117,317	825,957	876,346
Industrial	299,295	391,906	436,313	382,140	432,296	323,775	326,052
Other	<u>68,944</u>	<u>80,473</u>	<u>86,889</u>	<u>85,052</u>	<u>91,461</u>	<u>69,162</u>	<u>65,831</u>
Total	<u>\$1,527,835</u>	<u>\$1,984,227</u>	<u>\$2,329,103</u>	<u>\$2,162,171</u>	<u>\$2,508,758</u>	<u>\$ 1,864,234</u>	<u>\$ 1,935,823</u>
Average revenue per kWh (in cents):							
Residential	7.93	9.92	11.76	10.50	11.92	11.76	12.06
Commercial	10.24	12.19	13.53	12.32	13.68	13.56	13.92
Industrial	7.71	9.58	10.86	9.86	10.91	10.84	10.74
Other	15.38	17.39	17.74	17.77	19.19	19.15	19.86
All Classes	8.99	10.94	12.44	11.30	12.61	12.49	12.74
Average number of clients:							
Residential	1,200,061	1,217,584	1,237,053	1,254,043	1,270,371	1,268,393	1,284,841
Commercial	120,825	122,243	123,380	124,759	125,890	125,750	127,467
Industrial	2,040	1,986	1,929	1,874	1,804	1,817	1,680
Other	<u>3,129</u>	<u>3,094</u>	<u>3,306</u>	<u>3,212</u>	<u>3,236</u>	<u>3,222</u>	<u>3,208</u>
Total	<u>1,326,055</u>	<u>1,344,907</u>	<u>1,365,668</u>	<u>1,383,888</u>	<u>1,401,301</u>	<u>1,399,182</u>	<u>1,417,196</u>
Monthly average revenue per client:							
Residential	\$ 32.71	\$ 43.33	\$ 52.52	\$ 48.23	\$ 56.92	\$ 56.53	\$ 57.73
Commercial	474.88	599.01	693.13	647.37	739.61	729.81	763.90
Industrial	12,226.10	16,444.53	18,848.84	16,993.06	19,969.33	19,799.12	21,564.29
Other	1,836.16	2,167.45	2,190.18	2,206.62	2,355.30	2,385.06	2,280.10
All classes	96.01	122.95	142.12	130.20	149.19	148.04	151.77

(1) Includes generating capacity of the EcoEléctrica cogeneration facility.

(2) Includes generating capacity of the EcoEléctrica and AES-PR cogeneration facilities.

(3) Includes power purchased from the EcoEléctrica cogeneration facility.

(4) Includes power purchased from the EcoEléctrica and AES-PR cogeneration facilities.

Historical Capital Improvement and Financing Program

Capital improvements and their financing are made pursuant to a program established by the Authority and reviewed annually by the Consulting Engineers. The program for the five fiscal years ended June 30, 2003 and for the nine-month periods ended March 31, 2003 and 2004 is shown in the following table.

	Years Ended June 30,					Total ⁽¹⁾	Nine Months Ended March 31,	
	1999	2000	2001	2002	2003		2003 ⁽¹⁾	2004 ⁽¹⁾
Capital Improvements	(in thousands)							
Production plant	\$ 154,407	\$ 179,119	\$ 116,775	\$ 123,646	\$ 105,579	\$ 679,526	\$ 68,922	\$ 83,565
Transmission facilities	53,816	48,826	80,741	82,015	111,893	377,291	84,144	73,678
Distribution facilities.....	133,847	86,848	129,139	149,479	124,469	623,782	96,072	96,031
Other ⁽²⁾	67,694	85,591	67,393	60,874	50,165	331,717	31,027	55,071
Total.....	<u>\$ 409,764</u>	<u>\$ 400,384</u>	<u>\$ 394,048</u>	<u>\$ 416,014</u>	<u>\$ 392,106</u>	<u>\$ 2,012,316</u>	<u>\$ 280,165</u>	<u>\$ 308,345</u>
Financing								
Internally generated funds.....	\$ 62,958	\$ 74,265	\$ 100,500	\$ 77,307	\$ 119,001	\$ 434,031	\$ 99,941	\$ 59,125
Borrowed funds ⁽³⁾	346,806	326,119	293,548	338,707	273,105	1,578,285	180,224	249,220
Total.....	<u>\$ 409,764</u>	<u>\$ 400,384</u>	<u>\$ 394,048</u>	<u>\$ 416,014</u>	<u>\$ 392,106</u>	<u>\$ 2,012,316</u>	<u>\$ 280,165</u>	<u>\$ 308,345</u>
Allowance for funds used during construction	\$ 11,677	\$ 12,138	\$ 22,966	\$ 15,993	\$ 16,795	\$ 79,569	\$ 16,400	\$ 14,254

(1) Includes allowance for funds used during construction of \$79.6 million for the five fiscal years ended June 30, 2003, and \$16.4 million and \$14.3 million for the nine-month periods ended March 31, 2003 and 2004, respectively. The inclusion of such funds increases the carrying value of improvements by the amount of interest on borrowed construction funds used to finance plant additions during the period. See Note 2 to the Financial Statements under Utility Plant included in Appendix II hereto.

(2) Includes general land and buildings, general equipment, preliminary surveys and investigations.

(3) Includes interim financing for capital improvements and bond proceeds applied directly to construction.

Projected Five-Year Capital Improvement and Financing Program

Following a public hearing and approval by the Consulting Engineers, the Board must adopt the Authority's capital budget on or before the first day of the ensuing fiscal year. If revisions are required, the Board may amend the capital budget at any time during the fiscal year with the approval of the Consulting Engineers. The capital budget for fiscal year 2005 was adopted in June 2004.

The projected capital improvement program for the five fiscal years ending June 30, 2008 aggregates approximately \$2.2 billion. It is currently estimated that \$396.1 million, or approximately 18.0%, of the projected five-year capital improvement program will be financed by internally generated funds. Estimated capital costs reflect, among other factors, construction contingency allowances and annual cost escalations.

The five-year capital improvement program includes \$808.2 million for production plant. Of this amount, the Authority projects that approximately \$508.3 million will be invested in the improvement of generating units to extend their useful life and continue to increase their reliability and efficiency and the generating capacity of the System. The projected capital improvement program includes the replacement of generating units 5 and 6 at the San Juan Steam Plant as described under "Adequacy of Capacity - Additional Generating Facilities" above and certain costs related to the proposed west coast co-generation plant described under the same heading.

The projected capital improvement program also includes \$520.5 million for transmission facilities and \$504.0 million for distribution facilities. During the next five fiscal years, the Authority will dedicate a

significant amount of its resources to the improvement and expansion of its transmission and distribution facilities.

The Consulting Engineers have examined the projected capital improvement program and found it to be reasonable. The capital improvement program is subject to periodic review and adjustment because of changes in expected demand, environmental requirements, design, equipment delivery schedules, costs of labor, equipment and materials, interest rates and other factors. The following table presents a summary of the projected capital improvement program for the five fiscal years ending June 30, 2008 and its projected financing.

**Projected Capital Improvement Program
(in thousands)**

	Years Ending June 30,					Total ⁽²⁾
	2004 ⁽¹⁾	2005	2006	2007	2008	
<u>Capital Improvements</u>						
Production plant.....	\$ 119,274	\$ 152,568	\$ 172,314	\$ 192,089	\$ 171,906	\$ 808,151
Transmission facilities.....	99,685	117,334	98,934	99,757	104,786	520,496
Distribution facilities.....	124,111	95,346	98,893	98,297	87,368	504,015
Other ⁽³⁾	76,950	69,222	74,376	77,652	71,043	369,243
Total.....	<u>\$ 420,020</u>	<u>\$ 434,470</u>	<u>\$ 444,517</u>	<u>\$ 467,795</u>	<u>\$ 435,103</u>	<u>\$ 2,201,905</u>
<u>Financing Sources</u>						
Internally generated funds.....	\$ 82,139	\$ 102,499	\$ 60,202	\$ 74,135	\$ 77,131	\$ 396,106
Borrowed funds ⁽⁴⁾	337,881	331,971	384,315	393,660	357,972	1,805,799
Total.....	<u>\$ 420,020</u>	<u>\$ 434,470</u>	<u>\$ 444,517</u>	<u>\$ 467,795</u>	<u>\$ 435,103</u>	<u>\$ 2,201,905</u>
Allowance for funds used during construction ...	<u>\$ 21,076</u>	<u>\$ 12,328</u>	<u>\$ 9,758</u>	<u>\$ 21,771</u>	<u>\$ 26,014</u>	<u>\$ 90,947</u>

- (1) Based on actual results for the nine-month period ended on March 31, 2004, and an estimate for the last three months of fiscal year 2004, because as of the date of this Official Statement no final financial figures were available for this period.
- (2) Includes allowance for funds used during construction of \$90.9 million for the five-year period ending June 30, 2008 (see footnote (1) to the table under "Historical Capital Improvement and Financing Program" above).
- (3) Includes general land and buildings, general equipment, preliminary surveys and investigations.
- (4) For the purpose of this table, it is assumed that of the total \$1.5 billion Power Revenue Bonds expected to be issued in the five-year period ending June 30, 2008, \$690.0 million is expected to be used to repay lines of credit with Government Development Bank anticipated to be drawn during this period.

Rates

The Authority has the power to determine, alter, establish and collect reasonable rates for electric service, which shall produce sufficient revenues to cover the operating costs of the Authority, the payment of the principal of and the interest on its bonds, and other contractual obligations. Public hearings are required before the setting of permanent rates, with the final approval vested solely within the Authority. Act No. 21 of the Legislature of Puerto Rico, approved May 31, 1985 ("Act No. 21"), provides uniform procedures for public hearings and review of the actions of certain public corporations, including the Authority, in connection with changes in the rates set by such public corporations. Act No. 21 also authorizes the Legislature by resolution to review rates of certain public corporations, including the Authority. At the request of another public corporation covered by Act No. 21, the Secretary of Justice has rendered an opinion to the effect that Act No. 21 does not grant a veto power to the Legislature over rates adopted properly by such public corporation.

Electric service rates consist primarily of (i) basic charges, made up of demand, client and energy related charges, (ii) fuel adjustment charges to recover the cost to the Authority of fuel oil, and (iii) purchased power charges to recover the cost to the Authority of power purchased from the EcoEléctrica and AES-PR co-generation facilities (which went into effect in fiscal year 2000, when the Authority began purchasing power from the EcoEléctrica facility). Consequently, revenues will reflect changes in the fuel charge and the

purchased power charge caused by fluctuations in the price of fuel oil or purchased power. Basic charges currently average 5.7 cents per kilowatt-hour. The Authority has not increased basic charges since 1989. The following table presents the electric sales revenues derived from basic charges, fuel adjustment charges and purchased power charges for the five fiscal years ended June 30, 2003 and the nine-month periods ended March 31, 2003 and 2004.

	Electric Sales Revenues					Nine Months Ended	
	(in thousands)					March 31,	
	Years Ended June 30,					March 31,	
	1999	2000	2001	2002	2003	2003	2004
Basic charges.....	\$1,035,471	\$1,086,783	\$1,070,693	\$1,101,923	\$1,134,794	\$852,976	\$862,251
Fuel adjustment charges....	492,364	825,924	1,059,108	806,806	994,406	743,744	719,143
Purchased power charges..	-	71,520	199,302	253,442	379,558	267,514	354,429
Total.....	<u>\$1,527,835</u>	<u>\$1,984,227</u>	<u>\$2,329,103</u>	<u>\$2,162,171</u>	<u>\$2,508,758</u>	<u>\$1,864,234</u>	<u>\$1,935,823</u>

The fuel charges imposed in any month are based upon the average of (i) the actual average fuel oil costs for the second preceding month and (ii) the estimated average fuel oil costs for the current month. Purchased power charges are based on estimated purchased power costs for the current month. To the extent that such charges do not fully recover actual fuel or purchased power costs (or recover more than such costs), charges are adjusted in the second succeeding month.

Under the Act, certain residential clients receive a subsidy for the fuel adjustment charge. Residential clients who qualify for the subsidy are billed the full applicable basic charges and fuel adjustment charges, with the applicable subsidy taking the form of a credit against the bill. In addition, under legislation approved in July 1985, certain tourism facilities, such as hotels certified by the Tourism Company, receive subsidies from the Commonwealth. See “Subsidies, Contributions in Lieu of Taxes and Set Aside - Subsidies” below for a more detailed description of these subsidies.

Beginning in April 2003, the Authority began offering industrial clients with manufacturing operations a 6% credit on their base charge for a two-year period provided that the average price of fuel oil used in the calculation of the fuel adjustment charge equaled or exceeded \$20 per barrel. The Governing Board of the Authority increased the 6% credit to 8% for the period from August 2003 to March 2005. Approximately 655 industrial clients will benefit from this credit and it is estimated that during this two-year period they will save approximately \$20.3 million.

To promote an increase in industrial development, the Authority instituted five new special rates. These special rates offer a discount of approximately 11% to those clients that qualify. New industrial clients will receive this discount on their total electric bill. Existing industrial clients that expand their operations will receive this discount on the demand, energy, and adjustment charges associated with the expansion. These rates will be available for five years effective July 30, 2003. The Authority estimates that industry savings could be approximately \$18 million over this five-year period.

Pursuant to the 1974 Trust Agreement, the Consulting Engineers have reviewed the Authority’s rate schedules and believe that the Authority will receive sufficient Revenues to cover Current Expenses and to make the required deposits in the 1974 Sinking Fund, the Reserve Maintenance Fund, the Capital Improvement Fund and, if any are required, the Self-insurance Fund. See Appendix III, *Letter of the Consulting Engineers*.

Major Clients

The public sector, which consists of the Commonwealth government and its public corporations and the municipalities (included primarily in the commercial category), accounted for 11.9% of kWh sales and 13.7% of revenues from electric energy sales for the nine month period ended March 31, 2004.

The ten largest industrial clients accounted for 3.5% of kWh sales and 2.6% of revenues from electric energy sales for the twelve months ended March 31, 2004. No single client accounted for more than 0.5% of electric energy sales or more than 0.3% of revenues from electric energy sales.

In September 1997, the Authority established a new reduced rate for large industrial clients connected at an 115 kV voltage level and meeting certain criteria such as a minimum demand and a high load factor and power factor. This new rate is designed to induce such large clients to whom it may be economical to produce their own electricity to buy more electricity from the Authority and discourage their independent power production. As of March 31, 2004, four of the Authority's industrial clients were using such rate.

Fuel

For the fiscal year ended June 30, 2003, fuel oil expenses amounted to \$886.4 million, or 47.4% of total Current Expenses (\$720.3 million or 46.0% of total Current Expenses for the preceding fiscal year). For the nine months ended March 31, 2004, fuel oil expenses amounted to \$640.2 million, or 43.9% of total Current Expenses. For the five fiscal years ended June 30, 2003, fuel oil averaged 50.2% of total Current Expenses. See "Management's Discussion and Analysis of Operating Results" under *Net Revenues and Coverage*.

The Authority's thermal generating units, which produced approximately 85% of the net electric energy generated by the System in fiscal year 2003, are fueled by No. 6 fuel oil, except for the twenty-two smaller combustion-turbine units, the two Aguirre combined-cycle units and the 249 MW combustion turbine plant in Arecibo, which burn No. 2 distillate fuel oil.

The Authority maintains some generating capacity as a reserve (referred to as a "controlled reserve") in anticipation of unscheduled outages or other unforeseen events. Historically, the Authority has maintained 200 MW of controlled reserve. Under criteria in effect until recently, the Authority would have had to maintain more than 600 MW of additional reserve (referred to as "spinning reserve") to compensate for the required controlled reserve. However, based on its experience, the Authority implemented improvements in the System that have allowed it to reduce its spinning reserve requirements while continuing to provide reliable service to clients and reducing its fuel cost.

The Authority's fuel requirements for its generation facilities are covered by one-year contracts, which expire at various times. The Authority's contracted fuel oil prices consist of an escalation factor plus a fixed price differential. The escalation factor reflects the fuel oil price at the New York market at the time of purchase. The fixed price differential compensates for the fact that the fuel oil is delivered in the Commonwealth and not New York. It also takes into account other aspects of the delivery such as maximum cargo volume and draft restrictions. The Authority does not expect any difficulty in renewing its contracts at price differentials similar to those currently in effect.

Since the Authority's dependence on fuel oil has decreased with the coming on line of the EcoEléctrica and AES-PR co-generation plants, the Authority's customary inventory of fuel oil will cover 40 days of ordinary operations, up from 25 days in the past. Although sources of fuel oil are continually changing as a result of variations in relative price, availability and quality, the Authority has never been forced to curtail service to its clients because of fuel oil shortages. The Authority's total inventory capacity for fuel oil is 3.4 million barrels. As of March 31, 2004, the Authority had an inventory of 2.2 million barrels of fuel oil.

Average fuel oil costs and related costs of production for the five fiscal years ended June 30, 2003, and for the nine months ended March 31, 2003 and 2004, are shown in the following table:

Fuel Costs

	Years Ended June 30,					Nine Months Ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
Average fuel oil cost per barrel (net of handling costs).....	\$ 14.56	\$ 23.54	\$ 29.33	\$ 22.85	\$ 29.64	\$ 29.23	\$ 29.05
Number of barrels used (in millions).....	34.4	34.0	32.2	31.5	29.9	22.7	22.0
Fuel oil cost (in millions).....	\$ 500.9	\$ 801.4	\$ 944.8	\$ 720.3	\$ 886.4	\$ 662.9	\$ 640.2
Net kWh generated (including purchased power from 2000 to 2003) (in millions).....	18,876.8	19,065.1	18,159.2	18,247.4	17,259.0	13,113.9	12,577.9
Average net kWh per barrel.....	548.7	560.7	564.0	579.3	577.2	577.7	571.7
Average fuel oil cost per net kWh generated (in cents).....	2.65	4.20	5.20	3.95	5.14	5.05	5.09

With the addition of the output of the EcoEléctrica and AES-PR facilities to the Authority's System, the Authority's traditional dependence on oil-fired generation has decreased. The Authority estimates that 26% of its annual energy requirements are now being provided by non-oil-fired generating facilities, and that this percentage could increase to 33% upon EcoEléctrica and AES-PR reaching full contracted availability.

Starting in fiscal year 2002, the Authority has entered into a series of contracts intended to protect it against increases in the price of fuel oil. Under the guidelines adopted by the Authority's Governing Board, these contracts could cover up to 16.5% of total fuel oil consumption (approximately 5.2 million barrels of fuel oil). Under these contracts, the Authority receives in cash the amount by which the monthly average market price of No. 6 fuel oil exceeds a fixed price per barrel (ranging between \$22 to \$25 per barrel, depending on the contract). The most recent contracts expired in June 30, 2004. At the present level of fuel oil prices, the Authority has determined that it is not cost effective to enter into new contracts. In addition, the Authority used payments it received from its two co-generators in return for the granting by the Authority of certain waivers under their power purchase agreements to capitalize a special fund (referred to as the PREPA client fund) to provide billing credits to the Authority's clients to protect them against increases in the price of fuel oil. This fund will serve to smooth the effects of the fuel adjustment to the Authority's clients, and it is capitalized at approximately \$26.4 million as of March 31, 2004.

Subsidies, Contributions in Lieu of Taxes and Set Aside

Subsidies

Under the Act, a subsidy is provided for a portion of fuel charges to qualifying residential clients who use up to 425 kWh monthly or 850 kWh bi-monthly. This subsidy takes the form of a credit against their electric bills. The Act limits this subsidy to a maximum of \$100 million per year and limits the cost of fuel oil used in calculating the amount of such subsidy to a maximum of \$30 per barrel. The residential clients must pay any fuel adjustment charge resulting from a price of fuel oil in excess of \$30 per barrel.

Through fiscal year 1991, the subsidy was paid to the Authority by the Commonwealth each year and was recorded as a receivable on the Authority's financial statements. As of June 30, 1991, the amount owed by the Commonwealth to the Authority on account of this fuel oil subsidy program was \$94.9 million. In October 1991, the Authority and the Commonwealth entered into a non-interest bearing fifteen-year payment plan, starting in fiscal year 1993, for the payment of this amount. As of March 31, 2004, the amount owed by the Commonwealth was approximately \$31.6 million. In addition, in 1991, the Authority revised its subsidy implementing regulations to reduce the number of qualifying clients. Under these regulations, the subsidy has amounted to approximately \$14.8 million per year for the five fiscal years ended June 30, 2003. All subsidy

amounts arising since June 30, 1991 have been offset against a portion of the electric energy sales set aside as discussed in *Contributions in Lieu of Taxes and Set Aside* below.

Hotels receive a subsidy in an amount equal to 11% of their monthly billing, which has amounted to approximately \$2.9 million per year for the five fiscal years ended June 30, 2003. In order to receive this subsidy, hotels must maintain their electric service accounts on a current basis. This subsidy takes the form of a credit against their electric bills. In addition, the Authority has recently been offering certain discounts and incentives in the form of credits to certain industrial clients, as described above under “Rates.”

Contributions In Lieu of Taxes and Set Aside

Under the Act, the Authority is required to pay to the Secretary of the Treasury (for distribution to the municipalities) from its Net Revenues (as defined in the Act), after certain defined expenditures and subject to compliance with its obligations under the 1974 Agreement, contributions in lieu of taxes in the amount of 6% of its gross electric energy sales computed on the basis of an annual average fuel oil price of up to \$30 per barrel. Under certain circumstances, if the price exceeds \$30 per barrel, the Authority is empowered to raise this ceiling to provide the municipalities, through contributions in lieu of taxes, with sufficient income to offset their billings for consumption plus the necessary amounts to fulfill their obligations to the Authority. Contributions in lieu of taxes to municipalities can be used to offset accounts receivable balances owed to the Authority, as permitted by law. For fiscal year 2003, contributions in lieu of taxes to municipalities amounted to \$127.4 million, of which \$13.0 million was reimbursed to the municipalities and \$114.4 million was used to offset or reduce outstanding accounts receivable balances. In addition, for the nine-month period ended March 31, 2004, contributions in lieu of taxes to municipalities amounted to \$83.8 million.

The Act requires the Authority to set aside annually from its Net Revenues an additional amount equal to 5% of the Authority’s annual gross electric energy sales (based on kWh) (the “electric energy sales set aside”). One-fifth of the electric energy sales set aside is applied to cover the costs of the fuel oil subsidy program arising after June 30, 1991 (with any balance remaining being used to reduce the amounts owed by the Commonwealth to the Authority on account of such subsidy as of June 30, 1991). Another one-fifth of the electric energy sales set aside is paid to the Secretary of the Treasury for distribution among the municipalities (in addition to the contributions in lieu of taxes described above). The balance of the electric energy sales set aside is used to fund certain of the Authority’s capital improvements and other purposes. The Authority’s obligation to make available the electric energy sales set aside is also subject to the Authority’s obligations under the 1974 Agreement.

In accordance with the Act, if the Authority’s Net Revenues in any year are not sufficient to cover the full amount payable to the municipalities on account of contributions in lieu of taxes and the electric energy sales set aside, calculated as described above, the amount payable by the Authority to the municipalities is reduced to the amount available, and the excess is not carried forward as a liability for future years. During the five fiscal years ended June 30, 2003, the Net Revenues of the Authority were not sufficient to permit the payment to the municipalities of the full amount of contributions in lieu of taxes and to provide for the full amount of the electric energy sales set aside, due to the payment by the Authority of certain obligations under the 1974 Agreement, including deposits into the 1974 Sinking Fund.

On June 30, 2004, a bill to amend the Act was approved by the Legislature of Puerto Rico, and is presently pending signature by the Governor, to change the formula for computing contributions in lieu of taxes and set aside. Under this proposed amendment, 11% of the Authority’s gross electric energy sales will be distributed by the Authority as follows: (1) to fund all government subsidies programs, (2) to pay contributions in lieu of taxes to the municipalities, and (3) to finance the Authority’s capital improvement program and for other purposes. This proposed amendment also provides that the amount of the contribution in lieu of taxes payable to the municipalities will be the greater of the following amounts: (1) 20% of the Authority’s Adjusted Net Revenues (Net Revenues, as defined in the 1974 Agreement, less the cost of government subsidies); (2) actual electric power consumption by the municipalities; or (3) the prior five year moving average of the contributions in lieu of taxes paid to the municipalities. If the Authority does not have

sufficient available funds in any year to pay such contribution to the municipalities, the difference will be accrued and carried forward for a maximum of three years.

DEBT

The following table sets forth the bonds and notes of the Authority outstanding as of July 2, 2004 and as adjusted for the issuance of the Bonds and the refunding of the Refunded Bonds.

	Outstanding as of July 2, 2004	As adjusted ⁽¹⁾	As adjusted ⁽²⁾
	(in thousands)		
Power Revenue Bonds			
Publicly Offered	\$ 4,867,575	\$ 4,856,280	\$ 4,848,605
Rural Electrification.....	<u>29,903</u>	<u>29,903</u>	<u>29,574</u>
Sub-total.....	4,897,478	4,886,183	4,878,179
General Obligation Notes.....	130,000	130,000	125,000
Government Development			
Bank lines of credit	<u>61,452</u>	<u>61,452</u>	<u>61,452</u>
Total.....	<u>\$5,088,930</u>	<u>\$5,077,635</u>	<u>\$5,064,631</u>

(1) As adjusted for the issuance of the Series OO Bonds and Series PP Bonds and the refunding of the Series OO and Series PP Refunded Bonds.

(2) As adjusted for the expected issuance of the Series QQ Bonds and the refunding of the Series QQ Refunded Bonds.

Rural Electrification Bonds

The Rural Utilities Service (formerly the Rural Electrification Administration) has purchased Power Revenue Bonds issued by the Authority to provide funds for the construction of distribution facilities to service qualified areas. As of July 2, 2004, \$29.9 million of such bonds were outstanding at an interest rate of 5%.

General Obligation Notes

The Authority has issued \$125 million of its general obligation notes to certain commercial banks to finance the purchase of fuel oil. The general obligation notes are due on July 2, 2005. In December 1997, the Authority issued a \$5 million note to EcoEléctrica to finance part of the Authority's cogeneration expenses in connection with EcoEléctrica's cogeneration plant in the Municipality of Peñuelas. The note is due October 30, 2004.

Government Development Bank Lines of Credit

The Authority has three lines of credit approved by Government Development Bank. One is a \$68 million line of credit to fund payments made under a settlement agreement relating to certain litigation with the municipalities of Puerto Rico (see *Litigation*). As of July 2, 2004, the Authority had drawn \$61.4 million under this line of credit. In connection with the same litigation, the Government Development Bank approved a second line of credit of \$57 million for electric infrastructure projects in the municipalities. As of July 2, 2004, the Authority had not drawn any amount under this line of credit. The Authority is in the process of making improvements to the Isabela irrigation system. The project will be financed with a third line of credit of \$25.3 million approved by the Government Development Bank. The Authority expects that this line of credit will be paid by the Commonwealth of Puerto Rico from the proceeds of future bond issues. As of July 2, 2004, the Authority had drawn \$40,000 under this line of credit.

Principal and Interest Requirements

Principal and Interest Requirements, as used herein and as defined in the 1974 Agreement, means for any fiscal year the sum of all principal of, including Amortization Requirements for, and interest on, outstanding Power Revenue Bonds which is payable on January 1 in such fiscal year and on July 1 in the following fiscal year. The following table shows the annual Principal and Interest Requirements for the outstanding Power Revenue Bonds after giving effect to the issuance of the Series OO Bonds and Series PP Bonds and the refunding of the Series OO and Series PP Refunded Bonds, without taking into account the issuance of the Series QQ Bonds or the refunding of the Series QQ Refunded Bonds. The Amortization Requirements are subject to adjustment as provided in the definition thereof. See Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

Debt Service Requirements

Years Ending June 30	Outstanding Bonds Principal and Interest Requirements ⁽¹⁾	Series OO Bonds and Series PP Bonds			Total Debt Service Requirements
		Maturity and Amortization Requirements	Interest	Total	
2005	\$404,684,472.15	\$ 4,315,000.00	\$ 9,393,539.33	\$ 13,708,539.33	\$ 418,393,011.48
2006	429,943,707.57	1,525,000.00	10,926,606.26	12,451,606.26	442,395,313.83
2007	420,700,107.57	1,580,000.00	10,865,606.26	12,445,606.26	433,145,713.83
2008	390,194,277.57	1,650,000.00	10,802,406.26	12,452,406.26	402,646,683.83
2009	391,302,923.82	1,715,000.00	10,736,406.26	12,451,406.26	403,754,330.08
2010	359,583,383.82	3,770,000.00	10,652,906.26	14,422,906.26	374,006,290.08
2011	357,164,446.32	1,865,000.00	10,466,756.26	12,331,756.26	369,496,202.58
2012	360,462,742.56	1,960,000.00	10,377,826.26	12,337,826.26	372,800,568.82
2013	310,056,367.56	57,885,000.00	10,283,888.76	68,168,888.76	378,225,256.32
2014	307,955,816.30	60,295,000.00	7,393,538.76	67,688,538.76	375,644,355.06
2015	352,430,642.54	3,090,000.00	4,382,498.76	7,472,498.76	359,903,141.30
2016	348,447,192.54	285,000.00	4,231,436.26	4,516,436.26	352,963,628.80
2017	347,219,220.02	300,000.00	4,220,891.26	4,520,891.26	351,740,111.28
2018	297,384,926.26	310,000.00	4,209,641.26	4,519,641.26	301,904,567.52
2019	296,409,357.52	320,000.00	4,197,861.26	4,517,861.26	300,927,218.78
2020	294,041,420.02	335,000.00	4,185,381.26	4,520,381.26	298,561,801.28
2021	293,630,012.52	345,000.00	4,171,981.26	4,516,981.26	298,146,993.78
2022	252,963,868.78	19,290,000.00	4,157,750.00	23,447,750.00	276,411,618.78
2023	252,669,637.52	20,260,000.00	3,193,250.00	23,453,250.00	276,122,887.52
2024	232,530,650.02	21,270,000.00	2,180,250.00	23,450,250.00	255,980,900.02
2025	206,130,731.28	22,335,000.00	1,116,750.00	23,451,750.00	229,582,481.28
2026	206,124,037.52				206,124,037.52
2027	206,124,750.00				206,124,750.00
2028	173,775,618.76				173,775,618.76
2029	138,698,087.50				138,698,087.50
2030	138,695,775.00				138,695,775.00
2031	96,199,075.00				96,199,075.00
2032	47,916,137.50				47,916,137.50
2033	47,917,887.50				47,917,887.50
Total	\$7,961,357,273.04	\$224,700,000.00	\$142,147,171.99	\$366,847,171.99	\$8,328,204,445.03

(1) Debt service requirements on all Power Revenue Bonds outstanding on July 2, 2004, excluding debt service on the Series OO and Series PP Refunded Bonds (other than principal paid in fiscal year 2005 prior to the date hereof with respect to the Series OO and Series PP Refunded Bonds, which principal is included).

The following table shows the annual Principal and Interest Requirements for the outstanding Power Revenue Bonds after giving effect to the expected issuance of the Series QQ Bonds and the refunding of the Series QQ Refunded Bonds. The Amortization Requirements are subject to adjustment as provided in the definition thereof. See Appendix I, *Summary of Certain Provisions in the 1974 Agreement Excluding Proposed Supplemental Agreement*.

Debt Service Requirements

Years Ending June 30	Outstanding Bonds Principal and Interest Requirements ⁽¹⁾	Series QQ Bonds			Total Debt Service Requirements
		Maturity and Amortization Requirements	Interest	Total	
2005	\$ 411,827,186.48		\$ 1,249,268.65	\$ 1,249,268.65	\$ 413,076,455.13
2006	437,202,063.83		5,169,387.50	5,169,387.50	442,371,451.33
2007	427,952,463.83		5,169,387.50	5,169,387.50	433,121,851.33
2008	397,453,433.83		5,169,387.50	5,169,387.50	402,622,821.33
2009	398,561,080.08		5,169,387.50	5,169,387.50	403,730,467.58
2010	368,813,040.08		5,169,387.50	5,169,387.50	373,982,427.58
2011	364,302,952.58		5,169,387.50	5,169,387.50	369,472,340.08
2012	367,607,318.82		5,169,387.50	5,169,387.50	372,776,706.32
2013	359,087,006.32	\$ 13,500,000.00	5,169,387.50	18,669,387.50	377,756,393.82
2014	356,498,080.06	14,685,000.00	4,460,637.50	19,145,637.50	375,643,717.56
2015	340,761,466.30	15,450,000.00	3,689,675.00	19,139,675.00	359,901,141.30
2016	333,825,828.80	16,295,000.00	2,839,925.00	19,134,925.00	352,960,753.80
2017	332,597,936.28	17,195,000.00	1,943,700.00	19,138,700.00	351,736,636.28
2018	282,759,592.52	18,145,000.00	997,975.00	19,142,975.00	301,902,567.52
2019	300,927,218.78				300,927,218.78
2020	298,561,801.28				298,561,801.28
2021	298,146,993.78				298,146,993.78
2022	276,411,618.78				276,411,618.78
2023	276,122,887.52				276,122,887.52
2024	255,980,900.02				255,980,900.02
2025	229,582,481.28				229,582,481.28
2026	206,124,037.52				206,124,037.52
2027	206,124,750.00				206,124,750.00
2028	173,775,618.76				173,775,618.76
2029	138,698,087.50				138,698,087.50
2030	138,695,775.00				138,695,775.00
2031	96,199,075.00				96,199,075.00
2032	47,916,137.50				47,916,137.50
2033	47,917,887.50				47,917,887.50
Total	\$8,170,434,720.03	\$95,270,000.00	\$56,536,281.15	\$151,806,281.15	\$8,322,241,001.18

(1) Debt service requirements on all Power Revenue Bonds outstanding on July 2, 2004, and on the Series OO Bonds and Series PP Bonds, excluding debt service on the Refunded Bonds (other than principal paid in fiscal year 2005 prior to the date hereof with respect to the Refunded Bonds, which principal is included).

NET REVENUES AND COVERAGE

The following table presents the Net Revenues of the Authority under the provisions of the 1974 Agreement for the five fiscal years ended June 30, 2003 and for the nine-month periods ended March 31, 2003 and 2004 and the ratio of such Net Revenues to Principal and Interest Requirements on the Power Revenue Bonds. These calculations of Net Revenues differ in several important respects from the Authority's calculations of changes in net assets prepared in conformity with generally accepted accounting principles. For example, they do not include depreciation as a current expense and do not reflect interest expense as a deduction from Net Revenues.

Historical Net Revenues and Coverage

	Years Ended June 30,					Nine Months Ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
Average number of clients.....	1,326,055	1,344,907	1,365,668	1,383,888	1,401,301	1,399,182	1,417,196
Electric energy sales (in millions of kWh)	16,989	18,145	18,723	19,130	19,887	14,926	15,199
Source of Net Revenues							
(dollars in thousands)							
Revenues:							
Sales of electric energy:							
Residential ⁽¹⁾	\$ 471,070	\$ 633,151	\$ 779,682	\$ 725,797	\$ 867,684	\$ 645,339	\$ 667,594
Commercial.....	688,526	878,697	1,026,219	969,182	1,117,317	825,957	876,346
Industrial.....	299,295	391,906	436,313	382,140	432,296	323,775	326,052
Other.....	<u>68,944</u>	<u>80,473</u>	<u>86,889</u>	<u>85,052</u>	<u>91,461</u>	<u>69,163</u>	<u>65,831</u>
	1,527,835	1,984,227	2,329,103	2,162,171	2,508,758	1,864,234	1,935,823
Revenues from Commonwealth for rural electrification.....	941	881	705	739	704	531	441
Other operating revenues.....	8,827	10,240	8,210	8,514	9,625	6,713	7,107
Other (principally interest earned).....	<u>26,350</u>	<u>29,936</u>	<u>35,059</u>	<u>22,257</u>	<u>17,163</u>	<u>13,505</u>	<u>8,095</u>
	1,563,953	2,025,284	2,373,077	2,193,681	2,536,250	1,884,983	1,951,466
Current Expenses:							
Operations:							
Fuel.....	500,920	801,433	944,760	720,292	886,425	662,954	640,248
Purchased power.....	-	64,517	177,330	227,923	339,082	238,991	316,638
Other production.....	42,818	55,690	56,301	56,029	44,990	31,569	36,443
Transmission and Distribution.....	83,385	94,793	105,034	114,971	119,408	88,304	99,156
Customer accounting and Collection.....	67,517	76,598	83,453	84,689	89,710	67,786	67,150
Administrative and General.....	142,866	151,069	139,117	146,497	163,517	120,359	120,513
Maintenance ⁽²⁾	212,530	219,812	213,666	212,959	224,941	172,402	174,812
Other.....	<u>2,725</u>	<u>2,911</u>	<u>3,028</u>	<u>3,235</u>	<u>3,403</u>	<u>2,579</u>	<u>2,757</u>
	<u>1,052,761</u>	<u>1,466,823</u>	<u>1,722,689</u>	<u>1,566,595</u>	<u>1,871,476</u>	<u>1,384,944</u>	<u>1,457,717</u>
Net Revenues.....	<u>\$ 511,192</u>	<u>\$ 558,461</u>	<u>\$ 650,388</u>	<u>\$ 627,086</u>	<u>\$ 664,774</u>	<u>\$ 500,039</u>	<u>\$ 493,749</u>
Coverage							
Principal and Interest Requirements.....	<u>\$ 348,963</u>	<u>\$ 346,417</u>	<u>\$ 367,796</u>	<u>\$ 392,043</u>	<u>\$ 381,178</u>	-	-
Ratio of Net Revenues to Principal and Interest Requirements.....	1.46	1.61	1.77	1.60	1.74	-	-

(1) Net of residential subsidy. See "Subsidies, Contributions in Lieu of Taxes and Set Aside" under *The System*.

(2) Includes, for maintenance of generating facilities, \$126.1 million, \$115.6 million, \$113.0 million, \$112.2 million and \$122.6 million for fiscal years ended June 30, 1999, 2000, 2001, 2002 and 2003, respectively. For the nine months ended March 31, 2004 and 2003, the maintenance expense of generating facilities was \$100.8 million and \$94.8 million, respectively.

Management's Discussion and Analysis of Operating Results

The following represents the Authority's analysis of its operations for the nine-month periods ended March 31, 2003 and 2004, and for the five fiscal years ended June 30, 2003. For additional analysis of the Authority's results of operations, see *Management's Discussion and Analysis* in the Authority's audited financial statements, included as Appendix II.

For the nine months ended March 31, 2004 as compared to the nine months ended March 31, 2003, Revenues increased by \$66.5 and Current Expenses increased by \$72.8 million, resulting in a decrease in Net Revenues of \$6.3 million. The increases in Revenues and Current Expenses were mainly due to an increase in energy sales in kWh of 1.8% and an increase of \$0.0066 per kWh (or 10.4%) in the average price of purchased power. Accounts receivable of the Authority increased from \$501.2 million on June 30, 2003 to \$516.8 million on March 31, 2004. The increase in accounts receivable is related to the increase in Revenues and the proportion of accounts receivable to revenues is consistent with the preceding fiscal year. In addition, accounts receivable from the governmental sector increased from \$103.6 million on June 30, 2003 to \$137.5 million on March 31, 2004.

For the fiscal year ended June 30, 2003 as compared to the fiscal year ended June 30, 2002, Revenues increased by \$342.6 and Current Expenses increased by \$304.90 million, resulting in an increase in Net Revenues of \$37.7 million. These increases were mainly due to an increase of \$7.32 per barrel (or 32%) in the price of fuel oil. Accounts receivable of the Authority increased from \$438.6 million on June 30, 2002 to \$501.2 million on June 30, 2003. In addition, accounts receivable from the governmental sector decreased slightly from \$108.4 million on June 30, 2002 to \$103.6 million on June 30, 2003.

For the fiscal year ended June 30, 2002 as compared to the fiscal year ended June 30, 2001, Revenues decreased by \$179.4 million and Current Expenses decreased by \$156.1 million, resulting in a decrease in Net Revenues of \$23.3 million. These decreases were mainly due to a decrease of \$6.48 per barrel (or 22.1%) in the price of fuel oil. Accounts receivable of the Authority increased from \$410.7 million on June 30, 2001 to \$438.6 million on June 30, 2002. In addition, accounts receivable from the governmental sector increased from \$93.1 million on June 30, 2001 to \$108.4 million on June 30, 2002.

For the fiscal year ended June 30, 2001 as compared to the fiscal year ended June 30, 2000, Revenues increased by \$347.8 million and Current Expenses increased by \$255.9 million, resulting in an increase in Net Revenues of \$91.9 million. These increases were mainly due to an increase in electric energy sales in kWh of 3.2% and an increase of \$5.79 per barrel (or 24.6%) in the price of fuel oil. Accounts receivable of the Authority increased from \$385.2 million on June 30, 2000 to \$410.7 million on June 30, 2001. In addition, accounts receivable from the governmental sector decreased from \$113.6 million on June 30, 2000 to \$93.1 million on June 30, 2001. This decrease was mainly due to the increase in the amount paid by the Authority as contributions in lieu of taxes from \$82.0 million in fiscal 2000 to \$115.5 million in fiscal 2001, which was used to offset the accounts receivable balance owed by the municipalities.

For the fiscal year ended June 30, 2000 as compared to the fiscal year ended June 30, 1999, Revenues increased by \$461.3 million and Current Expenses increased by \$414.1 million, resulting in an increase in Net Revenues of \$47.2 million. These increases were mainly due to the damage caused by Hurricane Georges in September 1998, which affected the results for the 1999 fiscal year, and to an increase of \$8.98 (or 61.7%) in the price per barrel of fuel oil. As a result, the accounts receivable of the Authority increased from \$305.9 million on June 30, 1999 to \$385.2 million on June 30, 2000. The increase in accounts receivable was related to the increase in Revenues and the proportion of accounts receivable to revenues was consistent with the preceding fiscal year. In addition, accounts receivable from the governmental sector increased from \$83.0 million on June 30, 1999 to \$113.6 million on June 30, 2000 for the same reason.

For the fiscal year ended June 30, 1999, as compared to the fiscal year ended June 30, 1998, Revenues decreased by \$169.7 million and Current Expenses decreased by \$133.4 million, resulting in a decrease in Net Revenues of \$36.3 million. These decreases were mainly due to a decrease of \$3.83 per barrel (or 20.8%) in the price of fuel oil as well as the impact of Hurricane Georges on the results for the 1999 fiscal year. Accounts receivable of the Authority decreased from \$379.7 million on June 30, 1998 to \$305.9 million on June 30, 1999. Accounts receivable from the governmental sector decreased from \$164.9 million on June 30, 1998 to \$83.0 million on June 30, 1999 mainly due to collections from Puerto Rico Aqueduct and Sewer Authority and other government agencies.

The following table presents the disposition of Net Revenues, in the order of priority of payment, for the five fiscal years ended June 30, 2003 and for the nine months ended March 31, 2003 and 2004, in accordance with the provisions of the 1974 Agreement. As discussed above, the Net Revenues shown below and in "Projected Net Revenues" under *Net Revenues and Coverage* are calculated in a manner that differs in several important respects from the Authority's calculation of net income prepared in accordance with generally accepted accounting principles.

Disposition of Net Revenues	Historical Disposition of Net Revenues (in thousands)					Nine Months Ended	
	Years Ended June 30,					March 31,	
	1999	2000	2001	2002	2003	2003	2004
1974 Sinking Fund							
Interest.....	\$ 224,935	\$ 224,758	\$ 240,459	\$ 248,469	\$ 249,779	\$ 187,351	\$ 197,272
Principal.....	139,704	145,058	146,989	158,357	137,329	103,004	124,506
1974 Reserve Account.....	-	-	-	-	(30,000) ⁽¹⁾	(17,000) ⁽¹⁾	-
Reserve Maintenance Fund.....	6,000	7,000	7,000	7,000	7,000	5,247	5,247
Self-insurance Fund.....	-	-	-	-	-	-	-
Capital Improvement Fund.....	62,958	74,265	100,500	77,307	119,001	99,941	59,125
General Obligation Notes							
Interest.....	410	103	-	-	-	-	1,005
Contributions in lieu of taxes and other ⁽²⁾	<u>77,185</u>	<u>107,277</u>	<u>155,440</u>	<u>135,953</u>	<u>181,665</u>	<u>121,496</u>	<u>106,594</u>
Net Revenues.....	<u>\$ 511,192</u>	<u>\$ 558,461</u>	<u>\$ 650,388</u>	<u>\$ 627,086</u>	<u>\$ 664,774</u>	<u>\$ 500,039</u>	<u>\$ 493,749</u>

(1) The excess funds from this account were transferred to the 1974 Bond Service Account.

(2) Including the following amounts retained by the Authority to offset certain Commonwealth obligations to the Authority, the residential subsidy and other subsidies granted to the hotel industry: \$18.1 million, \$23.5 million, \$33.6 million, \$26.0 million and \$28.7 million for fiscal years ended June 30, 1999, 2000, 2001, 2002 and 2003, respectively. For the nine months ended March 31, 2003 and 2004, those subsidies amounted to \$21.0 million and \$22.8 million, respectively. See "Subsidies, Contributions in Lieu of Taxes and Set Aside" under *The System*.

Factors Affecting the Utility Industry

The electric utility industry generally has faced and is facing certain adverse factors. These include (1) the high cost of construction and operation of utility facilities, (2) the uncertain cost of capital, (3) regulations, licensing procedures, litigation and other factors which may delay the construction and increase the cost of new facilities or limit the use of, or necessitate costly modifications to, existing facilities, and (4) the substantially increased capital outlays and longer construction periods required for new facilities. The

Authority is unable to predict the future effect of these or other factors upon its operations and financial condition.

The electric utility industry in the United States mainland is changing from a regulated monopoly business to a deregulated competitive industry. The Federal Energy Regulatory Commission (“FERC”) has mandated wholesale wheeling and open access for transmission facilities owned by utilities that engage in interstate commerce. Many states have enacted or proposed laws and regulations that are designed to (i) insure open access to transmission facilities to promote wholesale power supply competition and (ii) phase in retail competition.

The Authority’s competitive situation is different from that of most United States mainland utilities. There are no wholesale clients in the Commonwealth. The application of FERC’s requirements to the Authority is limited because the Authority is not interconnected with any other utility. The Authority is not currently subject to FERC’s regulations regarding wholesale wheeling.

The absence of mandated open access to the Authority’s transmission and distribution system limits competition to on-site power for large industrial clients with little prospect of excess power sales. Additionally, the commercial availability of electric generating units depends heavily on economies of scale and tends not to be economic in small sizes, less than 60 MW, which size is significantly larger than the peak demand of the Authority’s largest industrial client.

Projected Net Revenues

The main assumptions used by the Authority in preparing the estimates of Net Revenues set forth below are the following:

Revenues..... Projected Revenues from sales of electric energy are based upon economic growth projections for the Commonwealth. The Revenue projections assume annual sales growth of 2.2%, and incorporate the Authority’s results for the first nine months of fiscal year 2004.

Fuel Projected fuel prices are based upon an analysis prepared by the Authority. The following table sets forth projected average per barrel fuel prices:

Projected Fuel Prices

Years Ending June 30,	Average Price Per Barrel ⁽¹⁾
2004.....	\$ 28.65 ⁽²⁾
2005.....	31.70
2006.....	29.72
2007.....	30.66
2008.....	31.59

(1) This is a blended price of No. 2 and No. 6 fuel oil prices. The prices exclude handling charges.

(2) Based on actual prices through March 31, 2004 and estimates for the remainder of the fiscal year.

The following table presents the Authority’s estimates of Net Revenues for the five fiscal years ending June 30, 2008, in accordance with the provisions of the 1974 Agreement, and the ratio of Net Revenues to Principal and Interest Requirements for Power Revenue Bonds.

Beginning in fiscal year 2000, a portion of the Authority’s electric sales is derived from energy purchased from the EcoEléctrica and AES-PR co-generating facilities. For purposes of the following table

and the 1974 Agreement, all payments by the Authority for the purchase of such energy are treated as a Current Expense and will be passed through to its clients in the same manner as its fuel costs are passed through. Payments made by the Authority for the purchase of power will fluctuate based on plant availability, price changes and other factors.

Projected Net Revenues and Coverage

	Years Ending June 30,				
	2004 ⁽¹⁾	2005	2006	2007	2008
Average number of clients	1,417,718	1,435,492	1,451,494	1,467,257	1,483,712
Electric energy sales (in millions of kWh).....	20,340.9	20,829.9	21,335.5	21,843.5	22,227.8
Authority generation (gross)(in millions of KWh).....	19,610.0	17,220.0	16,729.0	16,995.0	17,819.0
Purchased generation (gross)(in millions of KWh).....	5,947.0	7,511.0	7,381.0	7,736.0	7,511.0
Sources of Net Revenues					
(dollars in thousands)					
Revenues:					
Sales of electric energy:					
Residential	\$ 890,747	\$ 946,457	\$ 932,257	\$ 948,313	\$ 972,547
Commercial	1,172,288	1,234,804	1,265,333	1,314,945	1,371,653
Industrial.....	441,271	469,497	473,687	479,943	492,712
Other.....	88,797	90,877	89,351	89,428	90,542
	<u>2,593,103</u>	<u>2,741,635</u>	<u>2,760,628</u>	<u>2,832,629</u>	<u>2,927,454</u>
Revenues from Commonwealth for					
Rural Electrification	591	161	116	76	26
Other (principally, interests earned).....	24,766	27,403	29,403	31,403	33,403
	<u>2,618,460</u>	<u>2,769,199</u>	<u>2,790,147</u>	<u>2,864,108</u>	<u>2,960,883</u>
Current Expenses ⁽²⁾ :					
Operations:					
Fuel	850,461	898,527	869,098	886,653	948,386
Purchased Power	428,289	491,662	504,746	523,922	525,469
Other Production	49,231	50,141	51,179	52,238	53,319
Transmission and Distribution	127,245	123,446	126,000	128,608	131,270
Customer Accounting and Collections	91,457	100,671	102,754	104,881	107,052
Administration and general	161,650	166,519	169,964	173,481	177,073
Maintenance	235,776	251,058	256,253	261,557	266,971
Other – Interest Charges.....	3,278	2,130	2,183	2,237	2,293
	<u>1,947,387</u>	<u>2,084,154</u>	<u>2,082,177</u>	<u>2,133,577</u>	<u>2,211,833</u>
Net Revenues.....	<u>\$ 671,073</u>	<u>\$ 685,045</u>	<u>\$ 707,970</u>	<u>\$ 730,531</u>	<u>\$ 749,050</u>
Coverage					
Principal and Interest Requirements ⁽³⁾	\$ 433,837	\$ 413,077	\$ 473,299	\$ 477,508	\$ 488,681
Ratio of Net Revenues to Principal and Interest Requirements.....	1.55	1.66	1.50	1.53	1.53

(1) Based on actual results through March 31, 2004 and estimates for the remainder of the fiscal year.

(2) The Current Expenses (excluding fuel oil and purchased power) projections assume an annual growth of 2%.

(3) Includes debt service requirements for (i) the outstanding Power Revenue Bonds (including the Bonds, but excluding the Refunded Bonds), and (ii) expected Power Revenue Bond issues, all at an assumed interest rate of 6% (\$515.5 million in fiscal year 2006, \$463.9 million in fiscal year 2007, and \$489.7 million in fiscal year 2008) (no repayments of principal of these issues are assumed until after fiscal year 2005).

The Authority's estimates of Net Revenues, which were made as part of the adoption of its budget of Current Expenses for fiscal year 2005, have been reviewed and analyzed by the Consulting Engineers. The Consulting Engineers have concluded that (i) the methodology used by the Authority in preparing its revenue and capacity projections generally follows accepted utility practice and is appropriate for the Authority, (ii) the Authority's estimates of future growth form a reasonable basis for its projected operating results, and (iii) the Authority's rates should generate sufficient revenues to pay its Current Expenses and debt service and to finance that portion of its capital improvement program that is currently anticipated to be financed with current operating revenues. See Appendix III, *Letter of Consulting Engineers*.

Although the Authority and the Consulting Engineers believe that the assumptions upon which the estimates of Net Revenues are based are reasonable, actual results may differ from the estimates as circumstances change. In addition, such projections were not intended to comply with the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of financial projections. The projections have been prepared on the basis of Net Revenues as defined in the 1974 Trust Agreement which differs in several important respects from the Authority's net income prepared in conformity with generally accepted accounting principles in that they do not include, for example, depreciation as a current expense and do not reflect interest expense on Power Revenue Bonds as a deduction from Net Revenues.

The following table presents the projected disposition of Net Revenues, in the order of priority of payment, for the five fiscal years ending June 30, 2008, in accordance with the provisions of the 1974 Agreement.

**Projected Disposition of Net Revenues
(in thousands)**

	Years Ending June 30,				
	2004 ⁽¹⁾	2005	2006	2007	2008
Disposition of Net Revenues					
1974 Sinking Fund:					
Interest.....	\$ 266,140	\$ 256,693	\$ 278,415	\$ 274,153	\$ 297,939
Principal	166,006	156,384	194,884	203,355	190,742
Reserve.....	-	2,018	2,018	2,018	2,018
Reserve Maintenance Fund	7,000	7,000	7,000	7,000	7,000
Interest on Notes	670	-	-	-	-
Self-insurance Fund.....	-	-	-	-	-
Capital Improvement Fund.....	82,139	102,499	60,202	74,135	77,131
Contributions in lieu of taxes and other ⁽²⁾	<u>149,118</u>	<u>160,451</u>	<u>165,451</u>	<u>169,870</u>	<u>174,220</u>
Total Net Revenues.....	<u>\$ 671,073</u>	<u>\$ 685,045</u>	<u>\$ 707,970</u>	<u>\$ 730,531</u>	<u>\$ 749,050</u>

(1) Based on actual results for the nine-month period ended March 31, 2004 and an estimate for the last three months of fiscal year 2004.
(2) Includes the following amounts to be retained by the Authority and used to pay interest on its General Obligation Notes and to offset certain Commonwealth obligations to the Authority, the residential subsidy and the subsidy granted to the hotel industry: \$30.1 million, \$29.3 million, \$29.8 million, \$29.7 million and \$30.5 million for fiscal years ending June 30, 2004, 2005, 2006, 2007 and 2008, respectively. See "Subsidies, Contributions in Lieu of Taxes and Set Aside" under *The System*.

ENVIRONMENTAL MATTERS

The Authority's Planning and Environmental Protection Division is responsible for ensuring the Authority's compliance with all applicable federal and Commonwealth environmental laws and regulations. The Division is in charge of developing and implementing a comprehensive program to improve the Authority's performance in all applicable environmental media, taking into account new regulatory requirements as well as alleged instances of noncompliance cited by the Environmental Protection Agency ("EPA") and any other environmental agencies.

Environmental Litigation and Administrative Proceedings

Consent Decree

In February 1992, EPA conducted a multimedia inspection of the Authority's four thermoelectric plants as well as the Monacillos Transmission Center. EPA released a report of its findings in December 1992. In its findings, EPA identified several alleged instances of non-compliance related to the Authority's air, water and oil spill prevention control and countermeasures compliance programs.

The Authority and EPA undertook negotiations to resolve the issues regarding the deficiencies observed during the inspection and to ensure future compliance with all applicable laws and regulations. As a result of the negotiations, the Authority and EPA reached an agreement that resulted in a Consent Decree approved by the United States District Court for the District of Puerto Rico on March 19, 1999. In the Consent Decree, the Authority agreed to pay a civil penalty of \$1.5 million, which has already been paid, and to implement additional compliance projects amounting to \$4.5 million, which have already been funded to the full extent required by the Consent Decree. In addition, the Consent Decree requires that the Authority improve and implement compliance programs and operations in order to assure compliance with environmental laws and regulations.

In November 1999, pursuant to the provisions of the Consent Decree, the Authority filed a Notice of Dispute Resolution with the United States District Court for the District of Puerto Rico to contest EPA's interpretation of the applicable method to determine visible emission from the generating units. In this Notice, the Authority disputes the specific location where the visible emissions of the plume are read. In December 1999, the Authority filed another Notice of Dispute Resolution pursuant to the Consent Decree to dispute EPA's determination that the Costa Sur power plant is a repetitious violator of the visible emission requirements of the Consent Decree. The Authority has received several notices of violation in this respect, but the outcome of such notices depends upon the resolution of EPA's interpretation explained above. Although both Notices of Dispute Resolution are pending before the United States District Court, the parties reached an agreement in principle to settle such Notices and notified the court as to the agreement in June of 2004. A major program within the agreement is the reduction in two steps of the sulfur content in No. 6 fuel oil at the Authority's southbound power plants to 0.75% or less by March 1, 2005 and to 0.50% or less by March 1, 2007. The agreement implements EPA's interpretation of the applicable method to determine visible emissions, addresses the notices of violation and includes other minor programs. The Authority believes that the agreement, once finalized and approved by the Court, will enable the Authority to take additional measures that will enhance its ability to comply with the Consent Decree.

Probation

In September 1995, while preparing for Hurricane Luis, approximately 270,000 gallons of acidic wastewater were discharged from the Palo Seco power plant into the Bayamón River, affecting a nearby mangrove swamp. After investigations by the EPA and the United States Department of Justice, on June 11, 1999, the Authority pleaded guilty to a misdemeanor of negligently discharging a pollutant into waters of the

United States, in violation of the criminal provisions of the Clean Water Act, and was ordered to pay a \$140,000 fine, which it has paid. The Authority was placed on probation for two years.

In response to this violation, the Authority has undertaken an extensive program to prevent and detect violations of environmental law. Pursuant to this program, the Authority's plant personnel have been trained at seminars in methods to avoid and detect environmental violations.

In June 2001, the U.S. Probation Office filed a show cause motion with the magistrate judge alleging that the Authority had not complied with all the terms of its probation. The show cause order stated that EPA contended that the Authority had violated certain conditions of the Consent Decree, which in turn violated Condition Five of the probation conditions. Through negotiations with the government, resolution of these issues was reached by Letter Agreement dated December 13, 2001, under which the Authority agreed to an extension of its probation by 18 months, to the enumeration of a series of specific environmental requirements to be put in place in lieu of Condition Five, and to pay a \$10,000 fine.

The Government of the United States and the Authority executed a Settlement Agreement on June 20, 2002. The United States District Court for the District of Puerto Rico accepted the terms of the Settlement Agreement, after a hearing held on July 18, 2002, and entered an Amended Order of Probation on July 24, 2002. Material points of the agreement include the selection of a Visible Emissions Compliance Auditor acceptable to the Court, the funding of 14 air quality-monitoring stations in an amount not to exceed \$420,000 (of which \$417,945 has already been expended) to be provided to the Puerto Rico Environmental Quality Board and a fine of \$10,000. This fine was paid in August of 2002.

The Settlement Agreement also provides that the Authority will burn fuel with a sulfur content not to exceed 0.5% by weight at the Authority's Palo Seco and San Juan power plants for a period of not less than two years. Both power plants began burning 0.5% sulfur fuel in early 2003. The use of 0.5% sulfur fuel is expected to increase the Authority's fuel costs by approximately \$15 to 27 million per year for these two years. The Authority is mitigating this cost increase by using money from the Clients Fund and through a hedging program for fuel purchases (however, the most recent hedging agreements expired in June 30, 2004). The Court selected a Visible Emissions Compliance Auditor on May 2003. The Authority created an account to fund the air quality monitoring stations and has paid approximately \$220,000 to date.

Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

In June 2002, the Authority received a "Special Notice Concerning Remedial Investigation/ Feasibility Study for Soil at the Vega Baja Solid Waste Disposal Superfund Site." EPA has identified the Authority and six other entities as potentially responsible parties (PRPs), as defined in CERCLA. The Authority requested additional information from EPA regarding the extent of its activities at the site. In April 2003, the Authority agreed to join the other PRPs in an Administrative Order on Consent for Remedial Investigation and Feasibility Study, with the understanding that such agreement did not constitute an acceptance of responsibility. The Authority believes that participation in this study will enable the Authority to demonstrate that it has no responsibility regarding the site or that its responsibility, if any, is *de minimis*. Under the Administrative Order on Consent, the Authority committed up to \$250,000 as its contribution to partially fund the Remedial Investigation and Feasibility Study. It is expected that this amount will be disbursed over a two-year period, which is the approximate time it will take to complete the study.

Compliance Programs

The Authority continues to develop and implement a comprehensive program to improve environmental compliance in all applicable environmental media. This program has been and continues to be updated to conform to new regulatory requirements.

Air Quality Compliance

The Authority continues in its effort to reduce visible emissions at the Aguirre and Costa Sur power plants. While current operating permits allow the use of No. 6 fuel oil with up to 1.5% sulfur content, the Authority continues voluntarily to burn No. 6 fuel oil with 1.0% sulfur content. In general, the Authority is consistently maintaining over a 99% level of compliance with in-stack opacity requirements. Also, as part of the probation extension agreement discussed above, the Authority keeps burning No. 6 fuel oil with sulfur contents equal to or less than 0.5% at its Palo Seco and San Juan power plants and will switch to use No. 6 fuel oil with sulfur content equal to or less than 0.75% at Aguirre and Costa Sur power plants under the provisions of recent agreements.

The Authority continues the use of fuel additives under a test program. Since each power unit has its own characteristics, the program will allow the identification of the most suitable additive to improve maintenance and enhance environmental compliance. To date, water and oil-based fuel additives have been tested at the Aguirre, South Coast and Palo Seco power plants. Since the beginning of burning of No. 6 fuel oil with 0.5% or less sulfur content, additives have been discontinued at the Palo Seco power plant.

EPA issued an administrative order that allowed the removal of the SCR (“Selected Catalytic Reduction”) system from the Authority’s combustion turbine plant in Arecibo. As a result of the issuance of said administrative order, the PSD (“Prevention of Significant Deterioration”) permit was revised accordingly. Currently, the revision is under EPA’s evaluation. Also a revision to the Construction Permit related to the Puerto Rico Environmental Quality Board was submitted and is being evaluated by this agency. The removal of the SCR system had the effect of eliminating ammonia injection for Nitrogen Oxide emission control, resulting in expected savings of approximately \$5 million annually.

The Authority recently received a new PSD permit for the construction of two new generating units (Units 5 and 6) at the San Juan power plant. As part of the permit requirements, the Authority is requested to burn No. 6 fuel oil with sulfur content equal to or less than 0.5% at its existing generating units at that plant. The new generating units will burn No. 2 fuel oil with sulfur content equal to or less than 0.05%.

After implementing the Air Quality Compliance Programs pursuant to the Consent Decree and certain additional measures, like using No. 6 fuel oil with a sulfur content of 0.5% at the San Juan and Palo Seco power plants, and 0.75% at the Aguirre and Costa Sur power plants, the Authority expects to be in full compliance with all visible emission requirements.

Water Quality Compliance

As of April 2004, the Authority had achieved a level of compliance with the Clean Water Act regulations in excess of 99%.

The Authority has completed compliance plans for abating water pollution at its four major power plants - Aguirre, San Juan, South Coast, and Palo Seco, as required by the Consent Decree. The Authority has incurred \$1.33 million for water pollution abatement during the current fiscal year. Projects scheduled for fiscal year 2005 total approximately \$2.9 million.

On April 13, 1995, the Authority submitted to EPA a 316(a) Reopener Clause Draft Final Plan of Study for the Costa Sur power plant, requesting that it be permitted to discharge into the Caribbean Sea heated water that was previously used as part of the plant’s combustion/generation process (“thermal effluent”). In a letter dated December 20, 2000, EPA indicated that it was prepared to deny the Authority’s 316(a) request for its thermal effluent discharge. After extensive negotiations, EPA agreed that the Authority should perform an assessment of possible alternatives. On March 21, 2001, the Authority submitted to EPA a proposed plan that included a phased review of alternatives for the discharge of its thermal effluent. Said plan also included an

analysis that would determine the feasibility, reliability, potential effectiveness, and cost evaluation of these alternatives. In a letter dated August 23, 2001, EPA indicated that it would continue a cooperative effort with the Authority in order to develop a compliance plan for the disposition of the plants' thermal effluent. Currently this waiver request and field studies are under evaluation with EPA. After a meeting with EPA's officers in September 2003, the Authority agreed to review and update the existing alternatives to proceed with an analysis regarding feasibility, reliability, potential effectiveness, and cost evaluation of selected alternatives. This study is ongoing.

The Authority submitted to EPA the reports and waiver requests, pursuant to the Clean Water Act-Section 316 Thermal Waiver, for the San Juan and Palo Seco power plants on July 11, 1997 and November 18, 1997, respectively. EPA approved the field study work plan for the Aguirre power plant in August 2000. The contract to perform the study was signed in February 2003. The study is currently ongoing at a cost of \$1 million. As of April 2004, the fieldwork plan was completed. The study is expected to conclude by the end of October 2004.

Underground Injection Control Regulation

The Authority has prepared a compliance plan in order to comply with EQB's Underground Injection Control Regulation. The compliance plan consists of the licensing and construction of septic systems. In addition, the compliance plan includes the closing of systems where sanitary discharges can be connected to the facilities of the Puerto Rico Aqueduct and Sewer Authority. These projects for all four major power plants are 88% completed. For fiscal year 2005, the Authority allocated \$1.2 million for these projects.

Spill Prevention Control and Countermeasures Plan

To meet its obligations with respect to the Spill Prevention Control and Countermeasures Plan Act requirements and Consent Decree, the Authority will continue to implement corrective measures at all of its facilities. This program also includes scheduled major overhaul to dikes and fuel tanks. During fiscal year 2004, approximately \$9.1 million has been spent in projects under this program. The measures for this program are estimated to cost approximately \$16.7 million for the next five years. The Authority expects to spend approximately \$8.16 million during fiscal year 2005.

PCB Testing

The Authority has completed a ten-year EPA-mandated program to sample, test and identify its oil-filled transformers and other equipment in order to comply with applicable PCB regulations. The Authority continues to implement a program for the removal and disposal of all distribution transformers with a PCB concentration of 50 ppm or greater. The Authority estimates that approximately 2,800 PCB or PCB contaminated distribution transformers remain to be disposed of as of March 31, 2004. During fiscal year 2004, a total of 234 transformers were disposed of under this program. This program is subject to a three-year extension petition to the EPA, and it is scheduled for completion by the last quarter of fiscal year 2005. The budget assignment for this program for fiscal year 2005 is approximately \$1.9 million.

Asbestos Abatement

The Authority is engaged in encapsulating or gradually removing asbestos-containing insulation from its power plants. As of March 31, 2004, the Authority has spent approximately \$1.2 million in asbestos abatement projects during the fiscal year. For fiscal year 2005, the Authority allocated \$1.0 million for this program.

Capital Improvement Program

The Authority's capital improvement program for the five fiscal years ending June 30, 2009 includes \$80 million in order to comply with existing Commonwealth and federal environmental laws and regulations. The Authority believes it is taking the necessary steps to comply with all applicable environmental laws and regulations and Consent Decree requirements.

INSURANCE

Coverage

The Authority maintains, among others, insurance policies covering all-risk property (excluding transmission and distribution lines other than underground lines), boiler and machinery and public liability. The combined insurance coverage of these policies is \$650 million, consisting of a maximum of \$200 million under the all-risk property insurance policy, \$200 million under the boiler and machinery insurance policy, and \$250 million under an excess umbrella policy.

The policies' self-retention in case of earthquake and windstorm losses is \$25 million, and \$2 million for all other covered risks.

The proceeds of the all-risk property and boiler and machinery policies are used prior to drawing upon the Reserve Maintenance Fund or the Self-insurance Fund established under the 1974 Agreement.

The public general liability policy covers property damage and bodily injury to third parties with a \$75 million aggregate limit in excess of the self-retention limit of \$1 million per occurrence.

Like electric utilities located on the east coast of the United States, the Authority's transmission and distribution facilities are susceptible to adverse weather conditions, such as hurricanes. The Authority is currently self-insured with respect to property damage for its transmission and distribution systems, as are most other U.S. utilities. While the Authority and the Consulting Engineers believe that the Authority's reserves are generally sufficient, there can be no assurance that the Authority will be able to provide adequate coverage for damage that might be incurred as a result of any future adverse weather conditions.

In the Authority's opinion, its insurance coverage adequately protects it against property damage or bodily injury resulting from the possession, operation and maintenance of the System.

The State Insurance Fund, a Commonwealth agency which provides worker's compensation insurance, is funded by mandatory contributions from the Authority.

Self-insurance Fund

The Authority has supplemented the 1974 Agreement to create a Self-insurance Fund, which is funded from Net Revenues (after deposits to the Sinking Fund and the Reserve Maintenance Fund). The Authority has no obligation to make deposits to, or to replenish, the Self-insurance Fund in the event of withdrawals therefrom. Amounts on deposit in the Self-insurance Fund are available for the payment of principal of and interest on the Power Revenue Bonds. As of March 31, 2004, approximately \$81.6 million was on deposit in the Self-insurance Fund. See "Disposition of Revenues" in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

LABOR RELATIONS

As of March 31, 2004, the Authority had 9,606 employees (including Irrigation System Employees), of which 491 were temporary unionized employees. Of such employees, 6,756 were represented by four local unions. The Electrical Industry and Irrigation Workers Union (“UTIER”) represents 5,389 employees engaged in operations and maintenance. The three other unions represent construction workers (Insular Union of Industrial and Electrical Construction Workers or “UITICE”), professional employees (Professional Employees Independent Union or “UEPI”), and pilots (Electric Power Authority Pilots Union or “UPAEE”) employed by the Authority.

The agreement with UITICE expires on January 29, 2005. The agreement with UTIER expires on November 14, 2005, the agreement with UEPI expires on December 18, 2004 and the agreement with UPAEE expires on July 2, 2006.

Of the 9,606 employees, 3,161 are employed in the transmission and distribution facilities directorate, 2,244 are employed in the generating facilities directorate, 1,648 are employed in the customer service directorate, and the remaining employees are employed in the administrative directorates and other areas.

In order to improve the productivity of its employees, the Authority has instituted various programs to reduce absenteeism, increase safety measures, and minimize the level of drug use among its employees. In addition, the Authority continues to implement programs to provide both technical and supervisory training to its employees. The Authority believes that the implementation of these programs helps the Authority provide more reliable service for its clients.

PENSION PLAN

The Employees’ Retirement System of Puerto Rico Electric Power Authority (the “Retirement System”), a separate trust fund created by the Authority, administers the Authority’s defined benefit pension plan, which provides employee retirement and death benefits. The pension plan provides for contributions by both the Authority, based on annual actuarial valuations, and the plan members. The contributions recorded for the fiscal year ended June 30, 2003 and for the nine months ended March 31, 2004 were \$50.6 million and \$40.1 million, respectively. This represented 6.03% and 10.90% for fiscal year 2003, and 6.03% and 11.03% for the nine months ended March 31, 2004, of covered payroll for normal cost and unfunded actuarial accrued liability for such periods. Employee contributions and other withholdings are being paid to the Retirement System on a current basis. In the nine months ended March 31, 2004, total pension expense of the Authority was approximately \$40.1 million, including approximately \$25.9 million for past service costs. Unfunded past service liability to be borne entirely by the Authority was approximately \$571.7 million as of June 30, 2002, the date of the last actuarial valuation of the Retirement System. As of that date, the pension plan was 72% funded. Currently, the Retirement System’s actuaries are in the process of preparing a new actuarial valuation.

The Retirement System’s financial statements are audited by a firm of independent public accountants that does not serve as independent accountants to the Authority.

LITIGATION

There is no pending litigation of any nature restraining or enjoining or seeking to restrain or enjoin the issuance, sale or delivery of the Bonds or in any way contesting or affecting the validity of the Bonds, the resolutions or the proceedings of the Authority taken with respect to the authorization, issuance or sale thereof, or the pledge or application of any moneys under the 1974 Agreement or the existence or powers of the Authority.

The Authority is involved in various lawsuits arising in the normal course of business, none of which, in the opinion of the Authority and its General Counsel, if decided against the Authority, would have a material adverse effect on the Authority's financial condition or operations. Among the cases currently pending, some deal with environmental issues. These are described above in "Environmental Litigation and Administrative Proceedings" under *Environmental Matters*.

In May 1998, the Municipality of Ponce filed a complaint (subsequently joined by all the other municipalities) against the Authority in the local courts demanding the payment by the Authority of the full amount of contributions in lieu of taxes and electric energy sales set aside for prior fiscal years, calculated as described above in "Subsidies, Contributions in Lieu of Taxes and Set Aside" under *The Authority*, but without any deductions for payments made by the Authority required under the 1974 Agreement. The complaint challenges the reduction of the amount payable to the municipalities by the amount of deposits made by the Authority to certain funds under the 1974 Agreement and a previous indenture for the purposes of paying the costs of capital improvements, and seeks a payment by the Authority in the amount of such reduction. The Authority's position is that because the Act provides that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with the Authority's deposit obligations under the 1974 Agreement and such previous indenture and that shortfalls do not carry forward as future liabilities of the Authority, it is legally entitled to make such deposits even if their effect is to reduce such contributions and set aside available to municipalities. The complaint seeks a payment by the Authority in an amount of approximately \$358 million. The Authority filed a motion to dismiss the complaint and the municipalities filed a motion for summary judgment. The court has designated two special commissioners to study the allegations of the complaint related to accounting issues and legal issues.

On April 14, 2003, the Authority made a settlement offer consisting of a payment in cash of \$68 million and \$57 million for electric infrastructure projects in the municipalities, for a total of \$125 million. As of June 30, 2004, 76 out of the 78 municipalities had accepted the Authority's offer and had received or are in the process of receiving their proportional share of the settlement offer, including approximately \$63.7 million in cash and \$53.4 million in electric infrastructure projects previously approved by the Authority. This settlement has not materially affected the Authority's financial condition. After giving effect to the settlement, the amount claimed by the two remaining municipalities is approximately \$21.8 million. The Authority and the remaining two municipalities have been unable to reach an agreement and both municipalities have formally rejected the settlement offer of the Authority. At the current stage, the Authority cannot predict with any certainty the final outcome of this case.

On May 18, 2000, Abengoa, Puerto Rico, S.E. ("Abengoa"), the Authority's original contractor for the construction of the new generating units (units 5 and 6) at the San Juan power plant, unilaterally declared a termination of the contract and filed a complaint for breach of contract. The Authority filed a counter claim for breach of contract and for all damages caused to the Authority by the contract termination. The case is in the discovery stage. The Authority continues to defend vigorously from this claim, and has raised various defenses thereto. At the current stage, however, the Authority cannot predict with any certainty the outcome of this case or the range of potential loss, if any. In order to mitigate its possible losses, the Authority recently entered into an agreement with Washington Engineers P.S.C. for the completion of such generating units. The Authority expects the project to be completed during fiscal year 2006.

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico issued a report stating that the Authority overcharged its clients by approximately \$49.8 million, and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by clients of the Authority against the Authority demanding the reimbursement of such alleged overcharges. On June 17, 2004, the President of the Governing Board of the Authority sent a written response to the Comptroller and issued a press release in which the Authority denies that any overcharges have been made. The Authority's position is that the Comptroller incorrectly based his conclusion on data that is not relevant to the calculation of the Authority's rates, and that the Authority's rates were properly established in the year 2000 in accordance with

applicable laws and regulations. In particular, the Authority notes that its tariffs properly take into consideration the cost of the fuel used by the Authority's generating facilities and the cost of the electricity purchased from the two co-generating facilities that sell power to the Authority. See "Rates" under *The System* above.

TAX MATTERS

Series OO Bonds and Series PP Bonds

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law (i) interest on the Series OO Bonds and the Series PP Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) the Series OO Bonds and the Series PP Bonds and the interest thereon are exempt from state, Commonwealth and local taxation. Bond Counsel will express no opinion as to any other tax consequences regarding the Series OO Bonds and the Series PP Bonds.

The opinion on federal tax matters will be based on and will assume the accuracy of certain representations and certifications, and continuing compliance with certain covenants, of the Commonwealth to be contained in the transcript of proceedings and that are intended to evidence and assure the foregoing, including that the Series OO Bonds and the Series PP Bonds are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of those certifications and representations or that continuing compliance.

The Code prescribes a number of qualifications and conditions for the interest on state and local government obligations to be and to remain excluded from gross income for federal income tax purposes, some of which require future or continued compliance after issuance of the obligations in order for the interest to be and to continue to be so excluded from the date of issuance. Noncompliance with these requirements by the Commonwealth may cause the interest on the Series OO Bonds and the Series PP Bonds to be included in gross income for federal income tax purposes and thus to be subject to federal income tax retroactively to the date of issuance of the Series OO Bonds and the Series PP Bonds. The Commonwealth has covenanted, to the extent permitted by the Constitution and the laws of the Commonwealth, to take the actions required of it for the interest on the Series OO Bonds and the Series PP Bonds to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion. Bond Counsel is not aware of any provision of the Constitution or laws of the Commonwealth that would prevent the Commonwealth from complying with the requirements of the Code.

A portion of the interest on the Series OO Bonds and the Series PP Bonds earned by certain corporations may be subject to a federal corporate alternative minimum tax. In addition, interest on the Series OO Bonds and the Series PP Bonds may be subject to a federal branch profits tax imposed on certain foreign corporations doing business in the United States and to a federal tax imposed on excess net passive income of certain S corporations.

Under the Code, the exclusion of interest from gross income for federal income tax purposes may have certain adverse federal income tax consequences on items of income, deduction or credit for certain taxpayers, including financial institutions, certain insurance companies, recipients of Social Security and Railroad Retirement benefits, those that are deemed to incur or continue indebtedness to acquire or carry tax-exempt obligations, and individuals otherwise eligible for the earned income tax credit. The applicability and extent of these and other tax consequences will depend upon the particular tax status or other tax items of the owner of the Series OO Bonds and the Series PP Bonds. Bond Counsel will express no opinion regarding those consequences.

Ownership of tax-exempt obligations, including the Series OO Bonds and the Series PP Bonds, may also result in collateral income tax consequences under Puerto Rico law to financial institutions doing business in Puerto Rico.

Purchasers of the Series OO Bonds and the Series PP Bonds at other than their original issuance at the respective prices indicated on the inside cover page of this Official Statement should consult their own tax advisers regarding other tax considerations such as the consequences of market discount.

Original Issue Discount and Original Issue Premium

Certain of the Series PP Bonds (“Discount Bonds”) as indicated on the inside cover page of this Official Statement were offered and sold to the public at an original issue discount (“OID”). OID is the excess of the stated redemption price at maturity (the principal amount) over the “issue price” of a Discount Bond. The issue price of a Discount Bond is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which a substantial amount of the Discount Bonds of the same maturity is sold pursuant to that offering. For federal income tax purposes, OID accrues to the owner of a Discount Bond over the period to maturity based on the constant yield method, compounded semiannually (or over a shorter permitted compounding interval selected by the owner). The portion of OID that accrues during the period of ownership of a Discount Bond (i) is interest excluded from the owner's gross income for federal income tax purposes to the same extent, and subject to the same considerations discussed above, as other interest on the Bonds, and (ii) is added to the owner's tax basis for purposes of determining gain or loss on the maturity, redemption, prior sale or other disposition of that Discount Bond. A purchaser of a Discount Bond in the initial public offering at the price for that Discount Bond stated on the inside cover page of this Official Statement who holds that Discount Bond to maturity will realize no gain or loss upon the retirement of that Discount Bond.

Certain of the Series OO Bonds and certain of the Series PP Bonds (“Premium Bonds”) as indicated on the inside cover page of this Official Statement were offered and sold to the public at a price in excess of their stated redemption price (the principal amount) at maturity. That excess constitutes bond premium. For federal income tax purposes, bond premium is amortized over the period to maturity of a Premium Bond, based on the yield to maturity of that Premium Bond (or, in the case of a Premium Bond callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on that Premium Bond), compounded semiannually. No portion of that bond premium is deductible by the owner of a Premium Bond. For purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Premium Bond, the owner's tax basis in the Premium Bond is reduced by the amount of bond premium that accrues during the period of ownership. As a result, an owner may realize taxable gain for federal income tax purposes from the sale or other disposition of a Premium Bond for an amount equal to or less than the amount paid by the owner for that Premium Bond. A purchaser of a Premium Bond in the initial public offering at the price for that Premium Bond stated on the inside cover page of this Official Statement who holds that Premium Bond to maturity (or, in the case of a callable Premium Bond, to its earlier call date that results in the lowest yield on that Premium Bond) will realize no gain or loss upon the retirement of that Premium Bond.

Owners of Discount and Premium Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of OID or bond premium properly accruable in any period with respect to the Discount or Premium Bonds and as to other federal tax consequences and the treatment of OID and bond premium for purposes of state and local taxes on, or based on, income.

Series QQ Bonds

Assuming no change in existing law, it is expected that an opinion substantially similar to the opinion described above with respect to the Series OO Bonds and the Series PP Bonds, and subject to the same limitations as described above with respect to the Series OO Bonds and the Series PP Bonds, will be issued in connection with the issuance of the Series QQ Bonds. See “Delayed Delivery of the Series QQ Bonds” under *Plan of Financing* and Appendix IV, *Proposed Forms of Opinions of Bond Counsel*.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

The Arbitrage Group, Inc. will verify from the information provided to them the mathematical accuracy as of the date of the delivery of the Bonds of (1) the computations contained in the provided schedules to determine that the anticipated receipts from the securities and cash deposits listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements, if any, of the Refunded Bonds, and (2) the computations of yield on both the securities and the Bonds contained in such schedules used by Bond Counsel in its determination that the interest on the Bonds is excluded from gross income for federal income tax purposes. The verification agent will express no opinion on the assumptions provided or as to the exemption from taxation of the interest on the Bonds.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series OO Bonds and Series PP Bonds from the Authority at an aggregate discount of \$1,352,502.94 from the initial public offering prices of such bonds. The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series QQ Bonds from the Authority at an aggregate discount of \$598,980.86 from the initial public offering prices of such bonds. The obligation of the Underwriters to purchase the Series OO Bonds and the Series PP Bonds is subject to certain conditions precedent. The Underwriters will be obligated to purchase all the Series OO Bonds and the Series PP Bonds, if any such bonds are purchased. The obligation of the Underwriters to purchase the Series QQ Bonds is subject to certain conditions precedent and may be terminated as described above in “Delayed Delivery of the Series QQ Bonds” under *Plan of Financing*. The Underwriters will be obligated to purchase all the Series QQ Bonds if any such bonds are purchased. The Underwriters may offer to sell the Bonds to certain dealers (including dealers depositing the Bonds into unit investment trusts, certain of which may be sponsored or managed by the Underwriters) and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by the Underwriters. The Authority has agreed to indemnify the Underwriters, to the extent permitted by law, against certain liabilities, including liabilities under federal securities laws, or to contribute to payments that the Underwriters may be required to make in respect thereof.

J.P. Morgan Securities Inc., a managing underwriter, has entered into an agreement with R-G Investments Corporation, a Puerto Rico broker-dealer, pursuant to which R-G Investments has agreed to provide investment banking services to the Authority in connection with the issuance of the Bonds. Pursuant to this arrangement, the existence of which has been disclosed to the Authority and Government Development Bank, R-G Investments will be entitled to receive a portion of J.P. Morgan Securities Inc.’s net profits, if any, in connection with the underwriting of the Bonds. Other similar agreements with respect to the sharing of underwriting net profits have been entered into and disclosed to the Authority and Government Development Bank by the following Underwriters: Goldman, Sachs & Co. and FirstBank Puerto Rico; Merrill Lynch & Co. and BBVA Securities of Puerto Rico Inc.; Banc of America Securities LLC and Oriental Financial Services Corp.; Lehman Brothers Inc. and Santander Securities Corporation; Morgan Stanley & Co. Incorporated and Popular Securities, Inc.; and Wachovia Bank, National Association and Doral Securities Inc.

MATERIAL RELATIONSHIPS

Washington Group International, Inc. serves as the Consulting Engineers to the Authority under the provisions of the 1974 Trust Agreement. The Authority recently entered into a professional services agreement with Washington Engineers P.S.C., an affiliate of Washington Group International, Inc., to provide services to the Authority in connection with the construction of the San Juan 5 and 6 combined cycle generating units described above in “Adequacy of Capacity – Additional Generating Facilities” under *The System*.

See also *Government Development Bank for Puerto Rico*, below.

LEGAL MATTERS

The proposed forms of opinions of Squire, Sanders & Dempsey L.L.P., Bond Counsel, are set forth in Appendix IV to this Official Statement. Certain legal matters will be passed upon for the Underwriters by O’Neill & Borges, San Juan, Puerto Rico.

LEGAL INVESTMENT

The Bonds will be eligible for deposit by banks in the Commonwealth to secure public funds and will be approved investments for insurance companies to qualify them to do business in the Commonwealth as required by law.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Authority in connection with the Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates also participate in other financial transactions with Government Development Bank.

INDEPENDENT ACCOUNTANTS

The financial statements of the Authority as of and for the years ended June 30, 2003 and 2002 included in Appendix II hereto have been audited by Ernst & Young LLP, San Juan, Puerto Rico, independent accountants, as stated in their report appearing therein.

The prospective financial information included in this Official Statement has been prepared by, and is the responsibility of the management of the Authority. Ernst & Young LLP has neither examined nor compiled the accompanying prospective financial information, and accordingly, Ernst & Young LLP does not express an opinion or any other form of assurance with respect thereto. The Ernst & Young LLP report for fiscal years 2003 and 2002 included in Appendix II to this Official Statement relates to the historical financial information of the Authority. Such report does not extend to the prospective financial information and should not be read to do so.

RATINGS

The Bonds have been assigned ratings of “A3” by Moody’s Investors Service and “A-” by Standard & Poor’s Ratings Services. These ratings do not reflect the municipal bond insurance policies that cover certain of the Bonds identified on the inside cover page of this Official Statement. Moody’s and Standard & Poor’s are expected to give ratings of “Aaa” and “AAA,” respectively, to the CIFGNA Insured Bonds, the FGIC Insured Bonds and the XLCA Insured Bonds. These ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency. There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of either of such ratings may have an adverse effect on the market prices of the Bonds.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the “Rule”), promulgated by the SEC, the Authority has covenanted in its resolution authorizing the issuance of the Bonds for the benefit of the Beneficial Owners (as defined in such resolution and, generally, the tax owners of the Bonds):

(a) to file within 275 days after the end of each fiscal year with each NRMSIR and with any Commonwealth state information depository (“SID”), core financial information and operating data for the prior fiscal year, including (i) the Authority’s audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Authority’s System and revenues, expenditures, financial operations and indebtedness generally found in this Official Statement (but excluding the Commonwealth of Puerto Rico Financial Information and Operating Data Report incorporated by reference herein); and

(b) to file in a timely manner, with each NRMSIR or with the Municipal Securities Rulemaking Board (“MSRB”), and with any Commonwealth SID, notice of failure of the Authority to comply with clause (a) above and notice of any of the following events with respect to the Bonds, if material:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse opinions or events, affecting the tax exempt status of the Bonds;
- (vii) modifications to rights of security holders (including Beneficial Owners) of the Bonds;
- (viii) Bond calls;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the Bonds; and
- (xi) rating changes.

With respect to the following events:

Events (iv) and (v). The Authority does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Bonds, unless the Authority applies for or participates in obtaining the enhancement.

Event (vi). For information on the tax status of the Bonds, see *Tax Matters*.

As of the date of this Official Statement, there is no Commonwealth SID, and the name and address of each NRMSIR is: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's J.J. Kenny Repository, 55 Water Street, 45th Floor, New York, New York 10041; FT Interactive Data, Attn: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Authority may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Authority, such other events are material with respect to the Bonds, but the Authority does not undertake to provide notice of the occurrence of any material event except those events listed above.

The Authority acknowledges that its undertaking pursuant to the Rule described above is intended for the benefit of the Beneficial Owners of the Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Authority's obligations hereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Authority written notice of and request to cure such breach, and the Authority shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in the Federal district court for the District of Puerto Rico or in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Bonds benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of the Covenant at issue. Notwithstanding the foregoing, no challenge to the adequacy of the information provided in accordance with the filings mentioned in paragraphs (a) or (b) above may be prosecuted by any Beneficial Owner except in compliance with the remedial and enforcement provisions contained in Article VIII of the 1974 Agreement. See "Remedies of Bondholders" in Appendix I, *Summary of Certain Provisions of the 1974 Agreement Excluding Proposed Supplemental Agreement*.

The Covenants may only be amended if:

(a) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Authority, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or interpretations of the Rule, or any change in circumstances; and the amendment does not materially impair the interests of Beneficial Owners, as determined by parties unaffiliated with the Authority; or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of the Covenants, ceases to be in effect for any reason, and the Authority elects that the Covenants shall be deemed amended accordingly.

The Authority has further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

These Covenants have been made in order to assist the Underwriters to comply with the Rule.

MISCELLANEOUS

The foregoing summaries of or references to certain provisions of the 1974 Agreement, the proposed Supplemental Agreement, the various acts and the Bonds are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

There are appended to this Official Statement (i) summaries of the 1974 Agreement and the proposed Supplemental Agreement, (ii) the financial statements of the Authority for the fiscal years ended June 30, 2003 and June 30, 2002, together with the independent accountants' report of Ernst & Young LLP, San Juan, Puerto Rico, (iii) a letter from the Authority's Consulting Engineers, Washington Group International, Inc., regarding its opinion as to certain engineering matters in this Official Statement, (iv) the proposed forms of opinions of Squire, Sanders & Dempsey L.L.P., Bond Counsel, (v) a specimen of the CIFGNA insurance policy, (vi) a specimen of the FGIC insurance policy, and (vii) a specimen of the XLCA insurance policy.

The information set forth in this Official Statement, except for certain information on the page following the inside cover page, the information appearing in *Underwriting, Material Relationships*, Appendices III through VII, and the information pertaining to DTC, CIFGNA, FGIC and XLCA, was supplied by the Authority. The information pertaining to DTC, CIFGNA, FGIC and XLCA was supplied by DTC, CIFGNA, FGIC and XLCA, respectively.

This Official Statement will be filed with the repository established by the MSRB and each NRMSIR.

PUERTO RICO ELECTRIC POWER AUTHORITY

By: /s/ Héctor R. Rosario
Executive Director

APPENDIX I

DEFINITIONS OF CERTAIN TERMS

The following are definitions of certain terms defined in Section 101 of the 1974 Agreement and used in this Official Statement.

“Accreted Value” means with respect to any Capital Appreciation Bonds (i) as of any Valuation Date, the amount set forth for such date in the resolution authorizing such Capital Appreciation Bonds and (ii) as of any date other than a Valuation Date, the sum of (a) the Accreted Value on the preceding Valuation Date and (b) the product of (1) a fraction, the numerator of which is the actual number of days having elapsed from the preceding Valuation Date and the denominator of which is the actual number of days from such preceding Valuation Date to the next succeeding Valuation Date and (2) the difference between the Accreted Values for such Valuation Dates.

“Amortization Accrual” means for any period the amount of an Amortization Requirement that would accrue during such period if such Requirement accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by resolution of the Authority or an agreement supplemental to the 1974 Agreement, the monthly accrual in respect of an Amortization Requirement for a term bond shall commence on the first day of each month in the fiscal year for which such Requirement has been established and shall end on the first day of the month succeeding the relevant Deposit Day.

As applied to the term bonds of any Series, “Amortization Requirement” for any fiscal year means the principal amount fixed or computed for such fiscal year for the retirement of such term bonds by purchase or redemption.

The Amortization Requirements for the term bonds of each Series shall be initially the respective principal amounts for each fiscal year as fixed in a resolution of the Board adopted prior to the issuance of the bonds of such Series; provided, however, that if any additional term bonds of such Series shall be issued under the provisions of the first paragraph of Section 210 of the 1974 Agreement, the respective Amortization Requirements for the term bonds of such Series shall be increased in proportion as nearly as may be practicable to the increase in the total principal amount of the term bonds of such Series. The aggregate amount of such Amortization Requirements for the term bonds of each Series shall be equal to the aggregate principal amount of the term bonds of such Series. The Amortization Requirements for the term bonds of each Series shall begin in the fiscal year determined by the Board.

If at the close of any fiscal year the total principal amount of term bonds of any Series retired by purchase or redemption, or prior to the close of such fiscal year called for redemption, shall be in excess of the amount of the Amortization Requirements for the term bonds of such Series for such fiscal year, then the amount of the Amortization Requirements for the term bonds of such Series shall be reduced for such subsequent fiscal years in such amounts aggregating the amount of such excess as shall be determined by the Executive Director in an order filed with the 1974 Trustee on or before the 10th day of July following the close of such fiscal year.

If at the close of any fiscal year the total principal amount of term bonds of any Series retired by purchase or redemption, or called for redemption, prior to the close of such fiscal year shall be less than the amount of the Amortization Requirements for the term bonds of such Series for such fiscal year, then the amount of the Amortization Requirements for the term bonds of such Series for the next succeeding fiscal year shall be increased by the amount of the excess of such deficiency over the amount then held to the credit of the Redemption Account.

It shall be the duty of the 1974 Trustee, on or before the 15th day of July in each fiscal year, to compute the Amortization Requirements for the then current fiscal year for the term bonds of each Series then outstanding. The Amortization Requirement for the then current fiscal year shall continue to be applicable during the balance of such current fiscal year and no adjustment shall be made therein by reason of term bonds purchased or redeemed or called for redemption during such current fiscal year.

“Capital Appreciation Bonds” means any bonds as to which interest is payable only at the maturity or prior redemption of such bonds. For the purposes of (i) receiving payment of the redemption price if a Capital Appreciation Bond is redeemed prior to maturity to the extent provided in the resolution authorizing the Capital Appreciation Bonds, or (ii) receiving payment of a Capital Appreciation Bond if the principal of all bonds is declared immediately due and payable following an event of default as provided in Section 802 of the 1974 Agreement, or (iii) computing the principal amount of bonds held by the registered owner of a Capital Appreciation Bond in giving to the Authority or the 1974 Trustee any notice, consent, request, or demand pursuant to the 1974 Agreement for any purpose whatsoever, the principal amount of a Capital Appreciation Bond shall be deemed to be its Accreted Value. In the case of Capital Appreciation Bonds that are convertible to bonds with interest payable prior to maturity or prior redemption of such bonds, the term “Capital Appreciation Bonds” shall be limited to the period prior to such conversion, and after such conversion, the bonds shall be viewed as any other bonds of the same type for purposes of the 1974 Agreement.

“Current Expenses” means the Authority’s reasonable and necessary current expenses of maintaining, repairing and operating the System and shall include, without limiting the generality of the foregoing, all administrative expenses, insurance premiums, expenses of preliminary surveys not chargeable to capital expenditures, engineering expenses relating to operations and maintenance, fees and expenses of the 1974 Trustee and the Paying Agents, legal expenses, any payment to pension or retirement funds, and all other expenses required to be paid by the Authority under the provisions of the 1974 Agreement or by law, or permitted by standard practices for public utility systems, similar to the properties and business of the Authority and applicable in the circumstances, but shall not include any deposits to the credit of the 1974 Sinking Fund, the Reserve Maintenance Fund, the Subordinate Obligations Fund, the Self-insurance Fund and the Capital Improvement Fund.

“Deposit Day” means the date by which all of the moneys then held to the credit of the Revenue Fund shall be withdrawn by the Treasurer and deposited in the manner set forth under “Disposition of Revenues” herein.

“Designated Maturity Bonds” means the indebtedness incurred by the Authority under the terms of a separate trust agreement or resolution, which indebtedness has a maturity of at least ten (10) years and is secured, as to the unamortized principal thereof, on a subordinate basis to the bonds and for which (i) no amortization of principal has been established or (ii) the aggregate amount of the amortized principal that has been established is less than the principal amount of the indebtedness; provided that interest on said indebtedness and any amortized principal of said indebtedness may be payable on a parity, respectively, with interest on bonds and Amortization Requirements on term bonds, in which case said interest and amortized principal shall be included in the calculation of Principal and Interest Requirements on bonds for purposes of the 1974 Agreement and shall otherwise be deemed to be, and be payable as, interest and Amortization Requirements on bonds for purposes of the 1974 Agreement.

“Extendible Maturity Bonds” means bonds the maturities of which, by their terms, may be extended by and at the option of the bondholder or the Authority.

“Independent Consultant” means the consultant or consulting firm or corporation at the time employed by the Authority under the provisions of the 1974 Agreement to perform and carry out the duties of the Independent Consultant under the 1974 Agreement.

“Interest Accrual” means for any period the amount of interest that would accrue during such period if such interest accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by resolution of the Authority or an agreement supplemental to the 1974 Agreement, the monthly accrual in respect of interest on the bonds shall commence on the later to occur of the date of issue of the bonds of such Series and the date that is six months prior to the due date of such interest and shall end on the first day of the month following the relevant Deposit Day. In the case of Variable Rate Bonds, the amount deposited shall be based on the sum of the interest accrued through the business day preceding the relevant Deposit Day and the interest (calculated at the maximum rate of interest on such Bonds, or if there is no such maximum rate, then at the rate on such Bonds on the business day preceding the Deposit Day plus one percent (1%)) that would accrue on such Bonds from the Deposit Day to the later to occur of the first day of the next calendar month and any interest payment date on such Bonds occurring prior to the next Deposit Day.

“Net Revenues” means, for any particular period, the amount of the excess of the Revenues for such period over the Current Expenses for such period.

“Prerefunded Municipals” means any bonds or other obligations of any state of the United States of America or Puerto Rico or of any agency, instrumentality or local governmental unit of any such state or Puerto Rico (a) which are (x) not callable prior to maturity or (y) as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to give due notice of redemption and to call such bonds or other obligations for redemption on the date or dates specified in such instructions, (b) which are secured as to principal, redemption premium, if any, and interest by a fund consisting only of cash or Government Obligations or Time Deposits, secured in the manner set forth in Section 601 of the 1974 Agreement, which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (c) as to which the principal of and interest on such Government Obligations or Time Deposits, secured in the manner set forth in Section 601 of the 1974 Agreement, which have been deposited in such fund, along with any cash on deposit in such fund are sufficient to pay principal of and interest and redemption premium, if any, on the bonds or other obligations on the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in clause (a) above, as appropriate.

“Principal Accrual” means for any period the amount of principal that would accrue during such period if such principal accrued ratably on the basis of a year consisting of twelve (12) thirty-day months. Unless otherwise provided by resolution of the Authority or an agreement supplemental to the 1974 Agreement, the monthly accrual in respect of the principal of serial bonds shall commence on the first day of the twelfth month preceding the due date of such principal and shall end on the first day of the month succeeding the relevant Deposit Day.

“Principal and Interest Requirements” means, for any fiscal year, as applied to the bonds of any Series issued under the 1974 Agreement, the sum of:

- (a) the amount required to pay the interest on all outstanding bonds of such Series which is payable on January 1 in such fiscal year and on July 1 in the following fiscal year,
- (b) the amount required to pay the principal of all outstanding serial bonds of such Series which is payable after July 31 in such fiscal year and on or prior to July 31 in the following fiscal year, and
- (c) the Amortization Requirement for the term bonds of such Series for such fiscal year.

The Principal and Interest Requirements for the bonds of any Series issued under the 1974 Agreement shall be determined, as required from time to time, by the 1974 Trustee. In computing the Principal and Interest Requirements for any fiscal year for the bonds of any Series, the 1974 Trustee shall assume that an amount of the term bonds of such Series equal to the Amortization Requirement for the term bonds of such Series for such fiscal year will be retired by purchase or redemption on July 1 in the following fiscal year.

For purposes of determining the aggregate Principal and Interest Requirements in the covenant as to rates contained in Section 502 of the 1974 Agreement, the maximum Principal and Interest Requirements for purposes of Section 704 of the 1974 Agreement and the maximum aggregate Principal and Interest Requirements for purposes of Section 712 of the 1974 Agreement, the interest rate on Variable Rate Bonds shall be assumed to be one hundred ten percent (110%) of the greater of (i) the average interest rate on such Variable Rate Bonds during the twelve months ending with the month preceding the date of calculation, or such shorter period that such Variable Rate Bonds shall have been outstanding under the 1974 Agreement, or (ii) the rate of interest on such Variable Rate Bonds on the date of calculation. For purposes of determining the maximum aggregate Principal and Interest Requirements for purposes of Sections 208, 209 and 210 of the 1974 Agreement, the interest rate on Variable Rate Bonds outstanding or proposed to be issued on the date of calculation shall be determined in accordance with the formula in the previous sentence. If Variable Rate Bonds are payable at the option of the Bondholder and the source for said payment is a credit or liquidity facility, the “put” date or dates shall be ignored and the stated dates for Amortization Requirements and principal payments thereof shall be used for purposes of this calculation. If the Authority has notified the 1974 Trustee that a SWAP agreement is in effect in respect of Variable Rate Bonds, then for all

purposes of this paragraph, except for the purpose of determining the aggregate Principal and Interest Requirements in the covenant as to rates contained in Section 502 of the 1974 Agreement, in the certificate mentioned in clause (d) of Section 208 of the 1974 Agreement and in the covenant contained in Section 704 of the 1974 Agreement, the interest rate on such Variable Rate Bonds shall be the SWAP rate under such SWAP agreement.

For purposes of determining the above requirements in the case of Put Bonds, the “put” date or dates shall be ignored if the source for payment of said put is a credit or liquidity facility and the stated dates for Amortization Requirements and principal payments shall be used. For purposes of determining the above requirements in the case of Extendible Maturity Bonds, the bonds shall be deemed to mature on the later of the stated maturity date or the date to which such stated maturity date has been extended. For purposes of determining the above requirements in the case of Capital Appreciation Bonds, the principal and interest portions of the Accreted Value of Capital Appreciation Bonds becoming due at maturity or by virtue of an Amortization Requirement shall be included in the calculations of accrued and unpaid interest and principal requirements in such manner and during such period of time as is specified in the resolution authorizing such Capital Appreciation Bonds.

Principal and Interest Requirements on bonds shall be deemed to include the amount required to pay interest on outstanding Designated Maturity Bonds and any amortized principal of said Designated Maturity Bonds for any fiscal year, if said interest and amortized principal are payable, under the trust agreement or resolution providing for said Designated Maturity bonds, on a parity with interest and Amortization Requirements on bonds.

To the extent all or a portion of the principal of, Amortization Requirements for or interest on, any bonds of any Series are payable from moneys irrevocably set aside or deposited irrevocably for such purpose with a bank or trust company (which may include the 1974 Trustee) or from Investment Obligations irrevocably set aside or deposited irrevocably for such purpose with a bank or trust company (which may include the 1974 Trustee) or Time Deposits, secured in the manner set forth in Section 601 of the 1974 Agreement, and irrevocably set aside for such purpose, the principal of and the interest on which when due will provide sufficient moneys to make such payments, such principal, Amortization Requirements or interest shall not be included in determining Principal and Interest Requirements; provided, however, that for purposes of compliance with the Authority’s rate covenant (see “Rate Covenant” herein) said definition shall include any interest payable from any amount deposited to the credit of the Bond Service Account in the 1974 Sinking Fund from the proceeds of bonds to pay interest to accrue thereon. The Executive Director or his designee shall deliver to the 1974 Trustee a certificate describing the principal of, Amortization Requirements for and interest on any bonds for which moneys, Investment Obligations or Time Deposits have been set aside or deposited pursuant to this paragraph, and stating that such principal, Amortization Requirements and interest should not be included in determining the Principal and Interest Requirements. Upon request of the 1974 Trustee, the Authority shall cause to be delivered to the 1974 Trustee a certificate of an independent verification agent as to the sufficiency of the maturing principal amounts of any Investment Obligations or Time Deposits, together with interest thereon, set aside or deposited to pay said principal, Amortization Requirements and interest.

“Put Bonds” means bonds, other than Variable Rate Bonds, which by their terms may be tendered by and at the option of the holders thereof for payment prior to the stated maturity thereof.

“Reserve Account Insurance Policy” and “Reserve Account Letter of Credit” mean (1) the insurance policy, surety bond or other acceptable evidence of insurance, if any, or (2) the irrevocable, transferable letter of credit, if any, respectively, to be deposited in the 1974 Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, for the purpose of making the payments required to be made from the 1974 Reserve Account under Section 510 of the 1974 Agreement. The issuer providing such insurance or letter of credit shall be a municipal bond insurer or a banking association, bank or trust company or branch thereof whose policy or bond or letter of credit results in the rating of municipal obligations secured by such policy or bond or such letter of credit, respectively, to be rated, at the time of deposit into the 1974 Reserve Account, in one of the three highest grades by (i) either Standard & Poor’s Corporation or its successor, or Moody’s Investors Service, Inc. or its successor or (ii) if both such corporations shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, a nationally recognized rating agency.

“Revenues” means all money received by the Authority in connection with or as a result of its ownership or operation of the System, including the income derived by the Authority from the sale of electricity generated or

distributed by the System, any proceeds of use and occupancy insurance on the System or any part thereof and income from the investment of moneys under the 1974 Agreement, except income from the investment of moneys in the 1974 Construction Fund, the Capital Improvement Fund and the Subordinate Obligations Fund to the extent such income has been derived from the investment of moneys in such Fund to be used to pay Subordinate Obligations incurred to pay the cost of any work or properties which have not been included by the Authority as part of the System as provided in “Disposition of Revenues” below, and the Reserve Maintenance Fund which shall be deemed to be a part of said Funds, respectively. Except for the purpose of determining the amount of the Revenues in the covenant as to rates contained in Section 502 of the 1974 Agreement, Revenues shall not include any amounts paid to the Authority by a SWAP party in connection with Variable Rate Bonds.

“Subordinate Obligations” means any obligations of the Authority incurred as provided in “Disposition of Revenues” below.

“SWAP agreement” means an agreement between the Authority and a SWAP party whereby the SWAP party agrees to pay to the Authority amounts calculated on the basis of all or a portion of the interest on Variable Rate Bonds at or prior to the times such interest is due and payable in consideration of the Authority’s payment to the SWAP party of amounts set forth in the SWAP agreement.

“SWAP party” means a person who is party to a SWAP agreement and whose senior obligations are rated at the time of the execution and delivery of such SWAP agreement in one of the three highest rating categories (without regard to gradations within a category) by (i) Standard & Poor’s Corporation or its successor and (ii) Moody’s Investors Service or its successor.

“SWAP rate” means the fixed rate per annum on the principal amount of Variable Rate Bonds covered by a SWAP agreement equal to the percentage derived by dividing (i) the sum of the amounts in the last twelve months paid by the Authority in respect of interest on such bonds and to the SWAP party less the amount paid to the Authority by the SWAP party by (ii) such principal amount of Variable Rate Bonds; provided, however, that if such SWAP agreement has been in effect for less than twelve months, such percentage shall be multiplied by 360 divided by the number of days between the effective date of such SWAP agreement and the date of calculation determined on the basis of 30-day months.

“System” means all the properties presently owned and operated by the Authority as a single integrated system, together with all works and properties which may be after the date of the 1974 Agreement acquired or constructed by the Authority in connection with the production, distribution or sale of electric energy and the acquisition or construction of which shall be financed in whole or in part from the proceeds of bonds issued under the provisions of the 1974 Agreement or from moneys deposited to the credit of the 1974 Construction Fund, the Capital Improvement Fund or from Subordinate Obligations to the extent such works and properties have been included by the Authority as part of the System as provided in “Disposition of Revenues” below.

“Valuation Date” means with respect to any Capital Appreciation Bonds the date or dates set forth in the resolution authorizing such bonds on which Accreted Values are assigned to the Capital Appreciation Bonds.

“Variable Rate Bonds” means bonds issued with a variable, adjustable, convertible or similar interest rate which is not fixed in percentage at the date of issue for the term thereof, and which may or may not be convertible to a fixed interest rate for the remainder of their term.

**SUMMARY OF CERTAIN PROVISIONS OF
THE 1974 AGREEMENT EXCLUDING PROPOSED
SUPPLEMENTAL AGREEMENT**

(See also Summary of Certain Provisions of Proposed Supplemental Agreement)

The following statements are brief summaries of certain provisions of the 1974 Agreement. Said statements do not purport to be complete and reference is made to the 1974 Agreement, copies of which are available for examination at the office of the 1974 Trustee.

Provision for Variable Rate Bonds, Put Bonds, Extendible Maturity Bonds, Capital Appreciation Bonds and other types of bonds

Under the 1974 Agreement, the Authority may issue Capital Appreciation Bonds, Variable Rate Bonds, Put Bonds, Extendible Maturity Bonds and other types of bonds which may from time to time be created. The interest rate calculation methods and interest rate payment dates, which need not be semi-annual, shall be established by the Authority prior to the issuance of particular Series of bonds. The features of Variable Rate Bonds shall be established prior to their issuance and may provide, in addition to provisions for conversion to a fixed interest rate, that bondholders may demand payment of principal and interest within a stated period. In this connection, the Authority may provide for the remarketing of bonds that have been tendered pursuant to the demand features and for a credit facility or liquidity facility which may be drawn upon to make principal and interest payments on the Variable Rate Bonds. The terms for Put Bonds may contain some of the above provisions. The terms for Extendible Maturity Bonds may include an option to extend the maturity of such bonds granted to bondholders and the Authority. The terms for Capital Appreciation Bonds shall include Valuation Dates, the Accreted Value on such dates, the manner in which and the period during which principal and interest shall be deemed to accrue on said bonds and the amount of any deposit required for the 1974 Reserve Account. (1974 Agreement, Sections 208, 209 and 210).

Security for the Power Revenue Bonds

The Power Revenue Bonds are secured by a pledge of moneys in the Puerto Rico Electric Power Authority Power Revenue Bonds Interest and Sinking Fund (the “1974 Sinking Fund”), a special fund created by the 1974 Agreement. (1974 Agreement, Section 507).

The Authority covenants to deposit with the 1974 Trustee, to the credit of the 1974 Sinking Fund, a sufficient amount of the Revenues, over and above the expenses of maintaining, repairing and operating the System and any reserve therefor, to pay the principal of and the interest on all Power Revenue Bonds as the same shall become due and payable and to create a reserve for such purpose. (1974 Agreement, Section 507).

The Power Revenue Bonds shall not be deemed to constitute a debt or obligation of the Commonwealth or any of its municipalities or other political subdivisions. (1974 Agreement, Section 701).

Issuance of Power Revenue Bonds—Sections 208, 209 and 210 of the 1974 Agreement

Section 208 of the 1974 Agreement provides for the issuance of Power Revenue Bonds for Improvements, as defined in the 1974 Agreement, including the repayment of advances therefor, and to provide moneys for deposit to the Reserve Account in the 1974 Sinking Fund (the “1974 Reserve Account”), subject to the conditions and limitations therein. Power Revenue Bonds may be issued under Section 208 if, among other things:

- (i) the Net Revenues for any 12 consecutive calendar months out of the 18 calendar months immediately preceding the date of the issuance of such bonds, adjusted to reflect the then current rate schedule, are not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds (excluding the bonds then to be issued), and

(ii) the estimated average annual Net Revenues for each of the five fiscal years immediately following the fiscal year in which the issuance of such bonds occurs, adjusted to reflect the then current rate schedule and any rate schedule the Authority has covenanted to put in effect during such five fiscal years, shall be not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and the bonds then to be issued. (1974 Agreement, Section 208).

Section 209 of the 1974 Agreement provides for the issuance of Power Revenue Bonds for any proper corporate purpose of the Authority (other than for refunding outstanding Power Revenue Bonds or for Improvements), upon the conditions and limitations set forth therein. Power Revenue Bonds may be issued under Section 209 if, among other things, the earnings tests described above for the issuance of bonds under Section 208 of the 1974 Agreement are satisfied. (1974 Agreement, Section 209).

Section 210 of the 1974 Agreement provides for the issuance of Power Revenue Bonds to refund prior to or at their maturities all or any part of the outstanding bonds of any Series issued under the 1974 Agreement, including the payment of any redemption premium, accrued interest and financing costs and for the purpose of providing moneys for deposit to the credit of the 1974 Reserve Account, subject to the conditions and limitations set forth therein. Power Revenue Refunding Bonds may be issued under Section 210 if, among other things, either (i) the earnings tests described above for the issuance of bonds under Section 208 of the 1974 Agreement (except that effect is given to the retirement of the bonds to be refunded) are satisfied or (ii) the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and the bonds then to be issued (after giving effect to the retirement of the bonds to be refunded) shall be less than the maximum aggregate Principal and Interest Requirements on account of all outstanding Power Revenue Bonds (excluding the bonds then to be issued). Power Revenue Refunding Bonds may be issued without compliance with the foregoing tests to refund serial bonds of any Series of Power Revenue Bonds maturing within one year thereafter (and to pay interest thereon to maturity, if deemed necessary by the Authority), if the Authority shall determine that the moneys in the 1974 Sinking Fund will not be sufficient for paying such serial bonds at their maturity. The proceeds of Power Revenue Refunding Bonds shall, to the extent practicable, be invested and reinvested by the 1974 Trustee, with the approval of the Executive Director, in Government Obligations, Prerefunded Municipals or in Time Deposits, secured in the manner set forth in Section 601 of the 1974 Agreement, and the moneys so invested shall be available for use when required. (1974 Agreement, Section 210).

Collection of Revenues

1974 General Fund

A special fund is created by the 1974 Agreement and designated the “Puerto Rico Electric Power Authority General Fund” (the “1974 General Fund”). The Authority covenants that all Revenues, other than income from investments made under the provisions of the 1974 Agreement, will be deposited as received in the 1974 General Fund. (1974 Agreement, Section 503). On or before the 15th day of May in each year the Authority will cause to be prepared a proposed budget of Current Expenses and of Capital Expenditures for the ensuing fiscal year, showing separately, the amount to be expended during such fiscal year from moneys deposited to the credit of the 1974 Construction Fund and the amount of the working cash funds required for each month during such fiscal year. A public hearing on the proposed budget must be held on June 1 or on the first business day thereafter, and the Authority must finally adopt the Annual Budget on or before July 1. (1974 Agreement, Section 504). The Authority covenants that moneys in the 1974 General Fund will be used first for the payment of Current Expenses of the System, and that, if the amount expended in any fiscal year for Current Expenses shall exceed the amount provided therefor in the Annual Budget, the Authority will report such excess and the reasons therefor to the Consulting Engineers and to the 1974 Trustee as soon as practicable but not later than the end of the sixth month following the month in which such excess shall have occurred. (1974 Agreement, Section 505).

1974 Revenue Fund

A special fund is created by the 1974 Agreement and designated the “Puerto Rico Electric Power Authority Power Revenue Fund” (the “1974 Revenue Fund”). The Treasurer of the Authority is required to transfer, on or before the 15th day of each month, from the 1974 General Fund to the 1974 Revenue Fund an amount equal to the

amount of all moneys held in the 1974 General Fund on the last day of the preceding month less an amount to be held as a reserve for Current Expenses as the Treasurer may determine, equal to not more than 1/6 of the amount shown by the Annual Budget to be necessary for Current Expenses for the current fiscal year, such transfer to be made on the books of the Authority as of the close of the preceding month. (1974 Agreement, Section 506).

Disposition of Revenues

1974 Sinking Fund, Reserve Maintenance Fund, Subordinate Obligations Fund, Self-insurance Fund and Capital Improvement Fund

On or before the 25th day of each month, the Treasurer shall withdraw from the 1974 Revenue Fund, all the moneys then in such Fund and deposit the moneys so withdrawn to the credit of the following Accounts and Funds in the following order:

1. the Bond Service Account in the 1974 Sinking Fund, until there has been accumulated therein an amount equal to the sum of (i) the Interest Accrual on all the outstanding Power Revenue Bonds to and including the first day of the next calendar month, and (ii) the Principal Accrual on the outstanding serial bonds of each Series of outstanding Power Revenue Bonds to and including the first day of the next calendar month;

2. the Redemption Account in the 1974 Sinking Fund, until there has been deposited therein an amount equal to the Amortization Accrual for the term bonds of each Series of Power Revenue Bonds then outstanding to and including the first day of the next calendar month;

3. the 1974 Reserve Account until the balance therein is equal to the interest payable on all outstanding Power Revenue Bonds within the next ensuing 12 months; provided, however, that the monthly deposit in respect of any Series of Power Revenue Bonds issued under Section 208 or 209 of the 1974 Agreement need not exceed 1/60 of the amount of the increase in the interest payable within the next ensuing 12 months resulting from the issuance of bonds of such Series, and provided, further, that if the amount so deposited in any month to the 1974 Reserve Account shall be less than the required amount for such month, the requirement therefor shall nevertheless be cumulative and the amount of any deficiency in any month shall be added to the amount otherwise required to be deposited in each month thereafter until such time as the deficiency is made up; and that in the case of Variable Rate Bonds, the minimum amount to be deposited in the 1974 Reserve Account which shall be funded over the period required in the 1974 Agreement, shall be based initially on the interest rate in effect on the date of issuance of the Variable Rate Bonds and then shall be adjusted on the 25th day of each subsequent month based on the actual interest accrued from the 25th day of the previous month to the date of adjustment, except that in the case of Variable Rate Bonds in respect of which the Authority has notified the Trustee that a SWAP agreement is in effect, the Trustee shall use the SWAP rate in calculating the interest payable on such Bonds within the next ensuing twelve (12) months; and that in the case of Capital Appreciation Bonds, the minimum amount required to be deposited in the Reserve Account shall be an amount derived from the interest rate which has been used to calculate the assumed yield on such bonds through their maturity times the Accreted Value of such bonds on the Valuation Date occurring at or after the first day of the twelfth succeeding month to the date of calculation of this requirement, as may be further specified in the resolution authorizing Capital Appreciation Bonds;

4. the Puerto Rico Electric Power Authority Reserve Maintenance Fund (the "Reserve Maintenance Fund"), a special fund created by the 1974 Agreement, such amount, if any, of any balance remaining after making the deposits mentioned in paragraphs 1, 2 and 3 above as may be recommended by the Consulting Engineers; provided that the monthly requirements for deposit to the Reserve Maintenance Fund shall be cumulative, and provided further that in the event that the Authority shall covenant in respect of any Subordinate Obligation to limit the monthly deposit to the Reserve Maintenance Fund as described in Subordinate Obligations Fund below, the monthly deposit required by this paragraph shall be equal to the least of

(i) the amount described above in this paragraph,

(ii) \$400,000, and

(iii) an amount that when added to the amount then on deposit in the Reserve Maintenance Fund shall make the total amount on deposit equal to \$10,000,000;

5. one or more special accounts in the Puerto Rico Electric Power Authority Subordinate Obligations Fund (the “Subordinate Obligations Fund”), a special fund created under the 1974 Agreement, such amount, if any, of any balance remaining after making the deposits mentioned under paragraphs 1, 2, 3 and 4 above that together with amounts then on deposit in the Subordinate Obligations Fund will make the total amount then on deposit equal to any amounts required to be paid or accrued with respect to any Subordinate Obligations prior to the Deposit Day of the next succeeding month from or to the Subordinate Obligations Fund;

6. if the Authority shall have covenanted with respect to Subordinate Obligations to limit its deposit to the Reserve Maintenance Fund in accordance with the provisions of the second proviso of paragraph 4 above and in fact the deposit to said Fund pursuant to paragraph 4 was limited to the amount described in clause (ii) or (iii) of such paragraph, the Reserve Maintenance Fund, such amount of any balance remaining after making the deposits under paragraphs 1, 2, 3, 4 or 5 above as may be required to make the total amount deposited in the Reserve Maintenance Fund in such month equal to the amount described in clause (i) of clause (4) above;

7. the Puerto Rico Electric Power Authority Self-insurance Fund (the “Self-insurance Fund”), a special fund created by the 1974 Agreement, such amount of any balance remaining after making the deposits mentioned in paragraphs 1, 2, 3, 4, 5 and 6 above as may be determined by the Authority from time to time; and

8. the Puerto Rico Electric Power Authority Capital Improvement Fund (the “Capital Improvement Fund”), a special fund created by the 1974 Agreement, such amount of any balance remaining after making deposits mentioned under paragraphs 1, 2, 3, 4, 5, 6 and 7 above as may be determined by the Authority, with the approval of the Consulting Engineers; provided that the monthly requirements for deposit to the Capital Improvement Fund shall be cumulative.

Any balance remaining after making the deposits under paragraphs 1 through 8 above may be used for any lawful purpose of the Authority. (1974 Agreement, Section 507).

If amounts applied to the payment of interest, principal and redemption price on bonds are paid by a credit or liquidity facility issuer, the amounts deposited in the Bond Service Account allocable to said payment (other than a payment of the purchase price of bonds pursuant to a “put”) may be paid to said credit or liquidity facility issuer. (1974 Agreement, Section 509).

Moneys in the 1974 Reserve Account shall be used by the 1974 Trustee first for the purpose of paying the interest on the Power Revenue Bonds and maturing principal of serial bonds whenever and to the extent moneys in the Bond Service Account are insufficient for such purposes and thereafter for the purpose of making the required deposits to the Redemption Account mentioned in paragraph 2 above whenever the withdrawal from the 1974 Revenue Fund is insufficient for such purpose. Excess moneys in the 1974 Reserve Account shall be transferred to the Bond Service Account or may be used to reduce any Reserve Account Insurance Policy or Letter of Credit. The Authority may deposit a Reserve Account Insurance Policy or Letter of Credit into the 1974 Reserve Account, in lieu, or in partial satisfaction, of any required deposit into the 1974 Reserve Account. Said Reserve Account Insurance Policy or Letter of Credit may be secured by a lien on Revenues not inconsistent with the provisions of the 1974 Agreement and shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any date on which moneys are required to be paid out of the 1974 Reserve Account pursuant to Section 510 of the 1974 Agreement. If a disbursement is made under any Reserve Account Insurance Policy or Letter of Credit, the Authority shall be obligated either to reinstate the amount of such Reserve Account Insurance Policy or Reserve Account Letter of Credit following such disbursement or to deposit into the 1974 Reserve Account moneys, in accordance with the provisions of Section 507 of the 1974 Agreement, in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of

Credit, or a combination of such alternatives. The Authority may at any time substitute (i) all or a portion of the moneys held to the credit of the 1974 Reserve Account with a Reserve Account Insurance Policy or Reserve Account Letter of Credit, (ii) all or a portion of any Reserve Account Insurance Policy on deposit in the 1974 Reserve Account with moneys or a Reserve Account Letter of Credit, or a combination of such alternatives, or (iii) all or a portion of any Reserve Account Letter of Credit on deposit in the 1974 Reserve Account with moneys or a Reserve Account Insurance Policy, or a combination of such alternatives. Any moneys on deposit in the 1974 Reserve Account in substitution of which a Reserve Account Insurance Policy or Reserve Account Letter of Credit is deposited shall, to the extent not required to fund any deficiencies in the amount then required to be on deposit in the 1974 Reserve Account, be released and immediately paid over to the Authority to be used by the Authority for any proper corporate purpose. Prior to the expiration date of any Reserve Account Insurance Policy or Reserve Account Letter of Credit then on deposit to the credit of the 1974 Reserve Account, the Authority shall (x) cause the term of such Reserve Account Insurance Policy or Reserve Account Letter of Credit to be extended, (y) replace any such Reserve Account Insurance Policy with moneys (which may include, without limitation, moneys available under the Reserve Account Insurance Policy or from any other source available for such purpose) or a Reserve Account Letter of Credit, or a combination of such alternatives, or (z) replace any such Reserve Account Letter of Credit with moneys (which may include, without limitation, moneys available under the Reserve Account Letter of Credit or from any other source available for such purpose) or a Reserve Account Insurance Policy, or a combination of such alternatives; provided that in the event that the Authority has not extended or replaced the expiring Reserve Account Insurance Policy or Reserve Account Letter of Credit by the fifth business day prior to its date of expiration, the expiring Reserve Account Insurance Policy or Reserve Account Letter of Credit shall, on such date, be drawn upon and the moneys so made available shall thereupon be deposited in the 1974 Reserve Account. (1974 Agreement, Section 510).

Moneys in the Reserve Maintenance Fund shall be used only for the purpose of paying the cost of unusual or extraordinary maintenance or repairs, maintenance or repairs not recurring annually and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of the principal of and the interest on the Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the 1974 Sinking Fund, including moneys in the 1974 Reserve Account, are insufficient for such purpose. (1974 Agreement, Section 512).

Moneys in the Self-insurance Fund shall be used only for the purpose of paying the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of, a cause which is not covered by insurance required by the 1974 Agreement. See "Insurance" below. The Self-insurance Fund also serves as an additional reserve for the payment of the principal of and the interest on the Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the 1974 Sinking Fund, including the 1974 Reserve Account, and in the Reserve Maintenance Fund are insufficient for such purpose. (1974 Agreement, Section 512A).

Moneys in the Capital Improvement Fund shall be used only for the purpose of paying the cost of anticipated extensions and Improvements which cost has not otherwise been provided for from the proceeds of Power Revenue Bonds. The Capital Improvement Fund also serves as an additional reserve for the payment of principal of and the interest on Power Revenue Bonds and meeting the Amortization Requirements to the extent that moneys in the 1974 Sinking Fund, including the 1974 Reserve Account, in the Reserve Maintenance Fund and in the Self-insurance Fund are insufficient for such purpose. (1974 Agreement, Section 512B).

Subordinate Obligations Fund

Moneys in the Subordinate Obligations Fund shall be paid out or pledged by the Authority as necessary to enable the Authority to meet its Subordinate Obligations. Subordinate Obligations may be incurred or issued by the Authority for any proper corporate purpose of the Authority.

The Authority may covenant with the holders of any Subordinate Obligations to limit the deposits to the Reserve Maintenance Fund as authorized by paragraph 4 above and to add to the conditions, limitations and restrictions under which Power Revenue Bonds may be issued under the provisions of 1974 Agreement.

Subordinate Obligations shall be payable out of and may be secured by a pledge of (i) available amounts in the Subordinate Obligations Fund and (ii) any other available funds of the Authority. Any such payment or pledge shall be expressly subordinate and junior in all respects to the lien and charge of the Power Revenue Bonds upon the Revenues.

Before incurring any Subordinate Obligations the proceeds of which shall be applied to acquire or construct any works or properties by the Authority in connection with the production, distribution or sale of electric energy, the Authority shall specify by resolution whether or not such works or properties are to be included as part of the System. (1974 Agreement, Section 516).

1974 Construction Fund

A special fund is created by the 1974 Agreement and designated the “Puerto Rico Electric Power Authority Power System Construction Fund” (the “1974 Construction Fund”). The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of acquiring or constructing Improvements, together with the moneys received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the 1974 Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the 1974 Construction Fund and held by the Authority in trust. (1974 Agreement, Sections 208 and 401). Payments from the 1974 Construction Fund are made by the Executive Director or by any officer or employee of the Authority designated by him for such purpose. (1974 Agreement, Section 402).

Rate Covenant

The Authority covenants that it will at all times fix, charge and collect reasonable rates and charges for the use of the services and facilities furnished by the System so that the Revenues will be at all times sufficient to pay the Current Expenses of the System and to provide an amount at least equal to 120% of the aggregate Principal and Interest Requirements for the next fiscal year on account of all outstanding Power Revenue Bonds, reduced by any amount deposited in the Bond Service Account from the proceeds of bonds to pay interest to accrue thereon in such fiscal year.

The Authority further covenants that if at any time the Revenues shall not be sufficient to satisfy the foregoing covenant as to rates, it will revise the rates and charges for the services and facilities furnished by the System and, if necessary, it will revise its regulations in relation to the collection of bills for such services and facilities, so that such deficiency will be made up before the end of the next ensuing fiscal year. Should any deficiency not be made up in such next ensuing fiscal year, the requirement therefor, shall be cumulative and the Authority shall continue to revise such rates until such deficiency shall have been completely made up. (1974 Agreement, Section 502).

Investment of Funds

The 1974 Agreement provides for the following types of investments:

(a) Government Obligations, which are (i) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States Government, including securities evidencing ownership interests in such obligations or in specified portions thereof (which may consist of specific portions of the principal of or interest on such obligations), (ii) bonds, debentures or notes issued by any of the following federal agencies: Banks for Cooperatives, Federal Intermediate Credit Banks, Federal Home Loan Banks, Export-Import Bank of the United States, Government National Mortgage Association, Federal Land Banks, or the Federal National Mortgage Association (including participation certificates issued by such Association) and (iii) all other obligations issued or unconditionally guaranteed as to principal and interest by any agency or person controlled or supervised by and acting as an instrumentality of the United States Government pursuant to authority granted by the Congress;

(b) Investment Obligations, which are (i) Government Obligations, (ii) obligations of any state or territory of the United States or political subdivision thereof (other than obligations rated lower than the three highest grades by a nationally recognized rating agency), (iii) repurchase agreements with commercial banks fully secured by Government Obligations and (iv) any other investment obligations permitted for governmental instrumentalities under the laws of the Commonwealth which are rated in any of the three highest grades by a nationally recognized rating agency or which are collateralized by Investment Obligations; and

(c) Time Deposits, which are time deposits, certificates of deposit or similar arrangements with the 1974 Trustee, Government Development Bank for Puerto Rico or any bank or trust company which is a member of the Federal Deposit Insurance Corporation having a combined capital and surplus aggregating not less than \$100,000,000. (1974 Agreement, Section 101).

Moneys in the Bond Service Account, the Redemption Account and the 1974 Revenue Fund shall be invested by the 1974 Trustee or by the Authority, as the case may be, in Government Obligations which shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when such moneys will be required for the purposes intended, or in Time Deposits; provided, that each such Time Deposit shall permit the moneys so placed to be available for use when required for the purposes intended.

Any moneys in the 1974 Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the 1974 Reserve Account shall be invested by the 1974 Trustee or the Authority, as the case may be, in Investment Obligations which shall mature, or which shall be subject to redemption by the holder thereof at the option of such holder, in the case of the 1974 Construction Fund, the Self-insurance Fund, the Capital Improvement Fund and the Reserve Maintenance Fund, not later than the respective dates when the moneys invested will be required for the purposes intended, and in the case of the 1974 Reserve Account, as to approximately 50% of such moneys, not later than five years after the date of such investment, and as to the balance of such moneys, as directed by order of the Executive Director or other authorized officer of the Authority. In lieu of such investments, moneys in the 1974 Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the 1974 Reserve Account may be invested in Time Deposits which shall permit the moneys so placed to be available for use at the times provided for investments in Investment Obligations. (1974 Agreement, Section 602).

Any moneys in the Self-insurance Fund may also be invested by the Authority in any investments authorized by law for the Retirement System of the Employees of the Government for Puerto Rico and its Instrumentalities, but the Authority shall invest not less than the lesser of \$25,000,000 and the entire balance in such Fund in Investment Obligations with an average weighted maturity of not more than three years.

Prior to investing any moneys in the Self-insurance Fund in other than Investment Obligations, the Authority shall obtain an Independent Consultant's report recommending what portion of moneys held in the Self-insurance Fund the Authority shall maintain invested in Investment Obligations and shall, after duly considering the report, formally adopt, subject to the consent of Government Development Bank for Puerto Rico, and maintain an investment policy first determining the minimum portion of the moneys held for the credit of the Self-insurance Fund to remain invested in Investment Obligations and then setting forth prudent investment principles, considerations and goals, including liquidity, diversification of assets, safety and rate or rates of return, that will govern the investment strategies and goals for the balance of the Self-insurance Fund and shall advise the 1974 Trustee in writing of those investments other than Investment Obligations that are authorized by said investment policy. (1974 Agreement, Section 602).

Accounting

The Authority covenants that it will keep accurate records and accounts, according to standard practices for public utility systems similar to the properties and business of the Authority and applicable in such circumstances, of all items of cost and expenditures relating to the System, the Revenues collected and the application of the Revenues. The Authority further covenants that in the first month of each fiscal year it will cause an audit for the preceding fiscal year to be made of its books and accounts pertaining to the System by an independent firm of

certified public accountants widely known in the United States and approved by the 1974 Trustee. (1974 Agreement, Section 710). The Authority records Revenues and Current Expenses on the accrual basis.

Release of Property

The Authority covenants that so long as any Power Revenue Bonds shall be outstanding it will not sell, lease or otherwise dispose of or encumber the System or any part thereof and will not create or permit to be created any charge or lien on the Revenues ranking equally with or prior to the charge or lien on the Revenues of the Power Revenue Bonds. The Authority may, however, from time to time, sell machinery, fixtures, tools or other movable property or materials if the Authority shall determine that such articles are no longer needed or useful in connection with the construction or operation and maintenance of the System. Any such moneys received may be applied to replace any such properties sold or disposed of or shall be deposited in the Redemption Account or the 1974 Construction Fund. Other property forming part of the System, not needed or serving no useful purpose in connection with the System, may be sold, leased or transferred provided the proceeds of which shall be deposited in the Redemption Account or the 1974 Construction Fund and the rentals be deposited in the 1974 Revenue Fund.

Notwithstanding the previous paragraph, the Authority may abandon, sell, lease or transfer any property forming a part of the System, if, among other things, the Net Revenues for any 12 consecutive calendar months out of the 18 calendar months next preceding the date of such abandonment, sale, lease or transfer, adjusted to give effect to such abandonment, sale, lease or transfer and any replacement and to reflect the rate schedule then in effect, are not less than 120% of the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all outstanding Power Revenue Bonds and if the 1974 Reserve Account is fully funded. Any transferee of said property may be considered in lieu of or in addition to the Authority for purposes of such coverage if the transferee agrees to assume the Authority's obligations under the 1974 Agreement. Said coverage test need not be met if the transferee is a public corporation or other governmental entity provided the coverage is not reduced due to such transfer. The proceeds of such sale shall be deposited in the Redemption Account or in the 1974 Construction Fund, at the option of the Authority, or shall be applied to the replacement of the property so sold. The rentals under any such lease shall be deposited in the 1974 Revenue Fund.

In addition, the Authority may lease portions of the System or make contracts or other arrangements or grant licenses or easements with respect to the operation or use of the System, if certain reports and certificates of the Consulting Engineers are provided that confirm, among other things, that operational covenants will be binding on the lessee or other contracting entity and that the lease, contract, license, easement or other arrangement provides for rent or other payments that are projected to be sufficient with other projected Net Revenues of the System to make all payments of the Principal and Interest Requirements for all Power Revenue Bonds. Rents received under any such lease, contract, license, easement or other management shall be included as Revenues. (1974 Agreement, Section 712).

Insurance

The Authority covenants that it will at all times carry insurance, in a responsible insurance company or companies authorized and qualified under the laws of Puerto Rico to assume the risk thereof, covering such properties belonging to the System as are customarily insured, and against loss or damage from such causes as are customarily insured against, by companies engaged in similar business.

The Authority covenants that, immediately after any loss or damage, it will cause to be prepared plans and specifications for repairing, replacing or reconstructing the damaged property, and will forthwith proceed with the repair, replacement or reconstruction of the damaged or destroyed property unless it shall determine that the repair, replacement or reconstruction of such property is not essential to the efficient operation of the System. Any proceeds of any insurance not applied within 18 months after receipt by the Treasurer to repairing, replacing or reconstructing damaged or destroyed property shall be deposited in the Redemption Account or the 1974 Construction Fund, at the option of the Authority, unless the Authority shall be prevented from doing so by conditions beyond its control or unless the holders of 51% in aggregate principal amount of the Power Revenue Bonds then outstanding shall otherwise direct. (1974 Agreement, Section 707).

Consulting Engineers and Independent Consultant

The Authority covenants that so long as any of the Power Revenue Bonds are outstanding it will employ as Consulting Engineers an independent engineer or engineering firm having a wide and favorable repute in the United States for skill and experience in the construction and operation of electric systems. It shall be the duty of the Consulting Engineers to prepare an annual report setting forth their recommendations as to revisions of rates and charges. It shall be the duty of the Consulting Engineers to include in such report their recommendations as to the amount to be deposited in the Reserve Maintenance Fund, the Capital Improvement Fund and the Self-insurance Fund. (1974 Agreement, Section 706).

The Authority covenants that so long as any Power Revenue Bonds are outstanding it will employ as Independent Consultant one or more independent firms having a wide and favorable repute in the United States for expertise in risk management and other insurance matters related to the construction and operation of electric systems. It shall be the duty of the Independent Consultant to prepare at least biennially a report setting forth its recommendations, based on a review of the insurance then maintained by the Authority in accordance with the 1974 Agreement and the status of the Self-insurance Fund, of any changes in coverage, including its recommendations of policy limits and deductibles and self-insurance, and investment strategies for the Self-insurance Fund. (1974 Agreement, Sections 706 and 707).

Modifications

The Authority and the 1974 Trustee may, without the consent of the holders of the Power Revenue Bonds, enter into such supplemental agreements as shall not be inconsistent with the 1974 Agreement, to cure any ambiguity, to correct or supplement any provision in the 1974 Agreement which may be inconsistent with any other provision therein, to make any other provisions which shall not be inconsistent with the provisions of the 1974 Agreement, provided such action shall not adversely affect the interest of the bondholders, or to grant to or confer upon the 1974 Trustee for the benefit of the bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the bondholders or the 1974 Trustee, or to add to the conditions, limitations and restrictions on the issuance of bonds under the provisions of the 1974 Agreement other conditions, limitations and restrictions thereafter to be observed, or to add to the covenants and agreements of the Authority in the 1974 Agreement other covenants and agreements thereafter to be observed by the Authority or to surrender any right or power reserved to or conferred upon the Authority by the 1974 Agreement. (1974 Agreement, Section 1101).

The holders of not less than 60% in aggregate principal amount of the Power Revenue Bonds at the time outstanding shall have the right, from time to time (anything contained in the 1974 Agreement to the contrary notwithstanding), to consent to and approve the execution by the Authority and the 1974 Trustee of such agreement or agreements supplemental thereto as shall be deemed necessary or desirable by the Authority for the purpose of modifying, altering, amending, adding to, repealing or rescinding, in any particular, any of the terms or provisions contained in the 1974 Agreement or in any supplemental agreement; provided, however, that nothing contained in the 1974 Agreement shall permit, or be construed as permitting, (a) an extension of the maturity of any Power Revenue Bond, or (b) a reduction in the principal amount of any Power Revenue Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of the Revenues other than the lien and pledge created by the 1974 Agreement, or (d) a preference or priority of any Power Revenue Bond or Bonds over any other Power Revenue Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Power Revenue Bonds required for consent to such supplemental agreement. (1974 Agreement, Section 1102).

Remedies of Bondholders

Among the events described in the 1974 Agreement as “events of default” are the following:

- (a) payment of the principal of and redemption premium, if any, on any of the Power Revenue Bonds shall not be made when the same shall become due and payable, or

(b) payment of any installment of interest shall not be made when the same shall become due and payable, or

(c) the Authority shall for any reason be rendered incapable of fulfilling its obligations under the 1974 Agreement, or

(d) default in meeting any Amortization Requirement, with the specified period of grace, or

(e) if notice has been received by the 1974 Trustee and the Authority from the bank or other institution providing a credit or liquidity facility or other entity guaranteeing or securing bonds that an event of default has occurred under the agreement underlying said facility or if the issuer of a credit or liquidity facility or other entity has failed to make the facility available or to reinstate the interest component of the facility in accordance with its terms (but only to the extent provided for in the resolution authorizing the issuance of the Power Revenue Bonds secured by the credit or liquidity facility). (1974 Agreement, Section 802).

In the event of any such default the 1974 Trustee may, and upon the written request of the holders of not less than 20% in aggregate principal amount of all Power Revenue Bonds then outstanding shall, declare the principal of the Power Revenue Bonds then outstanding to be due and payable, and, providing it shall be indemnified to its satisfaction, the 1974 Trustee may, and upon the written request of the holders of not less than 10% in aggregate principal amount of the Power Revenue Bonds then outstanding shall, proceed to protect and enforce its rights and the rights of the bondholders under the 1974 Agreement by such suits, actions or special proceedings in equity or at law, or by such proceedings in the office of any board or officer having jurisdiction, either for the appointment of a receiver of the System as authorized by the Act or for the specific performance of any covenant or agreement or for the enforcement of any proper legal or equitable remedy, as the 1974 Trustee shall deem most effectual to protect and enforce the rights aforesaid; provided, however, that the 1974 Trustee shall not be required to proceed for the appointment of a receiver unless it shall have received the written request of the holders of not less than 25% in aggregate principal amount of such bonds then outstanding. (1974 Agreement, Sections 803, 804 and 902).

It is the intent of the 1974 Agreement that all proceedings shall be instituted and maintained for the benefit of all holders of outstanding Power Revenue Bonds. (1974 Agreement, Sections 808 and 809).

Defeasance

The 1974 Agreement provides that if, when the Power Revenue Bonds shall have become due and payable or shall have been duly called for redemption or irrevocable instructions to call said bonds for redemption or payment shall have been given by the Authority to the 1974 Trustee, the whole amount of the principal and the interest and the premium, if any, so due and payable upon all of the Power Revenue Bonds then outstanding shall be paid or sufficient moneys, or Government Obligations or Prerefunded Municipals or Time Deposits secured in the manner set forth in Section 601 of the 1974 Agreement, the principal of and the interest on which when due will provide sufficient moneys, shall be held by the 1974 Trustee or the paying agents for such purpose under the provisions of the 1974 Agreement, and provision shall be made for paying all other sums payable by the Authority, then and in that case the right, title and interest of the 1974 Trustee thereunder shall cease, determine and become void, and the 1974 Trustee in such case, on demand of the Authority, shall release the 1974 Agreement. For purposes of determining whether sufficient amounts have been deposited for defeasance, the interest to become due on Variable Rate Bonds shall be calculated at the maximum rate permitted by the terms thereof, and the principal, premium and interest to become due on Put Bonds and Extendible Maturity Bonds shall mean the maximum amount payable upon the exercise of put options by holders of said bonds or extensions of maturity by the holders of said bonds or the Authority. (1974 Agreement, Section 1201).

Bonds Not Deemed Outstanding

The Power Revenue Bonds and portions of Power Revenue Bonds which have been duly called for redemption under the provisions of Article III of the 1974 Agreement, or with respect to which irrevocable

instructions to call for redemption or payment at or prior to maturity have been given to the 1974 Trustee in form satisfactory to it, and for the payment of principal or the redemption price and the accrued interest of which sufficient moneys, or Government Obligations or Prerefunded Municipals or Time Deposits secured in the manner set forth in Section 601 of the 1974 Agreement, shall be held in separate accounts by the 1974 Trustee or by the paying agents in trust for the holders of the bonds or portions thereof to be paid or redeemed, all as provided in the 1974 Agreement, shall not thereafter be deemed to be outstanding under the provisions of the 1974 Agreement. (1974 Agreement, Section 307)

SUMMARY OF CERTAIN PROVISIONS OF PROPOSED SUPPLEMENTAL AGREEMENT

The following is a summary of certain provisions of the proposed Supplemental Agreement. The summary does not purport to be complete and reference is made to the proposed Supplemental Agreement, copies of which are available in substantially final form for examination at the principal corporate trust office of the 1974 Trustee.

Third Supplemental Agreement

The 1974 Agreement will be supplemented to provide that the Authority may grant a lien on Revenues on a parity with the lien of the holders of Power Revenue Bonds to providers of credit or liquidity facilities securing such bonds.

Puerto Rico Electric Power Authority
Audited Financial Statements

Financial Statements and Supplemental Information

Puerto Rico Electric Power Authority

June 30, 2003

Puerto Rico Electric Power Authority
Financial Statements and Supplemental Information
June 30, 2003

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Report of Independent Auditors

To the Governing Board of the
Puerto Rico Electric Power Authority

We have audited the accompanying balance sheets of the Puerto Rico Electric Power Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2003 and 2002, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements and supplemental information are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements and supplemental information based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

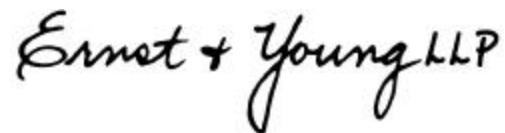
In our opinion, the financial statements and supplemental information referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2003 and 2002, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the financial statements, effective July 1, 2001, the Authority changed its accounting policy related to financial statements presentation to comply with the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*.

Our audits were conducted primarily for the purpose of expressing an opinion on the financial statements of the Authority taken as a whole. The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2003, on our consideration of the Authority's internal control over financial reporting and 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 audits.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Puerto Rico Electric Power Authority taken as a whole. The supplemental information included in Schedules II - VII is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole, and are prepared in accordance with the terms of the 1974 Agreement (described herein).

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

September 30, 2003

Stamp No. 1921009
affixed to
original of
this report.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the financial report of Puerto Rico Electric Power Authority (the Authority) presents the analysis of the Authority's financial performance during the fiscal year ended June 30, 2003. As management of the Authority, we offer readers of the financial statements this narrative overview and analysis of the financial activities. We encourage readers to consider the information presented here in conjunction with the financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The Authority's net assets increased by \$52.4 million or over 10.6 percent as a result of this year's operations.
- Operating income for the fiscal year was \$411.5 million, representing an 11.9 percent increase when compared to the fiscal year 2001-2002.
- Ratios of fuel and purchased power adjustment revenues to total operating revenues were 54.7 percent for 2002-2003 and 48.9 percent for 2001-2002.
- Operating expenses increased \$303.7 million, representing a 16.9 percent increase, when compared to fiscal year 2001-2002.
- Ratios of fuel oil and purchased power expenses to total operating expenses (excluding depreciation expenses) were 65.4 percent for 2002-2003 and 60.3 percent for 2001-2002.
- The increase in the fuel adjustment revenues and fuel expense of \$187.6 and \$166.1 million, respectively, was mainly due to an increase in fuel oil price per barrel of \$7.32 (or 32.0 percent).
- The Authority's Net Utility Plant increased by \$204.1 million or 4.7 percent and Total Assets increased by \$13.4 million or .21 percent.
- Accounts receivable increased from \$438.7 million on June 30, 2002 to \$502.6 million on June 30, 2003, representing a 14.6 percent increase.
- Accounts receivable from the governmental sector decreased from \$108.4 million on June 30, 2002 to \$103.6 million on June 30, 2003, representing a 4.4 percent decrease.

OVERVIEW OF FINANCIAL REPORT

Management's Discussion and Analysis (MD&A) of operating results serves as an introduction to the basic financial statements and supplementary information. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, projected capital improvement program, operational budget and other management tools were used for this analysis.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

During the 2002 fiscal year, the Authority adopted Government Accounting Standards Board (GASB) Statement No. 34 and related pronouncements. The implementation of these pronouncements had an effect on the Authority's basic financial statements such as the classification of net assets, modifications to certain note disclosures, and the inclusion of a Management's Discussion and Analysis (MD&A) section as required supplementary information. In addition, the statements of cash flows are now presented using the direct method.

REQUIRED FINANCIAL STATEMENTS

The financial statements of the Authority consolidate the financial position and operations of Puerto Rico Electric Power Authority and Puerto Rico Irrigation Systems, which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, Statement of Cash Flow and the notes to financial statements.

The Balance Sheet presents the financial position of the Authority and provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses and Changes in Net Assets presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the fiscal year.

The Statement of Cash Flows shows changes in cash and cash equivalents, resulting from operational, financing and investing activities, which include cash receipts and cash disbursement information, without consideration of the depreciation of capital assets.

The notes to the financial statements provide information required and necessary to the understanding of material information of the Authority's financial statements. The notes present information about the Authority's significant accounting policies, significant account balances and activities, risk management, obligations, commitments and contingencies, and subsequent events.

The financial statements were prepared by the Authority's management from the detail accounting books and records.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

FINANCIAL ANALYSIS

The Authority's net assets increased from last year by \$52.4 million. Our analysis below focuses on the Authority's net assets and changes in net assets during the year.

Authority's Net Assets *(In Thousands)*

	2003	2002
Current, non-current and other assets	\$1,645,846	\$1,836,558
Capital assets	4,563,533	4,359,399
Total assets	6,209,379	6,197,957
Long-term debt outstanding	4,511,718	4,632,928
Other liabilities	1,152,882	1,070,684
Total liabilities	5,664,600	5,703,612
Net assets:		
Invested in capital assets, net of related debt	175,301	113,475
Restricted	366,809	377,632
Unrestricted	2,669	1,238
Total net assets	\$ 544,779	\$ 492,345

The largest portion of the Authority's net assets (68 percent) is restricted and represents resources that are subject to external restrictions on how they may be used. An additional portion of the Authority's net assets (33 percent) reflects its investments in capital assets, less any related debt used to acquire those assets that is still outstanding.

Changes in the Authority's net assets can be determined by reviewing the following condensed Statement of Revenue, Expenses and Changes in Net Assets.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Authority's Changes in Net Assets (In Thousands)

	2003	2002
Operating revenues	\$2,513,963	\$2,166,632
Other income	30,625	42,323
Total revenues	2,544,588	2,208,955
Operating expenses	2,102,461	1,798,788
Interest expense, net	256,931	253,590
Total expenses	2,359,392	2,052,378
Income before contribution in lieu of taxes and other	185,196	156,577
Contribution in lieu of taxes and other	(175,737)	(128,787)
Income before contributed capital	9,459	27,790
Contributed capital	42,975	-
Change in net assets	52,434	27,790
Net assets, beginning of year	492,345	464,555
Net assets, end of year	\$ 544,779	\$ 492,345

For the fiscal year ended June 30, 2003, as compared to June 30, 2002, operating revenues and expenses increased by \$347.3 million (or 16.0%) and \$303.7 million (or 16.9%), respectively, resulting in an increase of net assets of \$52.4 million. The increase in operating revenues and expenses was mainly due to an increase in fuel oil price per barrel of \$7.32.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Authority's investment in capital assets as of June 30, 2003, amounts to approximately \$4,564 million (net of accumulated depreciation). This investment in capital assets includes land, generation, transmission and distribution systems, buildings, fixed equipment, furniture, fixtures and equipment. The total increase in the Authority's investment in capital assets (net of accumulated depreciation) for the current fiscal year was 5.0 percent.

A substantial portion of the capital expenditures for production plant in fiscal year ended June 30, 2003, was spent on the rehabilitation and life extension of generating plant in order to achieve and maintain higher levels of availability, reliability and efficiency.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Major capital asset events during fiscal year 2002-2003 included the following:

- The Authority is constructing new 230 kV transmission lines to complete the transmission loop on the eastern part of the island. The eastern loop will connect major switching and load centers on the eastern part of the island and boost electric system capacity in Puerto Rico's eastern region. The eastern loop is expected to be operating during fiscal year 2004.
- The Authority is also constructing a new 50-mile long 230 kV transmission line between its South Coast steam plant and the transmission center at Aguas Buenas. This new transmission line is expected to be operating in fiscal year 2006. Once in operation, this major infrastructure project will enhance the reliability of the transmission system, and will permit the increase of power transfers from the south coast of Puerto Rico to the northern and central regions.
- The Authority is constructing an underground 115 kV transmission circuit line around the San Juan metropolitan area in order to reduce the incidents of loss of power in the aftermath of hurricanes and other major storms which strike Puerto Rico from time to time. This circuit line is expected to be completed in fiscal year 2005. The Federal Emergency Management Agency has committed to provide \$75 million in grants. Other related projects related to the load growth forecast of the San Juan metropolitan area are the new gas insulated 115/38 kV transmission centers of Martín Peña and Isla Grande. In addition, three new 115/38 kV transmission centers under construction in the municipalities of Comerío, Juana Díaz and Hatillo will increase the load flow capability and improve the voltage regulation of the 38 kV system under emergency conditions.
- The Authority is also currently designing and building major underground systems located in high-density metropolitan areas. These underground systems will permit the replacement of overhead sub-transmission and distribution lines, thereby improving reliability and assisting municipalities undertaking urban renewal projects by removing unsightly poles, lines and transformers.

These projects are funded from cash reserves, excess-operating revenues, grants, and debt issued for such purpose.

Additional information on the Authority's capital assets can be found in Note 6 of this report.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Long-Term Debt

At the end of the fiscal year 2003, the Authority had total long-term debt outstanding of \$4,517 million, comprised of revenue bonds and other borrowings.

Authority Outstanding Debt

	2003	2002
	<i>(In Thousands)</i>	
Power revenue bonds, net	\$4,506,718	\$4,627,928
Note payable	5,000	5,000
	4,511,718	4,632,928
Current portion	(285,407)	(280,070)
Long-term debt excluding current portion	\$4,226,311	\$4,352,858

The Authority maintains ratings of "A3" by Moody's and "A-" by S&P for its bonds.

Additional information on the Authority's long-term debt can be found in Notes 5, 8 and 11.

ECONOMIC FACTORS AND NEW YEAR'S BUDGETS AND RATES

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main drive of the Puerto Rico economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. Thus, historically, the real growth rates of the Puerto Rico economy have closely followed those of the U.S. economy. In fiscal year 2003 Puerto Rico experienced the consequences of the slowdown in the U.S. economy, since the U.S. Real GDP increased by only 0.8%.

The economy of Puerto Rico is expected to resume growing in fiscal year 2004, advancing at rates between 2% and 3% in real terms, according to the latest forecast prepared by Interamerican University of Puerto Rico. The Authority expects this turnaround in economic performance to contribute to achieving the conservative income projections of the Authority for fiscal year 2004.

The Authority adopted the 2004 fiscal year budget on June 15, 2003. The electric revenues for fiscal year 2004 are projected to approximately \$3,112 million. This budget includes approximately \$446.7 million for the Capital Improvement Program (CIP), representing an increase of about [3.8%] from fiscal year 2003.

Puerto Rico Electric Power Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer. The executive offices of the Authority are located at 1110 Ponce de León Avenue, San Juan, Puerto Rico 00907.

Puerto Rico Electric Power Authority
Balance Sheets

	June 30	
	2003	2002
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 50,451	\$ 165,255
Receivables, net	502,609	438,678
Fuel oil, at average cost	53,465	59,971
Materials and supplies, at average cost	130,844	135,808
Prepayments and other assets	20,808	20,420
Total current assets	758,177	820,132
Other non-current receivables	42,069	43,080
Restricted assets:		
Cash and cash equivalents held by trustee for payment of principal and interest on bonds	275,765	273,743
Investments held by trustee	321,649	350,678
Construction fund and other special funds	133,332	282,364
Total restricted assets	730,746	906,785
Utility plant:		
Plant in service	6,331,267	6,169,225
Accumulated depreciation	(3,210,237)	(3,015,056)
	3,121,030	3,154,169
Construction in progress	1,442,503	1,205,230
Total utility plant, net	4,563,533	4,359,399
Other properties	39,751	-
Deferred expenses:		
Unamortized debt issue cost	39,218	33,849
Other	35,885	32,712
Total deferred expenses	75,103	66,561
Total assets	\$6,209,379	\$ 6,195,957

	June 30	
	2003	2002
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Notes payable to banks	\$ 185,000	\$ 125,000
Accounts payable and accrued liabilities	545,002	497,974
Customers' deposits	141,863	133,510
Total current liabilities	<u>871,865</u>	<u>756,484</u>
Current liabilities payable from restricted assets:		
Current portion of long-term debt and notes payable	285,407	280,070
Accrued interest	121,942	123,183
Total liabilities payable from restricted assets	<u>407,349</u>	<u>403,253</u>
Noncurrent liabilities:		
Long-term debt, excluding current portion payable from restricted assets	4,226,311	4,352,858
Deferred credit for purchase of power payable from restricted assets	29,160	41,422
Sick leave benefits to be liquidated after one year	128,912	120,412
Supplemental spouse survivor benefits	1,003	21,300
Pension benefits exchanged for forfeited sick leave	-	7,883
Total noncurrent liabilities	<u>4,385,386</u>	<u>4,543,875</u>
Total liabilities	<u>5,664,600</u>	<u>5,703,612</u>
Net assets:		
Invested in utility plant, net of related debt	175,301	113,475
Restricted for capital activity and debt service	366,809	377,632
Unrestricted	2,669	1,238
Total net assets	<u>544,779</u>	<u>492,345</u>
Total net assets and liabilities	<u><u>\$6,209,379</u></u>	<u><u>\$6,195,957</u></u>

See accompanying notes.

Puerto Rico Electric Power Authority
Statements of Revenues, Expenses and Changes in Net Assets

	Year ended June 30	
	2003	2002
	<i>(In Thousands)</i>	
Operating revenues	\$2,513,963	\$2,166,632
Operating expenses:		
Operations:		
Fuel	886,425	720,292
Purchased power	339,082	227,923
Other production	45,366	56,299
Transmission and distribution	120,631	115,834
Customer accounting and collection	90,299	85,183
Administrative and general	164,915	152,142
Maintenance	228,167	215,994
Depreciation	227,576	225,121
Total operating expenses	2,102,461	1,798,788
Operating income	411,502	367,844
Interest income	20,296	25,766
Other income	10,329	16,557
Income before interest charges and contribution in lieu of taxes	442,127	410,167
Interest charges:		
Interest on bonds	249,779	247,982
Interest on other long-term debt	-	487
Other interest	3,403	3,235
Amortization of debt discount, issuance costs and refunding loss	20,544	17,880
Allowance for funds used during construction	(16,795)	(15,994)
Total interest charges, net	256,931	253,590
Income before contribution in lieu of taxes and contributed capital	185,196	156,577
Contribution in lieu of taxes and other	(175,737)	(128,787)
Income before contributed capital	9,459	27,790
Contributed capital	42,975	-
Changes in net assets	52,434	27,790
Net assets, beginning balance	492,345	464,555
Net assets, ending balance	\$ 544,779	\$ 492,345

See accompanying notes.

Puerto Rico Electric Power Authority
Statements of Cash Flows

	Year ended June 30	
	2003	2002
	<i>(In Thousands)</i>	
Cash flows from operating activities		
Cash received from customers	\$ 2,286,108	\$ 2,887,245
Cash paid to suppliers and employees	(1,863,829)	(2,385,448)
Net cash flows provided by operating activities	422,279	501,797
Cash flows from noncapital financing activities		
Proceeds from penalties to AES Puerto Rico, L.P.	-	1,652
Other special funds, net	3,885	(1,768)
Principal paid on fuel line of credit	(980,000)	(1,015,000)
Proceeds from fuel line of credit	980,000	1,015,000
Interest paid on fuel line of credit	(2,287)	(3,505)
Net cash flows provided by (used in) noncapital financing activities	1,598	(3,621)
Cash flows from capital and related financing activities		
Construction expenditures	(422,758)	(412,777)
Allowance for funds used during construction	16,795	15,994
Net (decrease) increase in construction funds	17,212	(18,801)
Power revenue bonds:		
Proceeds from issuance of bonds, net of original issue discount	98,125	500,007
Principal paid on revenue bonds	(155,163)	(147,116)
Interest paid on revenue bonds	(245,090)	(223,065)
Proceeds from issuance of refunding bonds, net of original issue discount	556,346	206,896
Defeased bonds, net of original issue discount or premium	(644,443)	(199,376)
Payment of bond anticipation notes	60,000	(80,000)
Proceeds from bond anticipation notes	-	80,000
Interest paid on bond anticipation notes	-	(487)
Net cash flows used in capital and related financing activities	(718,976)	(278,725)
Cash flows from investing activities		
Purchases of investment securities	(2,800,788)	(1,057,086)
Proceeds from sale and maturities of investment securities	2,967,103	860,437
Interest on investments	33,215	43,463
Net cash flows provided by (used in) investing activities	199,530	(153,186)
Net (decrease) increase in cash and cash equivalents	(95,569)	66,265
Cash and cash equivalents at beginning of year	468,309	402,044
Cash and cash equivalents at end of year	\$ 372,740	\$ 468,309

	Year ended June 30	
	2003	2002
	<i>(In Thousands)</i>	
Cash and cash equivalents		
Unrestricted	\$ 50,451	\$ 165,255
Restricted:		
Cash and cash equivalents held by trustee for payment of principal and interest on outstanding bonds	275,765	273,743
Cash and cash equivalents held in construction and other special funds	46,524	29,311
	<u>\$ 372,740</u>	<u>\$ 468,309</u>
 Reconciliation of net operating revenues to net cash provided by operating activities		
Operating income	\$ 411,502	\$ 367,844
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	227,576	225,121
Amortization of other assets	17,610	11,472
Contribution in lieu of taxes	(175,737)	(128,787)
Changes in assets and liabilities:		
Receivables	(69,690)	(16,571)
Fuel oil	4,219	19,934
Materials and supplies	5,159	10,525
Prepayments and other assets	(388)	5,714
Deferred debits	(10,189)	(15,031)
Noncurrent liabilities, excluding note payable to GDB	(31,943)	(33,380)
Accounts payable and accrued liabilities	35,808	46,985
Customers' deposits	8,352	7,971
Total adjustments	<u>10,777</u>	<u>133,953</u>
 Net cash flows provided by operating activities	 <u>\$ 422,279</u>	 <u>\$ 501,797</u>

See accompanying notes.

Puerto Rico Electric Power Authority

Notes to Financial Statements

June 30, 2003

1. Reporting Entity

Puerto Rico Electric Power Authority (the Authority) is a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (the Commonwealth) created on May 2, 1941, pursuant to Act No. 83, as amended, re-enacted, and supplemented, of the Legislature of Puerto Rico (the Act) for the purpose of conserving, developing and utilizing the water and power resources of Puerto Rico in order to promote the general welfare of the Commonwealth. Under the entity concept, the Authority is a component unit of the Commonwealth. The Authority produces, transmits, and distributes substantially all of the electric power consumed in Puerto Rico.

The Authority has broad powers including, among others, to issue bonds for any of its corporate purposes. The Authority is required under the terms of a Trust Agreement, dated as of January 1, 1974, as amended (the 1974 Agreement), and the Act to determine and collect reasonable rates for electric service in order to produce revenues sufficient to cover all operating and financial obligations, as defined.

Basis of Presentation – Blended Component Unit

The financial statements of the Authority include the financial position and operations of the Puerto Rico Irrigation Systems (Irrigation Systems). The Irrigation Systems operate pursuant to the provisions of the Act, and Acts No. 83 and 84, approved on June 20, 1955, regarding the Puerto Rico Irrigation Service, South Coast, and Isabela Irrigation Service, respectively, and the Lajas Valley Public Irrigation Law, approved on June 10, 1953, as amended.

The Irrigations Systems conform to the requirements of Governmental Accounting Standards Board (GASB) No. 14, *The Financial Reporting Entity*, on its stand-alone financial statements. GASB No. 14 establishes standards for defining and reporting on the financial reporting entity. It also establishes standards for reporting participation in joint ventures. It applies to financial reporting by primary governments, governmental joint ventures, jointly governed organizations, and other stand-alone governments; and it applies to the separately issued financial statements of governmental component units. In addition, this Statement should be applied to governmental and nongovernmental component units when they are included in a governmental financial reporting entity.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

1. Reporting Entity (continued)

Basis of Presentation – Blended Component Unit (continued)

Condensed financial information as of June 30, 2003 and 2002, and for the year then ended for the Irrigation Systems is as follows:

	2003	2002
	<i>(In Thousands)</i>	
Balance sheets:		
Assets:		
Receivables, net	\$ 6,157	\$ 7,943
Prepayments and other assets	2,172	2,139
Utility Plant, net of depreciation	19,496	18,745
Total assets	27,825	28,827
Liabilities:		
Accounts payable, net	872	839
Statement of revenues, expenditures and changes in net assets		
Operating revenues	5,205	4,461
Operating expenses	(6,240)	(5,207)
	(1,035)	(746)
Net assets, beginning balance	27,988	28,734
Net assets, ending balance	\$26,953	\$27,988

2. Summary of Significant Accounting Policies

The following is a summary of the most significant accounting policies followed by the Authority in preparing its financial statements:

Basis of Accounting

The accounting and reporting policies of the Authority conform with the accounting rules prescribed by the Governmental Accounting Standards Board (GASB). As such, it functions as an enterprise fund. The Authority maintains its accounting records on the accrual method of accounting in conformity with accounting principles generally accepted in the United States. Although the Authority is not subject to all Federal Energy Regulatory Commission (FERC) regulations, the Authority has adopted the uniform system of accounts prescribed by FERC.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Basis of Accounting (continued)

The Authority follows the provisions of GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," as amended by GASB Statement No. 34, which requires proprietary activities to apply all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, and Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless the pronouncements conflict or contradict GASB pronouncements.

This pronouncement permits the adoption of all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict or contradict GASB pronouncements. The Authority, as allowed by GASB, decided not to implement any FASB Statement or Interpretation issued after November 30, 1989.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount 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. Because of uncertainties inherent in the estimation process, it is possible that actual results could differ from those estimates.

GASB Statement Nos. 34, 37 and 38

During the 2002 fiscal year the Authority adopted the provisions of GASB Statement No. 34, *Basic Financial Statements^{3/4}and Management's Discussion and Analysis^{3/4}for State and Local Governments* (Statement 34); GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus* (Statement 37); and GASB Statement No. 38, *Certain Financial Statement Disclosures* (Statement 38). Statements 34, 37 and 38 established standards for external financial reporting and disclosure for all state and local government entities, which for the Authority includes a statement of net assets, a statement of revenues, expenses and changes in net assets and a statement of cash flows. The most significant change related to the implementation of Statement 34 for Authority is the requirement that net assets be classified into three components – invested in capital assets, net of related debt; restricted; and unrestricted, on a retroactive basis. Previously, Authority net assets were reported as fund equity, as either retained earnings or contributions in aid of construction. These classifications are defined as follows:

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

GASB Statement Nos. 34, 37 and 38 (continued)

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, or other long-term borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
- Restricted – This component of net assets consists of net assets subject to external constraints on their use imposed by creditors (such as through debt covenants), contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

The adoption of Statements No. 34, No. 37, and No. 38 had no effect on the financial statements except for the classification of net assets, changes in financial statement presentation and modification of certain financial statement note disclosures.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Authority considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents. Cash and cash equivalents included in the restricted funds are considered cash equivalents for purposes of the statements of cash flows.

Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions.

Materials and Supplies

Materials and supplies inventories are carried at average cost and are stated at the lower of cost or market.

Investments

The Authority follows the provisions of GASB Statement No. 31, *“Accounting and Financial Reporting for Certain Investments and for External Investment Pools,”* which require the reporting of investments at fair value in the balance sheet and the recording of changes in fair value in the statement of revenues, expenses and changes in net assets. The fair value is based on quoted market prices.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments (continued)

The funds under the 1974 Agreement may be invested in:

- Government obligations, which are direct obligations of, or obligations whose principal and interest is guaranteed by the U.S. Government, or obligations of certain of its agencies or instrumentalities.
- Investment obligations of any of the states or territories of the United States or political subdivisions thereof (other than obligations rated lower than the three highest grades by a nationally recognized rating agency) and repurchase agreements with commercial banks fully secured by U.S. Government obligations.
- Time deposits with Government Development Bank for Puerto Rico (GDB) or the Authority's Trustee under the 1974 Agreement or any bank or trust company member of the Federal Deposit Insurance Corporation having a combined capital and surplus of not less than \$100 million.

Effective April 1999, the 1974 Agreement was amended to provide that permitted investments of moneys to the credit of the Self-insurance Fund be expanded (subject to the Authority's adoption of an investment policy with the consent of GDB) to coincide with the investments permitted for the pension fund for employees of the Commonwealth of Puerto Rico and its instrumentalities. Such investments include various debt instruments, such as mortgage loans and leases, common and preferred stock, real property and various other financial instruments.

Utility Plant

Utility plant is carried at cost, which includes labor, materials, overhead, and an allowance for the cost of funds used during construction (AFUDC). AFUDC represents the cost of borrowed funds used to finance construction work in progress. AFUDC is capitalized as an additional cost of property and as a reduction of interest expense. Capitalized interest expense is reduced by interest income earned on related investments acquired with proceeds of tax-exempt borrowings. Such costs are recovered from customers as a cost of service through depreciation charges in future periods. Capitalized interest during the years ended June 30, 2003 and 2002 amounted to \$16.8 million and \$15.9 million, respectively. These amounts are net of interest income earned on investments amounting to \$3.1 thousand and \$3.9 million, respectively.

Maintenance, repairs, and the cost of renewals of minor items of property units are charged to operating expenses. Replacements of major items of property are charged to the plant accounts. The cost of retired property, together with removal cost less salvage, is charged to accumulated depreciation with no gain or loss recognized.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Depreciation

Depreciation is computed on the straight-line method at rates considered adequate to allocate the cost of the various classes of property over their estimated service lives. The annual composite rate of depreciation, determined by the Authority's consulting engineers, was approximately 4.25% for 2003 and 2002.

Unamortized Debt Expense

Debt expenses and discounts incurred in the issuance of bonds are deferred and amortized using the straight-line method, which approximates the interest method, over the term of the related debt.

For refunding debt, the excess of reacquisition cost over the carrying value of long-term debt is deferred and amortized to operating expenses using the straight-line method over the remaining life of the original debt or the life of the new debt, whichever is shorter.

Asbestos Containment Deferred Costs

Maintenance costs incurred in the containment of asbestos are deferred and included in other deferred expenses. Such costs are amortized as recovered over an estimated life of 12 years.

Pension Plan

Pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and actual contributions.

Accounting for Compensated Absences

Accumulated unpaid vacation and sick leave pay are accrued when earned and an additional amount is accrued as a liability for the employer salary-related benefits associated with compensated absences using salary rates in effect at the balance sheet date.

The cost of compensated absences expected to be paid in the next twelve months is classified as accounts payable and accrued liabilities while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

Revenue Recognition, Fuel Costs and Purchase Power

Clients are billed monthly, except for rural clients who are billed bimonthly. Revenues are recorded based on services rendered during each accounting period, including an estimate for unbilled services. Revenues include amounts resulting from a fuel and purchased power cost recovery clause (Fuel Adjustment Clause), which is designed to permit full recovery through customer billings of fuel costs and purchased power. Fuel costs and purchased power are reflected in operating expenses as the fuel and purchased power are consumed.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Contributions in Lieu of Taxes and Governmental Subsidies

The Act exempts the Authority from all taxes that otherwise would be levied on its properties and revenues by the Commonwealth and its Municipalities, except as follows:

Municipalities

To the extent net revenues, as defined, are available, the Authority is required under the Act to make a contribution in lieu of taxes of 6% to the Municipalities of gross electric sales. For these purposes, net revenues include gross electric energy sales (with certain exemptions) computed on the basis of an annual average fuel oil price of up to a maximum of \$30 per barrel. The Authority, subject to its obligations under the 1974 Agreement, may modify the maximum annual average fuel price per barrel to a higher level to provide the Municipalities with sufficient income to absorb their billings for electricity consumption plus the necessary amounts to fulfill their obligations to the Authority. The contribution in lieu of taxes to Municipalities can be used to offset accounts receivable balances owed by the Municipalities to the Authority as permitted by law. Should, in any given year, the Authority's net revenues not be sufficient to cover the calculated maximum contribution in lieu of taxes, said contribution shall be reduced to the amounts available, and the excess does not carry forward as a liability for future years.

Commonwealth of Puerto Rico

To the extent net revenues are available, the Authority is also required under the Act to set aside an additional 5% of gross electric sales for the purpose of (i) financing improvements, (ii) offsetting other subsidies (other than cost of fuel adjustments to certain residential clients) of the Commonwealth, and (iii) any other lawful corporate purpose. However, 20% of the 5% electric energy sales set aside for the Commonwealth must be applied against the cost of the Authority's fuel oil subsidy program. Another one-fifth of the electric energy sales set aside must be paid to the Secretary of the Treasury for distributing among the Municipalities (in addition to contribution in lieu of taxes described above). Amounts assigned to (ii) above, are classified as a contribution in lieu of taxes in the accompanying statements of revenues, expenses and changes in net assets and reduce the related accounts receivable in the balance sheets.

Contributed Capital

The Authority records contributed capital as income in the year earned. The Authority receives contributed capital in the form of cash and property from residential projects developed during recent years.

Reclassifications

Certain reclassifications have been made to the 2002 financial statements to conform with the 2003 financial statements presentation.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

3. Cash and Cash Equivalents

The 1974 Agreement established the General Fund, the Revenue Fund, and certain other funds (see Note 5). All revenues (other than income from investments and construction funds obtained from financing) are deposited in these funds. The monies held in these funds are presented as unrestricted cash and cash equivalents in the balance sheets.

At June 30, 2003, the carrying amount and bank balance of cash deposits held by the Authority and restricted cash deposits held by the Trustee under the 1974 Agreement are as follows (in thousands):

	2003		2002	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Unrestricted	\$ 50,451	\$ 45,142	\$165,255	\$171,831
Restricted:				
Held by the Trustee	275,765	275,765	273,743	273,743
Held by the Authority	46,524	46,524	29,311	29,311
	\$372,740	\$367,431	\$468,309	\$474,885

Cash deposits, except for minor amounts, are covered by the Federal Deposit Insurance Corporation, or collateral held on behalf of the Authority by the Secretary of the Treasury of the Commonwealth of Puerto Rico (the Secretary) or its agent in the name of the Secretary.

4. Accounts Receivable

At June 30, receivables consist of (in thousands):

	2003	2002
Electric and related services:		
Government agencies and municipalities	\$103,629	\$108,428
Residential, industrial, and commercial	289,587	248,114
Recoveries under fuel adjustment clause under (over) billed	(756)	(8,055)
Unbilled services	145,715	124,641
Commonwealth subsidy (fuel adjustment clause) for certain residential clients	31,598	31,598
Miscellaneous accounts and others	10,603	8,101
	580,376	512,827
Allowance for uncollectible accounts	(36,951)	(34,551)
	543,425	478,276
Accrued interest on investments	1,253	3,482
Less - Other non-current receivables, mostly related to Commonwealth	(42,069)	(43,080)
	\$502,609	\$438,678

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

4. Accounts Receivable (continued)

On October 29, 1991, the Authority entered into an agreement with the Commonwealth for the payment of the outstanding fuel adjustment subsidy receivable amounting to approximately \$94 million. Under this agreement, the Commonwealth is paying that amount over a fifteen-year period in installments of approximately \$6.3 million per year, without interest. As of June 30, 2003 and 2002, the outstanding fuel adjustment subsidy receivable amounted to approximately \$31.6 million.

In addition, the Authority has other subsidies and reimbursable costs receivable from the Commonwealth, which are reduced by means of charges (accounted for as a contribution in lieu of taxes and to the extent net revenues, as defined, are available) against a portion of the 5% of gross electric sales it is required to set aside under the Act. The portion of such receivables and other governmental receivables not expected to be collected during the next fiscal year are reflected in the accompanying balance sheets as other noncurrent receivables.

5. Restricted Assets

At June 30, 2003 and 2002, certain investments and cash deposits of the Authority were restricted to comply with long-term principal and interest debt service requirements (sinking funds) as well as for self-insurance. These restricted assets are held by the Trustee under the 1974 Agreement (see Note 3) in the following funds:

1974 Reserve Account - Reserve for payment of principal of and interest on Power Revenue Bonds in the event moneys in Bond Service Account or Redemption Account are insufficient for such purpose.

1974 Self-insurance Fund - Fund to pay the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of a cause, which is not covered by insurance required under the 1974 Agreement. The 1974 Self-insurance Fund also serves as an additional reserve for the payment of the principal of and interest on the Power Revenue Bonds, and meeting the amortization requirements to the extent that moneys in the Bond Service Account, the Redemption Account and the 1974 Reserve Account are insufficient for such purpose.

Bond Service Account and Redemption Account (1974 Sinking Fund) - Current year requirements for principal of and interest on Power Revenue Bonds. As of June 30, 2003, cash and cash equivalents in this account amounted to \$275.8 million (2002 - \$273 million).

At June 30, investments held by the Trustee consist of (in thousands):

	2003	2002
1974 Reserve Account	\$241,409	\$260,193
1974 Self - insurance Fund	80,240	77,353
1974 Sinking Fund	-	13,132
	\$321,649	\$350,678

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

5. Restricted Assets (continued)

Investments held by Trustee under the 1974 Agreement are invested exclusively in securities of the U.S. Government and its agencies.

The Authority also has cash and investment securities held by the trust department of a commercial bank restricted for the following purposes:

1974 Construction Fund - Special fund created by the 1974 Agreement. The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of acquiring or constructing improvements, together with the money received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the 1974 Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the 1974 Construction Fund and held by the Authority in trust.

Reserve Maintenance Fund - Fund to pay the cost of unusual or extraordinary maintenance or repairs, not recurring annually, and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of principal of and interest on the Power Revenue Bonds and meeting the amortization requirements to the extent that moneys in the 1974 Sinking Fund, including money in the 1974 Reserve Account, are insufficient for such purpose.

Cogeneration Fund - Fund created on December 15, 1997 pursuant to an agreement between the Authority and EcoEléctrica L.P., a joint venture of private companies, for the purpose of enabling the Authority to pay certain expenses in connection with the Authority's activities concerning cogeneration planning and implementation.

Other Fund - During fiscal year 1999, one of the partners of EcoEléctrica, L.P. (EcoEléctrica) sold its interest in the partnership to a utility company. Pursuant to the agreement between the Authority and EcoEléctrica, the Authority received \$29.6 million as a waiver of certain contractual provisions. During fiscal year 2000, the Authority received \$18 million from AES Puerto Rico, L.P. (AES) as a waiver of certain contractual provisions of its co-generation contract. The Authority will use the proceeds received from EcoEléctrica and AES to reduce the cost of power to be purchased under the respective agreements thus reducing its customers' invoices.

At June 30, the 1974 Construction Fund and other special funds consist of (in thousands):

	2003		2002	
	Cash and Cash Equivalents	Investments	Cash and Cash Equivalents	Investments
1974 Construction Fund	\$35,844	\$ 921	\$25,405	\$166,710
Reserve Maintenance Fund	-	42,701	1,022	40,454
Other Funds	10,680	43,186	2,884	45,889
	\$46,524	\$86,808	\$29,311	\$253,053

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

5. Restricted Assets (continued)

Following is the composition of the investments in the 1974 Construction Fund and other special funds (in thousands):

	<u>2003</u>	<u>2002</u>
U.S. Government obligations	\$58,470	\$225,459
Corporate bonds	5,225	4,527
Equity securities	<u>23,113</u>	<u>23,067</u>
	<u>\$86,808</u>	<u>\$253,053</u>

6. Utility Plant

As of June 30, utility plant consists of:

	<u>2003</u>	<u>2002</u>
	<i>(In Thousands)</i>	
Distribution	\$ 2,039,383	\$ 1,984,478
Transmission	995,842	985,724
Production	1,573,700	1,574,173
Other production	566,293	536,089
Hydroelectric	85,705	85,637
General	1,039,711	972,577
Irrigation systems	<u>30,633</u>	<u>30,547</u>
	6,331,267	6,169,225
Less- Accumulated depreciation	<u>(3,210,237)</u>	<u>(3,015,056)</u>
	3,121,030	3,154,169
Construction in progress	<u>1,442,503</u>	<u>1,205,230</u>
	<u>\$ 4,563,533</u>	<u>\$ 4,359,399</u>

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

6. Utility Plant (continued)

Utility plant activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Increases	Decreases	Transfers	Ending Balance
Utility plant	\$ 6,169,225	\$ -	\$(32,948)	\$ 194,990	\$6,331,267
Construction work in progress	1,205,230	432,263	-	(194,990)	1,442,503
Total utility plant	7,374,455	432,263	(32,948)	-	7,773,770
Less:					
Accumulated depreciation	(3,015,056)	(228,129)	32,948	-	(3,210,237)
Total utility plant, net	\$ 4,359,399	\$ 243,885	\$ -	\$ -	\$4,563,533

Construction work-in-progress at June 30, 2003, consists principally of expansions and upgrades to the electric generation, distribution and transmission systems.

7. Other Property – Optical Fiber Network (OFN)

On September 2000, the Authority entered into two agreements with Puerto Rico Information Network, Inc. (PRIN). The first agreement (Development and Management Agreement) establishes that PRIN would design and develop an OFN that will form part of the Authority's internal communications system. The second agreement (Initial Installment Purchase Agreement) establishes that upon the completion of the OFN, PRIN would transfer to the Authority title to the network.

On October 10, 2002, the Authority paid \$36.8 million to acquire the OFN.

In addition, the Authority is currently negotiated the cancellation of both agreements with PRIN.

8. Defeasance of Debt

During 2003 and in prior years, the Authority has refunded in advance certain Power Revenue Bonds and other obligations by placing the proceeds of new debt in an irrevocable trust to provide for future debt service payments on such bonds. Accordingly, the trust accounts, assets, and liabilities for the defeased bonds are not included in the Authority's financial statements. At June 30, 2003 and 2002, \$614.4 million and \$723.0 million, respectively, of Power Revenue Bonds series B, N, O, P, Q, R, T, V, X, and HH, REA-A, B, C, E, F, G, H, which remain outstanding are considered defeased.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

9. Notes Payable to Banks

On July 3, 1999, the Authority, GDB, and certain banks entered into an agreement for a revolving line of credit to be used for financing fuel purchases. Under the agreement, the Authority borrowed \$125 million. The average effective interest rate during each year and at year-end was 1.09% and 1.32%, respectively, for 2003; and 1.92% and 1.91%, respectively, for 2002.

On June 3, 2003, the Authority and GDB entered into agreement for a line of credit of \$200 million to be used for interim financing of the capital improvement program. As of June 30, 2003, the Authority had borrowed \$60 million from this line of credit. The interest rate on this line of credit was 2.37%.

On July 2, 2003, the Authority and GDB entered into another agreement for a line of credit of \$68 million to fund made under a settlement agreement relating to a certain litigation with the municipalities of Puerto Rico.

10. Accounts Payable and Accrued Liabilities

	2003	2002
	<i>(In Thousands)</i>	
Accounts payable, accruals, and withholdings in process of payment	\$279,797	\$281,528
Additional accruals and withholdings:		
Injuries and damages and other	28,295	20,523
Accrued vacation and payroll benefits	54,058	52,403
Accrued sick leave and payroll benefits - exclusive of benefits to be liquidated after one year of approximately \$128.9 million and \$120.4 million in 2003 and 2002, respectively	15,695	21,584
Accrued accident leave	-	3,973
Accrued compensation	26,309	24,043
Accrued pension plan contribution and withholding from employees:		
Employees' Retirement System	12,275	3,398
Supplemental unfunded benefit obligation spouse-survivor benefit - exclusive of benefit to be liquidated after one year of approximately \$21.3 million in 2002	14,818	15,579
Supplemental unfunded pension obligation exchanged for forfeited sick leave benefits - exclusive of benefits to be liquidated after one year of approximately \$1.0 million and \$7.8 million in 2003 and 2002, respectively	4,634	3,902
Employees health plan	16,498	14,273
Contract retainage	23,561	21,674
Contribution in lieu of taxes	38,576	11,645
Other accrued liabilities	30,486	23,449
	\$545,002	\$497,974

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt

At June 30, long-term debt consists of:

	2003	2002
	<i>(In Thousands)</i>	
Power Revenue Bonds payable:		
Publicly offered at various dates from 1988 to 2003, interest rates ranging from 3.8% to 7.0%, maturing to 2031	\$4,647,960	\$4,687,535
RUS issues - interest rate of 5%, maturing to 2028	31,703	150,831
	4,679,663	4,838,366
Less unamortized discount and debt reacquisition costs	(172,945)	(210,438)
Revenue bonds payable, net	4,506,718	4,627,928
Note payable	5,000	5,000
	4,511,718	4,632,928
Less current portion of long-term debt	(285,407)	(280,070)
	\$4,226,311	\$4,352,858
	\$4,226,311	\$4,352,858

Long-term debt activity for the years ended June 30, 2003 and 2002, was as follows:

	2003	2002
	<i>(In Thousands)</i>	
Long-term debt excluding current portion	\$4,632,928	\$4,242,155
New issues:		
Power revenue bonds	98,125	515,305
Power revenue refunding bonds	506,840	205,065
Debt discount on new bond issues – net	49,506	23
Defeasance of bonds	(614,435)	(203,735)
Debt discount and excess reacquisition costs on cancelled bonds – net	(30,008)	(9,131)
Accretion of capital appreciation bonds	5,930	14,296
	4,648,886	4,763,978
Payment to bondholders:		
Power revenue – July 1	(154,455)	(143,214)
Power revenue – January 1	(708)	(3,902)
Total payments	(155,163)	(147,116)
Amortization of debt discount and excess reacquisition costs	17,995	16,066
Balance at end of year	\$4,511,718	\$4,632,928
Current portion of long-term debt	\$ 285,407	\$ 280,070

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable

The Authority has issued Power Revenue Bonds pursuant to the 1974 Agreement principally for the purpose of financing the cost of Improvements, as such term is defined in the 1974 Agreement, and subject to the conditions and limitations set forth therein.

In the 1974 Agreement, the Authority covenants to fix, charge, and collect rates so that revenues will be sufficient to pay current expenses and to provide the greater of (i) the required deposits or transfers under the Sinking Fund, the 1974 Self-insurance Fund and the Reserve Maintenance Fund or (ii) 120% of the aggregate principal and interest requirements for the next fiscal year on account of all outstanding Power Revenue Bonds.

Gross revenues, exclusive of income on certain investments, less current expenses as defined in the Agreement have been pledged to repay Power Revenue Bonds principal and interest (see Note 5).

During fiscal year 2003, the Authority issued its Power Revenue Bonds, Series KK, LL and MM. In addition, the Authority issued the Series KK and MM Bonds pursuant to Section 210 of the 1974 Agreement to refund blocks of the following bond issues summarized below:

<u>Series</u>	<u>Principal Amount Refunded</u>
Series B	\$115,101,500
Series O	140,025,561
Series P	9,230,000
Series Q	9,295,000
Series R	5,285,000
Series T	179,770,000
Series V	4,240,000
Series X	26,550,000
Series HH	10,435,000
Rea A	3,842,000
Rea B	13,120,000
Rea C	10,582,000
Rea D	14,910,000
Rea E	10,523,000
Rea F	7,525,000
Rea G	32,101,000
Rea H	21,900,000
	<hr/>
Total refunded	<u><u>\$614,435,061</u></u>

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable (continued)

The refunding permitted the Authority to realize savings on its debt service requirements on bonds outstanding under the 1974 agreement. Reduction of the total debt service payments over the next 21 years is approximately \$7,000,000. This will generate an economic gain (difference between present value of the old and new debt service payments) of approximately \$6,900,000. The Authority deposited the net proceeds of the Series KK and MM Power Revenue Refunding Bonds with the 1974 trustee, as escrow agent. The net proceeds were invested in Government Obligations, the principal of and interest on which when due, will provide moneys sufficient to pay the redemption price of the Refunded Power Revenue Bonds on and the interest coming due on the Refunded Power Revenue Bonds through their respective dates of redemption. See Note 8.

Upon the deposit with the 1974 Trustee referred to above, the Refunded Power Revenue Bonds will, in the opinion of the Bond Counsel, no longer be outstanding under the provisions of the 1974 Agreement and the Refunded Power Revenue Bonds will thereupon be defeased.

The Authority issued the Power Revenue Bonds, Series LL for the purpose of paying a portion of the cost of its CIP.

A summary of the net proceeds of the Power Revenue Bonds, Series KK, Series LL, Series MM, and application of the proceeds follows:

Principal amount of Series KK Refunding Bonds	\$401,785,000
Principal amount of Series LL Bonds	98,125,000
Principal amount of Series MM Refunding Bonds	105,055,000
Plus:	
Net original issue premium	52,999,882
Other available moneys	1,483,484
	<u>\$659,448,366</u>
 Application of net proceeds:	
Deposit to Escrow Fund for Refunded Power Revenue Bonds	\$646,092,216
Deposit to 1974 Construction Fund	13,356,150
	<u>\$659,448,366</u>
 Costs of Issuance	 <u>\$659,448,366</u>

Maturities of the Power Revenue Refunding Bonds Series KK issued during fiscal year 2003 range from July 1, 2005 to July 1, 2016. The Series KK Bonds bear fixed interest rates ranging from 4% to 5.50%. Interest on the Series KK Bonds is payable on each January 1 and July 1.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable (continued)

Maturities of the Power Revenue Bonds Series LL issued during fiscal year 2003 range from July 1, 2016 to July 1, 2019. The Series LL Bonds bear a fixed interest rate of 5.50%. Interest on the Series LL Bonds is payable on each January 1 and July 1.

Maturities of the Power Revenue Refunding Bonds, Series MM issued during fiscal year 2003 range from July 1, 2004 to July 1, 2023. The Series MM Bonds bear fixed interest rates ranging from 3% to 5%. Interest on the Series MM Bonds is payable on each January 1 and July 1.

During fiscal year 2002, the Authority issued its Power Revenue Bonds, Series II and JJ. The Authority issued the Series JJ Bonds pursuant to Section 210 of the 1974 Agreement to refund blocks of the following previous bond issues summarized below:

Series	Principal Amount Refunded
Series HH	\$108,300,000
Series Q	20,870,000
Series T	10,835,000
Series V	7,910,000
Series X	55,820,000
Total refunded	\$203,735,000

The refunding permitted the Authority to realize savings on its debt service requirements on bonds outstanding under the 1974 agreement. Reduction of the total debt service payments over the next 16 years is approximately \$11,000,000. This will generate an economic gain (difference between present value of the old and new debt service payments) of approximately \$9,600,000. The Authority deposited the net proceeds of the Series JJ Power Revenue Bonds Refunding Bonds with the 1974 trustee, as escrow agent. The net proceeds were invested in Government Obligations, the principal of and interest on which when due, will provide moneys sufficient to pay the redemption price of the Refunded Power Revenue Bonds on and the interest coming due on the Refunded Power Revenue Bonds through their respective dates of redemption. See Note 8.

Upon the deposit with the 1974 Trustee referred to above, the Refunded Power Revenue Bonds will, in the opinion of the Bond Counsel, no longer be outstanding under the provisions of the 1974 Agreement and the Refunded Power Revenue Bonds will thereupon be defeased.

The Authority issued the Power Revenue Bonds, Series II for the purpose of paying a portion of the cost of its CIP.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt (continued)

Power Revenue Bonds Payable (continued)

A summary of the net proceeds of the Power Revenue Bonds, Series II and Series JJ, and application of the proceeds follows:

Principal amount of Series II Bonds	\$515,305,000
Principal amount of Series JJ Refunding Bonds	205,065,000
Plus:	
Net original issue premium	4,918,094
 Proceeds	 \$725,288,094
 Application of net proceeds:	
Deposit to Escrow Fund for Refunded Power Revenue Bonds	\$211,325,000
Repayment of notes held by GDB	80,000,000
Deposit to 1974 Construction Fund	420,000,000
Costs of Issuance	13,963,094
 Total	 \$725,288,094

Maturities of the Power Revenue Bonds Series II issued during fiscal year 2003 range from July 1, 2016 to July 1, 2031. The Serial Bonds bear fixed interest rates ranging from 5% to 5.38%. The Term Bonds bear fixed interest rates ranging from 5.13% to 5.25%. Interest on the Term Bonds and Serial Bonds is payable on each January 1 and July 1.

Maturities of the Power Revenue Refunding Bonds Series JJ issued during fiscal year 2003 ranges from July 1, 2006 to July 1, 2018. The Series JJ Bonds bear fixed interest rates ranging from 4.00% to 5.38%. Interest on the Serial JJ Bonds is payable on each January 1 and July 1.

Note Payable

On December 15, 1997, the Authority borrowed \$5,000,000 from EcoEléctrica (the Note) for the purpose of enabling the Authority to pay certain expenses in connection with Authority's activities concerning cogeneration planning and implementation. The Note bears interest at a rate per annum equal to LIBOR minus three percent (3%) and will be paid at the earliest of various events described in the Note agreement. As of June 30, 2003, the interest rate was 0% (2002 – 2.25%).

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

11. Long-Term Debt (continued)

Scheduled Maturities of Long-Term Debt

The scheduled maturities of long-term debt with interest thereon at June 30, 2003, including sinking fund debt service requirements, are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
	<i>(In thousands)</i>		
2004	\$ 299,490	\$ 363,033	\$ 662,523
2005	186,576	232,098	418,674
2006	193,824	222,094	415,918
2007	195,765	210,909	406,674
2008	176,812	199,358	376,170
2009-2013	908,483	857,411	1,765,894
2014-2018	988,910	599,421	1,588,331
2019-2023	848,033	362,558	1,210,591
2024-2028	677,250	154,751	832,001
2029-2031	209,520	20,323	229,843
	<u>4,684,663</u>	<u>3,221,956</u>	<u>7,906,619</u>
Less:			
Unamortized discount	11,459	-	11,459
Excess reacquisition costs	(184,404)	-	(184,404)
Interest	-	(3,221,956)	(3,221,956)
Total long-term debt	<u>4,511,718</u>	<u>-</u>	<u>4,511,718</u>
Current portion, net of discount and excess reacquisition costs	<u>(285,407)</u>	<u>-</u>	<u>(285,407)</u>
Long-term debt, excluding current portion	<u>\$4,226,311</u>	<u>\$ -</u>	<u>\$ 4,226,311</u>

12. Employees' Retirement Benefits

Pension Plan

Plan Description

All of the Authority's permanent full-time employees are eligible to participate in the Authority's Pension Plan, a single employer defined benefit pension plan (the Plan) administered by the Employees' Retirement System of the Puerto Rico Electric Power Authority (the System). The System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the Retirement System of the Puerto Rico Electric Power Authority, PO Box 13978, San Juan, Puerto Rico 00908-3978.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

12. Employees' Retirement Benefits (continued)

Pension Plan (continued)

Plan Description (continued)

Benefits include maximum retirement benefits of 75% of average basic salary (based on the three highest annual basic salaries) for employees with 30 years of service; also, reduced benefits are available upon early retirement. The Plan was amended on February 9, 1993 to provide revised benefits to new employees limiting the maximum retirement basic salary to \$50,000. The plan was further amended in January 1, 2000 to provide improved retirement benefits to employees with 25 years or more of credited service. Disability and death benefits are also provided. Separation benefits fully vest upon reaching 10 years of credited service.

If a member's employment is terminated before he becomes eligible for any other benefits under this Plan, he shall receive a refund of his member contribution plus interest compounded annually. The Plan is not subject to the requirements of the Employees Retirement Income Security Act of 1974 (ERISA).

Funding Policy and Annual Pension Cost

The contribution requirements of plan members and the Authority are established and may be amended by the Authority. The Annual Pension Cost (APC) and the Annual Required Contribution (ARC) were computed as part of an actuarial valuation performed as of June 30, 2002 and projected to June 30, 2003 based on current year demographic data.

Supplemental Benefits not Funded Through the System

Supplemental benefits were unfunded and such benefits were reimbursed to the System when paid up to December 31, 1999. Effective January 1, 2000, the Board of Trustees of the System approved the transfer of the obligation for supplemental benefits provided by the Authority and not funded through the System (supplemental pension obligations exchanged for forfeited sick leave benefits and the supplemental spousal survivor benefits) to the Retirement System. Also, the Board of Trustees of the System accepted an amortization period for the Plan of 40 years, which commenced on June 30, 1996.

Supplemental Pension Obligations Exchanged for Forfeited Sick Leave Benefits

The Authority's employees with over 20 years of service are entitled to exchange accrued sick leave for supplemental pension benefits and/or be paid in cash the value of such sick leave upon separation from employment.

An accrued liability of \$5.6 million and \$11.8 million exists as of June 30, 2003 and 2002, respectively, including the current and non-current portions.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

12. Employees' Retirement Benefits (continued)

Supplemental Benefits not Funded Through the System (continued)

Supplemental Pension Obligations Exchanged for Forfeited Sick Leave Benefits (continued)

The Authority's annual pension cost for the year ended June 30, 2003 and related information for the Plan and supplemental benefits follows:

	<u>Pension Plan</u>
Contribution rates:	
Authority	16.93%
Plan members	10.78%
Annual pension cost (thousands)	\$50,634
Contributions made and accruals (thousands)	\$50,634
Actuarial valuation date	6/30/2002
Actuarial cost method	Entry age
Amortization method	Level percentage of pay, closed (4% payroll increases per year)
Remaining amortization period	34 years
Asset valuation method	3-year smoothed market
Actuarial assumptions:	
Investment rate of return (net of administrative expenses)*	8.5%
Projected salary increases*	5.0%
*Includes inflation at	3%
Cost-of-living adjustments	From 8% per year for yearly pension up to \$3,600 and 4% per year for yearly pension between \$3,600 and \$7,200, 2% per year for yearly pension in excess of \$7,200. The minimum adjustment is \$300 per year. The maximum is \$600 per year.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

12. Employees' Retirement Benefits (continued)

Supplemental Benefits not Funded Through the System (continued)

Fiscal Year Ending	Three-Year Trend Information (In Millions)		
	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
Pension Plan			
06/30/98	\$29.20	100%	\$ -
06/30/99	28.80	100%	\$ -
06/30/00	39.80	100%	\$ -
06/30/01	35.00	100%	\$ -
06/30/02	43.00	100%	\$ -
06/30/03	50.60	100%	\$ -

The annual required contribution amounted to \$50.6 million in 2003 and \$43.0 million in 2002.

Post Retirement Health Benefits

The Authority also provides certain health care benefits for retired employees and spouses. Substantially all of the Authority's employees may become eligible for those benefits if they reach normal retirement while working for the Authority.

Costs of benefits provided by the Authority are based on a cost-plus plan. Such costs include claims received from the plan administrators, a charge for an administration fee and an accrual for incurred but not reported claims. The costs of health care benefits to retirees amounted to approximately \$47.0 million in 2003 and \$41.1 million in 2002. Currently, 9,421 retirees meet eligibility requirements.

13. Revenues from Major Clients and Related Parties

Electric operating revenues from major clients and related parties are as follows:

	2003	2002
	<i>(In Thousands)</i>	
Governmental sector, principally instrumentalities, agencies and corporations of the Commonwealth of Puerto Rico	\$268,286	\$244,095
Municipalities	112,276	102,740
	\$380,562	\$346,835

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

14. Net Assets

Restricted assets at June 30, 2003 and 2002 include \$366.8 million and \$377.6 million, respectively, which have been appropriated principally to comply with long-term principal and interest debt services requirements and a reserve for damaged or destroyed property of the Authority not fully covered by insurance as required by the 1974 Agreement. Funds set aside for self-insurance purposes are deposited in the Self-Insurance Fund held by the Trustee (see Note 5).

15. Contribution in Lieu of Taxes (See Note 2)

	2003	2002
	<i>(In Thousands)</i>	
Municipalities	\$152,925	\$109,961
Commonwealth:		
Hotels	3,623	3,052
Fuel adjustment subsidy	18,485	15,035
Other subsidies (offset against outstanding accounts receivable and reimbursable costs)	704	739
	\$175,737	\$128,787
	\$175,737	\$128,787

16. Commitments and Contingencies

Environmental Matters

Facilities and operations of the Authority are subject to regulations under numerous Federal and Commonwealth environmental laws, including the Clean Air Act, Clean Water Act, and the National Pollutant Discharge Elimination System (NPDES). In February 1992, the Environmental Protection Agency (EPA) performed an inspection of various facilities of the Authority and became aware of deficiencies in different areas, principally air opacity; water quality; spill prevention control and countermeasures; and underground storage tanks. As a result, the Authority and undertake Supplemental Environmental Projects (SEPs).

On June 20, 2002, the Government of the United States (the Federal Government) and the Authority executed a Settlement Agreement to resolve litigation over the proposed extension of the Authority's term of probation arising from certain alleged environmental violations.

The United States District Court for the District of Puerto Rico accepted the terms of the Settlement Agreement, after a hearing held on July 18, 2002, and entered an Amended Order of Probation on July 24, 2002. The material points of the Settlement Agreement and the Probation Order are the following:

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

16. Commitments and Contingencies (continued)

Environmental Matters (continued)

The Authority's term of probation will extend for 18 months, commencing on the date the Federal Government and the Authority select a Visible Emissions Compliance Auditor acceptable to the Court;

The Authority will burn fuel with sulfur content not to exceed 0.50% by weight at the Authority's Palo Seco and San Juan power plants for a period not less than two years, starting not later than one year from July 24, 2002. This shall be a test period, and the Authority is not obligated to continue burning such fuel after the test period expires. Based on current market prices, this would increase the Authority's fuel costs by approximately \$15 to \$27 million per year for these two years. The Authority plans to mitigate this cost increase by using money in its Clients Fund;

The Authority will pay for the purchase of up to fourteen air quality monitoring stations in an amount not exceeding \$420,000; and

The Authority is required to pay a nominal fine of \$10,000 to the Federal Government. In addition, the Authority has voluntarily decided to burn fuel with sulfur content not to exceed 1.0% by weight at Palo Seco and San Juan power plants, starting in late 2003 until use of 0.50% sulfur content fuel begins at both plants.

Commitments to Purchase Power

In October 1994, the Authority signed a contract with AES Puerto Rico, L.P. (AES) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for twenty-five (25) years. This project commenced operations in November 2002.

In March 1995, the Authority also signed a contract with EcoEléctrica, L.P. (EcoEléctrica) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plant. The term of the agreement is for twenty-two (22) years. This project has been in operation since 2000.

Under both agreements, the cost of the purchased power will be based on the quantity of energy delivered and dependable capacity available, as more fully explained in the contracts. The Authority also has the option to purchase the generating facilities if certain conditions, as defined in the contracts, are met. However, in no event will the exercise price of each of the purchase options be below fair value. The Authority is not responsible for and does not guarantee the debt or operations of AES or EcoEléctrica. Both contracts obligate the Authority to purchase power only if generated by the plants.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

16. Commitments and Contingencies (continued)

Risk Management

The Authority is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery and public liability. The all-risk property and boiler and machinery policies have a combined coverage of \$400 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million, \$1 million for all other covered risks, except boiler and machinery losses, which carry \$2 million retention. The public general liability policy covers property damage and bodily injury to third parties with a \$50 million aggregate limit in excess of the self-retention limit of \$1 million per occurrence.

The Authority considers its Self-insurance Fund sufficient to provide for its self-insurance risk (see Note 5). Claims expenditures and liabilities are recorded when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated.

The Authority has a cost plus health insurance program covering substantially all employees. The Authority contracted an administrator for the processing, approval and payment of claims plus an administrative fee. The accrual for employees health plan includes the liability for claims processed and an estimate for claims incurred but not reported.

The State Insurance Fund Corporation (SIF) provides workers' compensation to the Authority. In addition, the Authority is self-insured to pay the difference between the SIF payment and (i) 100% of the employee salary during the first 104 weeks and (ii) 80% of the employee salary for 52 additional weeks.

In addition, the Authority is self insured for its transmission and distribution lines. Transmission and distribution lines amounted to approximately \$3.0 billion at June 30, 2003 and 2002, respectively.

The net assets and restricted assets set aside in the Self-insurance Fund for self-insurance amounted to approximately \$80.2 million at June 30, 2003 and \$77.4 million at June 30, 2002.

Changes in the balances of the health insurance program and other self-insurance risks during fiscal years 2003 and 2002 were as follows:

	Liability Beginning Balance	Expenses	Payments	Liability Ending Balance
	<i>(In Thousands)</i>			
2003	\$38,768	\$116,545	\$104,422	\$50,891
2002	\$46,822	\$ 90,268	\$ 98,323	\$38,768

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

16. Commitments and Contingencies (continued)

Contingencies

The Authority is a defendant or codefendant in several lawsuits incidental to its business, some involving substantial amounts. In those instances that management and legal counsel believe that the outcome of the litigation will be unfavorable to the Authority, a provision has been made to cover the estimated liability. Management, based on discussions with legal counsel, believes that the additional liability, if any, resulting from the ultimate resolution of these matters will not have a material effect on the Authority's financial position or results of operations.

On May 18, 2000, Abengoa, Puerto Rico, S.E. (Abengoa), the Authority's contractor for the repowering of San Juan steam plant units 5 and 6, unilaterally declared a termination of the contract with the Authority and filed a complaint for breach of contract. The Authority has moved for time to answer the complaint and has filed a counter claim for the cost of the project and for all damages caused to the Authority by the alleged illegal contract termination. The Authority believes that the actions by the contractor will not materially affect the ability of the Authority to provide service nor will there be a material difference in the quality of service provided by the Authority.

In May 1998, the Municipality of Ponce filed a complaint against the Authority in the San Juan Superior Court requesting the payment by the Authority of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenges the application of the Net Revenues by the Authority in making deposits to certain funds under the 1974 Agreement and under a prior trust indenture (now terminated) for the purposes of paying costs of capital improvements and seeks a payment by the Authority in the amount by which the amount available to pay contributions in lieu of taxes and electric energy sales set aside to the Municipality of Ponce has been reduced as a result of such application. The Authority has filed a motion to dismiss the complaint. Since the filing of the suit by the Municipality of Ponce, fifty-one other municipalities have filed similar claims. The Authority understands that because the Act provides that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with the Authority's deposit obligations under the 1974 Agreement and the prior indenture and shortfalls do not carry forward as future liabilities of the Authority as described above, it is legally entitled to make such deposits even if the effect is to reduce such contributions and set aside available to municipalities.

On April 14, 2003, the Authority made a settlement offer consisting of a payment in cash of \$68 million and \$57 million for electric infrastructure projects in the municipalities. As part of the settlement agreement, the municipalities supported an amendment to the Act, that was proposed by the Authority, that the amount payable to municipalities will be calculated based on a percentage of the net revenues defined on the 1974 Agreement.

Construction and Other Commitments

As of June 30, 2003, the Authority has commitments of approximately \$183.7 million on active construction, maintenance, and engineering services contracts.

Puerto Rico Electric Power Authority
Notes to Financial Statements (continued)

17. Supplemental Disclosures of Noncash Capital and Financing Information

The accreted value of capital appreciation bonds equals the original principal amount of such capital appreciation bonds plus interest accrued from its date of issuance. During the years ended June 30, 2003 and 2002, the accrued interest on capital appreciation bonds amounted to \$5.9 million and \$14.3 million, respectively.

18. Subsequent Events

Bond Issuance

On August 8, 2003, the Authority issued \$517,305,000 Power Revenue Bonds, Series NN to finance a portion of the cost of various projects under its capital improvement program.

On August 18, 2003, the Commonwealth of Puerto Rico approved Act No. 189 which authorizes the Authority to create, acquire and maintain corporations, partnerships or subsidiary corporations, profit or non-profit entities.

Report on Compliance and on
Internal Control Over Financial Reporting
Based on an Audit of the Financial Statements in
Accordance with Government Auditing Standards

To the Board of Directors
Puerto Rico Electric Power Authority

We have audited the financial statements of Puerto Rico Electric Power Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2003 and 2002, and have issued our report thereon, dated September 30, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

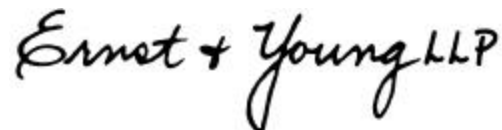
Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its 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 statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the 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 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 internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies and pass-through entities, and is not intended to be an should not be used by anyone other than these specified parties.



September 30, 2003

Stamp No. 1920965
affixed to
original of
this report.

Puerto Rico Electric Power Authority

Supplementary Information
Schedule of Funding Progress

(In Millions)

June 30, 2003

Actuarial Valuation Date	Actuarial Value of Assets (a) Note 1	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL Percentage Of Covered Payroll [(b) - (a)]/(c)
Pension Plan						
6/30/96	\$1,000	\$1,256	\$256	80%	\$261	98%
6/30/97	1,084	1,333	249	81%	271	92%
6/30/98*	1,268	1,495	227	85%	274	83%
6/30/99**	1,443	1,538	95	94%	277	34%
6/30/00	1,550	1,799	250	86%	278	90%
6/30/01	1,547	1,964	417	79%	290	144%
6/30/02	1,441	2,012	572	72%	298	192%

Note 1: The system, as permitted by the GASB, reflects its investments at an average fair market value of the last three years to determine its actuarial funding.

* Estimated valuation, projected from actual 6/30/97 valuation.

** Estimated valuation, projected from actual 6/30/98 valuation. Does not reflect benefit improvements effective January 1, 2000.

Puerto Rico Electric Power Authority

Note to Schedules II-VII - Information Required by the 1974 Agreement

As of June 30, 2003 and 2002 and the Years then Ended

Schedules II - VII present certain information which is required by the 1974 Agreement. The Net Revenues data, as defined in the 1974 Agreement (Net Revenues), presented in Schedules II and III differ in some important respects from generally accepted accounting principles (GAAP). Such differences are explained below; Schedule II also presents a reconciliation of Net Revenues with GAAP.

The most significant differences between Net Revenues and GAAP are the following:

- 1) Revenues do not include investment income on investments in the construction fund (see Note 5 to the financial statements);
- 2) Depreciation and interest expense on bonds covered by the 1974 Agreement are not included as deductions in calculating Net Revenues;
- 3) Amortization of debt discount and issuance costs and the allowance for funds used during construction are not considered in the computation in calculating Net Revenues;
- 4) Contribution in lieu of taxes is not considered a deduction for purposes of Net Revenues;
- 5) Net Revenues do not include revenues or expenses of the Irrigation Systems (see Note 1 to the financial statements).

For further details and information on the definition of Net Revenues, please refer to the 1974 Agreement.

Schedule II

Puerto Rico Electric Power Authority
Sources and Disposition of Net Revenues
Under the Provisions of the 1974 Agreement for the Years Ended June 30, 2003 and 2002
Statements of Income (GAAP) and Reconciliation of Net Income
(In Thousands)

	2003			2002		
	1974 Agreement	Statement of Income (GAAP)	Reconciliation of Net Income	1974 Agreement	Statement of Income (GAAP)	Reconciliation of Net Income
Reconciliation of components of net income:						
Revenues:						
Operating revenues	\$2,508,758	\$2,513,963	\$ 5,205	\$2,162,171	\$2,166,632	\$ 4,461
Revenues from Commonwealth for rural electrification	704	704	-	739	739	
Other operating revenues	9,625	9,625	-	8,514	8,514	
Other	17,163	17,163	-	22,257	22,257	
1974 Agreement construction fund investment income and gain sale of other properties	-	46,107	46,107	-	10,813	10,813
	<u>2,536,250</u>	<u>2,587,562</u>		<u>2,193,681</u>	<u>2,208,955</u>	
Current expenses:						
As shown	1,871,476	1,874,885		1,566,595	1,573,667	
Other interest	-	3,403		-	3,235	
Total as defined	<u>1,871,476</u>	<u>1,878,288</u>	(6,812)	<u>1,566,595</u>	<u>1,576,902</u>	(10,307)
Net revenues, as defined	<u>\$ 664,774</u>			<u>\$ 627,086</u>		
Depreciation	\$ -	<u>227,576</u>	(227,576)	\$ -	<u>225,121</u>	(225,121)
Disposition of Revenues: (not classified in order of payment)						
Interest on debt	249,779	249,779		248,469	248,469	
Amortization debt discount and financing expenses	-	473		-	3,197	
Amortization of bond defeasance	-	20,070		-	14,683	
Allowance for funds used during construction	-	(16,795)		-	(15,994)	
Net interest on long-term debt	<u>249,779</u>	<u>253,527</u>	(3,748)	<u>248,469</u>	<u>250,355</u>	(1,886)
Power revenue bonds:						
Principal	137,329	-	137,329	158,357	-	158,357
Reserve	(30,000)	-	(30,000)			
Internal Funds	119,001	-	119,001	77,307	-	77,307
Reserve Maintenance Fund	7,000	-	7,000	7,000	-	7,000
Contribution in lieu of taxes	181,665	175,737	5,928	135,953	128,787	7,166
Total expenses (GAAP)		<u>2,535,128</u>			<u>2,181,165</u>	
Net revenues, as defined	<u>\$664,774</u>			<u>\$ 627,086</u>		
Net income		<u>\$ 52,434</u>	\$ 52,434		<u>\$ 27,790</u>	\$ 27,790

See accompanying notes.

Puerto Rico Electric Power Authority

Supplemental Schedule of Sources and Disposition
of Net Revenues under the Provisions of the 1974 Agreement
for the Years Ended June 30, 2003 and 2002
(In Thousands)

	2003	2002
Sources of Net Revenues:		
Revenues:		
Electric revenues	\$2,508,758	\$2,162,171
Revenues from the Commonwealth for rural electrification	704	739
Other operating revenues	9,625	8,514
Other (principally interest)	17,163	22,257
	2,536,250	2,193,681
Current Expenses:		
Operations:		
Fuel	886,425	720,292
Purchased Power – Eco-Eléctrica	220,295	226,896
Purchased Power – AES	118,787	1,027
Other production	44,990	56,028
Transmission and distribution	119,408	114,971
Customer accounting and collection	89,710	84,689
Administrative and general	163,517	146,498
Maintenance	224,941	212,959
Interest (Other than long term debt)	3,403	3,235
	1,871,476	1,566,595
Net revenues, as defined	\$ 664,774	\$ 627,086
Disposition of Net Revenues:		
Revenue fund:		
Power revenue bonds - sinking fund requirements:		
Interest	\$ 249,779	\$ 247,982
Principal	137,329	158,357
Reserve	(30,000)	-
Reserve maintenance fund	7,000	7,000
Balance available for capital improvements and other needs	119,001	77,307
	483,109	490,646
General obligation notes:		
Interest	-	487
Principal	-	-
	-	487
Contribution in lieu of taxes and other:	181,665	135,953
Net revenues, as defined	\$ 664,774	\$ 627,086

See accompanying notes.

Schedule IV

Puerto Rico Electric Power Authority
Supplemental Schedule of Funds Under the Provisions of the 1974 Agreement
(In Thousands)

	For the years ended June 30							
	2003				2002			
	Total	Held by Authority Other Assets	Restricted Deposits with Trustee Other Assets	Non-Current Assets	Total	Held by Authority Other Assets	Restricted Deposits with Trustee Other Assets	Non-Current Assets
By Account								
1974 Agreement (restricted):								
Sinking Fund – principal and interest	\$275,765	\$ -	\$275,765	\$ -	\$ 286,875	\$ -	\$286,875	\$ -
Reserve account	241,409	-	-	241,409	260,193	-	-	260,193
Self Insurance Fund	80,240	-	-	80,240	77,353	-	-	77,353
Reserve Maintenance Fund	42,701	42,701	-	-	41,476	41,476	-	-
Construction Fund								
Rural Utilities Service (RUS)	1,486	565	921	-	1,426	505	921	-
Other	35,280	35,280	-	-	190,689	190,689	-	-
Cogeneration Fund	-	-	-	-	-	-	-	-
PREPA Client Fund	52,366	52,366	-	-	48,773	48,773	-	-
Financing Fuel Fund	1,500	1,500	-	-	-	-	-	-
General purpose (unrestricted):								
General	47,894	47,894	-	-	162,719	162,719	-	-
Working funds	2,558	2,558	-	-	2,536	2,536	-	-
Total	\$781,199	\$182,864	\$276,686	\$321,649	\$1,072,040	\$446,698	\$287,796	\$337,546
By type of assets held								
Working funds	\$ 2,558	\$ 2,558	\$ -	\$ -	\$ 2,536	\$ 2,536	\$ -	\$ -
Cogeneration Fund	-	-	-	-	-	-	-	-
PREPA Client Fund	-	-	-	-	-	-	-	-
Cash in bank and time deposits (by depository institutions):								
Government Development Bank for Puerto Rico	1	1	-	-	-	-	-	-
Banco Popular de Puerto Rico	9,700	9,700	-	-	8,654	8,654	-	-
Citibank, N. A.	20,838	20,838	-	-	6,285	6,285	-	-
State Street Bank and Trust Co., N.A.	275,765	-	275,765	-	273,743	-	273,743	-
Banco Bilbao Vizcaya	38	38	-	-	30,053	30,053	-	-
Banco Bilbao Vizcaya, Mayagüez, PR	356	356	-	-	217	217	-	-
First Bank, San Juan, Puerto Rico	472	472	-	-	334	334	-	-
Banco Santander, Santurce, Puerto Rico	15,680	15,680	-	-	86,539	86,539	-	-
Western Bank, Mayagüez, Puerto Rico	810	810	-	-	637	637	-	-
Economic Development Bank	-	-	-	-	30,000	30,000	-	-
Other institutions	-	-	-	-	-	-	-	-
	326,218	50,453	275,765	-	438,998	165,255	273,743	-
Investment Securities	454,981	132,411	921	321,649	633,042	281,443	14,053	337,546
Total	\$781,199	\$182,864	\$276,686	\$321,649	\$1,072,040	\$446,698	\$287,796	\$337,546

See accompanying notes.

Puerto Rico Electric Power Authority
 Supplement Schedule of Changes in Cash and Investments by Funds
 Year ended June 30, 2003
(In Thousands)

	General Purposes Funds				
	Total	General Fund	Revenue Fund	Working Fund	General Obligations Notes Fund
Balances at June 30, 2002	\$1,072,040	\$ 162,601	\$ 118	\$2,536	\$ -
Operations:					
Net revenues	-	(664,774)	181,665	-	-
Funds provided from internal operations	491,065	491,065	-	-	-
1974 Agreement investment income	-	(3,133)	-	-	-
Offset of current year's contribution in lieu of taxes against certain government accounts receivable	-	152,925	(152,925)	-	-
Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to General					
Obligations Notes Fund	-	22,812	(22,812)	-	-
Funds used for construction	(421,335)	-	-	-	-
Funds used for restoration of plant	-	-	-	-	-
Proceeds from penalties to AES	-	-	-	-	-
Financing:					
Proceeds from new bond issues-net of original issue discounts	654,471	-	-	-	-
Defeased bonds-net of original issue discounts	(644,443)	-	-	-	-
Accretion of capital appreciation bonds	5,930	5,930	-	-	-
Amortization of debt discount and excess reacquisition costs	20,544	20,544	-	-	-
Sinking Funds and account transfers	-	-	-	-	-
Notes issued for construction	60,000	-	-	-	-
Notes issued for fuel purchases	980,000	980,000	-	-	-
Payment of notes	(980,000)	(980,000)	-	-	-
Payment of interest	(245,090)	-	-	-	-
Payment of current maturities of long-term debt	(155,163)	-	-	-	-
Changes in assets and liabilities:					
Working funds	-	(22)	-	22	-
Accounts receivable (includes non-current)	(67,904)	(67,904)	-	-	-
Fuel oil	4,219	4,219	-	-	-
Materials and supplies	5,159	5,159	-	-	-
Prepayments and other	(355)	(355)	-	-	-
Deferred debits	(10,189)	(10,189)	-	-	-
Accounts payable and accrued liabilities (includes non-current)	3,898	3,898	-	-	-
Customer deposits	8,352	8,352	-	-	-
Interfund transfers, etc.	-	(95,313)	(5,928)	-	-
Total before interfund accounts	781,199	35,814	118	2,558	-
Add (deduct) interfund accounts	-	11,962	-	-	-
Balances at June 30, 2003	\$ 781,199	\$ 47,776	\$ 118	\$2,558	\$ -

See accompanying notes.

Sinking Fund				Other Funds			
Interest 1974 Agreement	Principal 1974 Agreement	Reserve 1974 Agreement	Self Insurance Fund	Construction 1974 Agreement	Reserve Maintenance Fund	Cogeneration Fund	Clients Fund
\$ 130,835	\$ 156,040	\$260,193	\$77,353	\$ 192,115	\$41,476	\$ -	\$48,773
219,779	137,329	-	-	119,001	7,000	-	-
-	-	-	-	-	-	-	-
-	-	-	-	3,133	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	(421,335)	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	654,471	-	-	-
30,000	-	(30,000)	-	(644,443)	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	60,000	-	-	-
-	-	-	-	-	-	-	-
(245,090)	-	-	-	-	-	-	-
-	(155,163)	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
975	(1,652)	11,216	2,887	85,786	(5,775)	-	5,093
136,499	136,554	241,409	80,240	48,728	42,701	-	53,866
-	-	-	-	(11,962)	-	-	-
\$ 136,499	\$ 136,554	\$241,409	\$80,240	\$ 36,766	\$42,701	\$ -	\$53,866

Puerto Rico Electric Power Authority
 Supplement Schedule of Changes in Cash and Investments by Funds
 Year ended June 30, 2003
 (In Thousands)

	General Purposes Funds				
	Total	General Fund	Revenue Fund	Working Fund	
Balances at June 30, 2001	\$ 795,994	\$ 89,916	\$ 31	\$2,417	\$ -
Operations:					
Net revenues	-	(627,086)	136,440	-	-
Funds provided from internal operations	492,074	492,074	-	-	-
1974 Agreement investment income	-	(10,813)	-	-	-
Offset of current year's contribution in lieu of taxes against certain government accounts receivable	-	108,161	(108,161)	-	-
Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to General					
Obligations Notes Fund	-	25,991	(25,991)	-	-
Funds used for construction	(412,015)	-	-	-	-
Funds used for restoration of plant	-	-	-	-	-
Financing:					
Proceeds from new bond issues-net of original issue discounts	720,370	-	-	-	-
Defeased bonds-net of original issue discounts	(199,376)	-	-	-	-
Accretion of capital appreciation bonds	14,296	14,296	-	-	-
Amortization of debt discount and excess reacquisition costs	16,066	16,066	-	-	-
Sinking Funds and account transfers	-	-	-	-	-
Notes issued for construction	80,000	-	-	-	-
Notes issued for fuel purchases	1,015,000	1,015,000	-	-	-
Payment of notes	(1,095,000)	(1,015,000)	-	-	-
Payment of interest	(227,057)	(3,505)	-	-	-
Payment of current maturities of long-term debt	(147,116)	-	-	-	-
Changes in assets and liabilities:					
Working funds	-	(119)	-	119	-
Accounts receivable (includes non-current)	(23,945)	(23,945)	-	-	-
Fuel oil	19,934	19,934	-	-	-
Materials and supplies	10,525	10,525	-	-	-
Prepayments and other	5,788	5,788	-	-	-
Deferred debits	(15,041)	(15,041)	-	-	-
Accounts payable and accrued liabilities (includes non-current)	13,572	13,572	-	-	-
Customer deposits	7,971	7,971	-	-	-
Interfund transfers, etc.	-	2,959	(2,201)	-	-
Total before interfund accounts	1,072,040	126,744	118	2,536	-
Add (deduct) interfund accounts	-	35,857	-	-	-
Balances at June 30, 2002	\$1,072,040	\$ 162,601	\$ 118	\$2,536	\$ -

See accompanying notes.

Sinking Fund				Other Funds			
Interest 1974 Agreement	Principal 1974 Agreement	Reserve 1974 Agreement	Self Insurance Fund	Construction 1974 Agreement	Reserve Maintenance Fund	Cogeneration Fund	Clients Fund
\$ 114,177	\$ 147,391	\$245,633	\$73,388	\$ 41,540	\$32,612	\$ 5,096	\$43,793
247,982	158,357	-	-	77,307	7,000	-	-
-	-	-	-	-	-	-	-
-	-	-	-	10,813	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	(412,015)	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	720,370	-	-	-
-	-	-	-	(199,376)	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	80,000	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	(80,000)	-	-	-
(223,065)	-	-	-	(487)	-	-	-
-	(147,116)	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
(8,259)	(2,592)	14,560	3,965	(81,894)	1,864	(5,096)	4,980
130,835	156,040	260,193	77,353	156,258	41,476	-	48,773
				35,857			
\$ 130,835	\$ 156,040	\$260,193	\$77,353	\$ 192,115	\$41,476	\$ -	\$48,773

Puerto Rico Electric Power Authority
 Supplemental Schedule of Changes in Long-Term
 Debt and Current Portion of Long-Term Debt
 Years ended June 30, 2003 and 2002
(In Thousands)

	2003	2002
Long-term debt excluding current portion:		
Balance at the beginning of year	\$4,352,858	\$3,956,216
Transfers to current liabilities:		
Power revenue bonds	(142,505)	(125,181)
Total transfers	(142,505)	(125,181)
Remainder	4,210,353	3,831,035
New issues:		
Power revenue bonds	98,125	515,305
Power revenue refunding bonds	506,840	205,065
Note payable to EcoElectrica	-	-
Debt discount on new bond issues - net	49,506	23
Defeasance of bonds	(614,435)	(203,735)
Debt discount and excess reacquisition costs on cancelled bonds - net	(30,008)	(9,131)
Accretion of capital appreciation bonds	5,930	14,296
Balance at the end of year	\$4,226,311	\$4,352,858
Current portion of long-term debt:		
Balance at beginning of year	\$ 280,070	\$ 285,939
Transfer from long-term debt	142,505	125,181
Payments to bondholders:		
Power revenue - July 1	(154,455)	(143,214)
Power revenue - January 1	(708)	(3,902)
Total payments	(155,163)	(147,116)
Amortization of debt discount and excess reacquisition costs	17,995	16,066
Balance at end of year	\$ 285,407	\$ 280,070

See accompanying notes.

August 12, 2004

Puerto Rico Electric Power Authority
San Juan, Puerto Rico

Dear Sirs:

Washington Group International, Inc. (“Washington Group”) serves as the Consulting Engineers under the provisions of the Trust Agreement, dated as of January 1, 1974, as amended, by and between Puerto Rico Electric Power Authority (the “Authority”) and U.S. Bank Trust National Association, in the Borough of Manhattan, City and State of New York, successor trustee. Such Trust Agreement is referred to herein as the “Agreement”, and the trustee under the Agreement is referred to herein as the “Trustee”. The Agreement requires the Consulting Engineers annually to prepare and file with the Authority and the Trustee a report with their recommendations as to any necessary or advisable revisions of rates and charges and such other advices and recommendations as they may deem desirable. In addition, the report will include the amount that should be deposited monthly during the next fiscal year to the credit of the Reserve Maintenance Fund; the amount, if any, to be deposited to the Self-insurance Fund in the next fiscal year; and, the amount to be deposited to the Capital Improvement Fund in the next fiscal year. The most recent such recommendations and report provided to the Authority and the Trustee was dated as of June 2003.

In preparing this letter and in reaching the conclusions and opinions contained herein and referred to in the Official Statement to which this letter is appended, Washington Group has relied upon inquiries, observations and analyses made and conducted by it in the performance of its duties under the Agreement and upon its professional experience. Washington Group also has relied upon various financial, economic, political and other information and projections provided to it by the Authority and other sources, some of such information and projections having been accepted by Washington Group without it having conducted an independent investigation thereof. In addition, Washington Group has made assumptions which it believes to be reasonable to make including, but not limited to, the following:

1. that the Authority will adhere to its proposed schedule of programmed regular maintenance;
2. that the Authority will continue to maintain the effective availability of its generating units;
3. that the Authority’s current capacity expansion plan will be realized as to increases in capacity and approximate timing;

4. that the Authority's forecasts of costs and availability of fuels are reasonable;
5. that financing will be available to the Authority at reasonable rates, in adequate amounts and at appropriate times;
6. that the Authority will not be adversely affected by labor disputes and will have adequate levels of labor productivity;
7. that there will be no material changes in the requirements of regulatory authorities, the Legislature of Puerto Rico will not enact any legislation that will adversely affect the Authority, nor will there be unforeseen technological developments;
8. that the demographic, statistical, economic and other information regarding Puerto Rico obtained by Washington Group from publicly available sources is reliable;
9. that the Authority will not be unduly affected by natural disasters; and
10. that the Authority will not experience unforeseeable or extraordinary conditions not included in usual estimates and opinions of engineers.

Based upon and subject to the foregoing which should be read in conjunction with and as part of the following conclusions, it is our considered opinion with respect to the Authority that:

1. The Authority's production, transmission and distribution plant is in good repair and sound operating condition;
2. The Authority's generating capacity expansion plan is adequate and should allow the Authority to meet targeted electric reliability criteria;
3. The Authority's projections of future load growth and estimates of peak load referred to in the Official Statement, to which this letter is appended, under the caption "Adequacy of Capacity" are reasonable for base planning purposes;
4. The Authority's revenue and base capacity planning forecasts (and the methodologies and assumptions on which they are based) are reasonable for planning purposes and are generally consistent with electric utility industry practices;
5. The Authority's current projected capital improvement program is reasonable and the estimated expenditures are consistent with the Authority's future needs;
6. The Authority's estimates of future growth form a reasonable basis for its projected operating results;
7. The Authority's electric rates and charges should generate sufficient revenues to pay its current expenses and debt service and to finance that portion of its capital improvement program that is currently anticipated to be financed with current operating revenues; and

8. The 961 MW of capacity presently being provided by the two cogenerators described in the Official Statement to which this letter is appended, and their role in the Authority's capacity expansion program should not cause the Authority to experience a meaningful reduction in control over its revenue producing capability as a result of the purchase rather than self-generation of electricity. The methodology used by the Authority in determining its avoided cost of generating or otherwise obtaining an equivalent amount of energy, pursuant to the Public Utilities Regulatory Policies Act of 1978, as amended (which requires the Authority to pay an amount based upon such avoided cost for power generated and made available to the Authority), is reasonable.

Very truly yours,

WASHINGTON GROUP INTERNATIONAL, INC.

A handwritten signature in cursive script, reading "George W. Romano, Jr.", written in black ink.

George W. Romano, Jr.
Manager,
Utility Management
Services Department

PROPOSED FORMS OF BOND COUNSEL OPINIONS

Upon delivery of the Series OO Bonds and Series PP Bonds, Squire, Sanders & Dempsey L.L.P. is prepared to render its final opinion with respect to the Series OO Bonds and Series PP Bonds in substantially the following form:

August 26, 2004

Puerto Rico Electric Power Authority
San Juan, Puerto Rico

Re: \$136,105,000 Puerto Rico Electric Power Authority Power Revenue Refunding Bonds, Series OO and \$88,595,000 Puerto Rico Electric Power Authority Power Revenue Refunding Bonds, Series PP

Gentlemen:

We have served as bond counsel in connection with the issuance by the Puerto Rico Electric Power Authority (the "Authority"), a governmental instrumentality of the Commonwealth of Puerto Rico, of its \$136,105,000 aggregate principal amount of Power Revenue Refunding Bonds, Series OO (the "Series OO Bonds") and \$88,595,000 aggregate principal amount of Power Revenue Refunding Bonds, Series PP (the "Series PP Bonds" and, together with the Series OO Bonds, the "Bonds"). The Bonds are dated, mature on July 1 of the years and in such principal amounts, bear interest at the rates and are subject to redemption, all as set forth in the Resolution referred to hereinbelow. The Bonds are issuable as fully registered bonds without coupons, in authorized denominations of \$5,000 or any multiple thereof, in the manner and in accordance with the terms and conditions of the Resolution.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the "Transcript") of the Authority relating to the issuance of the Bonds, including, without limitation, Act No. 83 of the Legislature of Puerto Rico, approved May 2, 1941, as amended and re-enacted by Act No. 19, approved April 8, 1942, as amended, creating the Authority (formerly called Puerto Rico Water Resources Authority) and Act No. 111, approved May 6, 1941, as amended by Act No. 153, approved May 14, 1943 (said Acts No. 83, No. 19, No. 111 and No. 153, as amended, being herein collectively referred to as the "Authority Act"); the Trust Agreement, dated as of January 1, 1974, as amended (the "Trust Agreement"), by and between the Authority and U.S. Bank Trust National Association, as successor trustee; Resolution No. 3206, duly adopted by the Authority on August 10, 2004 (the "Resolution"); and such other documents as we have deemed necessary to render this opinion. Capitalized words used herein without definitions have the meanings ascribed thereto in the Trust Agreement.

We have also examined a copy of each of the Series OO Bonds and the Series PP Bonds, as executed and authenticated. We assume that all other such Bonds have been similarly executed and authenticated.

From such examination, we are of the opinion that:

1. The Authority Act is valid.
2. Said proceedings have been validly and legally taken.
3. The Series OO Bonds have been duly authorized and issued to provide funds to refund certain of the Authority's outstanding bonds, to wit: (i) from the Authority's \$163,875,000 aggregate principal amount of Power Revenue Refunding Bonds, Series S, \$4,760,000 principal amount maturing July 1, 2015, (ii) from the Authority's \$123,405,000 aggregate principal amount of Power Revenue Refunding Bonds, Series U, \$440,000 principal amount maturing July 1, 2005, \$465,000 principal amount maturing July 1, 2006, \$490,000 principal amount maturing July 1, 2007, \$520,000 principal amount maturing July 1, 2008, \$550,000 principal amount maturing July 1, 2009 and \$117,815,000 principal amount maturing July 1, 2014, (iii) from the Authority's \$326,560,000 aggregate principal amount of Power Revenue Bonds, Series X, \$1,495,000 principal amount of the \$7,195,000 aggregate principal amount maturing July 1, 2005, (iv) from the Authority's \$508,555,000 aggregate principal amount of Power Revenue Bonds, Series DD, \$10,220,000 principal amount maturing July 1, 2005 and (v) from the Authority's \$612,240,000 Power Revenue Bonds, Series HH, \$11,335,000 principal amount maturing July 1, 2005.
4. The Series PP Bonds have been duly authorized and issued to provide funds to refund certain of the Authority's outstanding bonds, to wit, from the Authority's \$326,560,000 aggregate principal amount of Power Revenue Bonds, Series X, \$5,700,000 principal amount of the \$7,195,000 aggregate principal amount maturing July 1, 2005 and \$82,205,000 principal amount maturing July 1, 2025.
5. The Trust Agreement provides for the issuance of additional bonds, from time to time, under the conditions, limitations and restrictions therein set forth.
6. The Bonds are valid and binding special obligations of the Authority, payable solely from the Puerto Rico Electric Power Authority Power Revenue Bonds Interest and Sinking Fund established under the Trust Agreement, to the credit of which Fund the Authority has covenanted to deposit a sufficient amount of the revenues of the System, over and above the expenses of repair, maintenance and operation, to pay the principal of and the interest on all bonds issued under the provisions of the Trust Agreement as the same become due and payable and to create a reserve for such purpose, which Fund is pledged to and charged with the payment of the principal of and the interest on all bonds issued under the provisions of the Trust Agreement.
7. The Trust Agreement provides for the fixing and collecting by the Authority of rates and charges for the use of the services and facilities of the System sufficient for the payment of the expenses of the Authority incurred in the repair, maintenance and operation of

the System and for the payment of the principal of and the interest on all bonds issued under the provisions of the Trust Agreement as the same become due and payable, including reserves for such purposes.

8. The bonds issued under the provisions of the Trust Agreement, including the Bonds, do not constitute a debt of the Commonwealth of Puerto Rico or of any of its municipalities or other political subdivisions, and neither the Commonwealth of Puerto Rico nor any such municipality or other political subdivision is liable thereon, and such bonds, including the Bonds, are payable only out of the revenues of the System, to the extent provided in the Trust Agreement.

9. The interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. We express no opinion as to any other tax consequences regarding the Bonds.

Under the Code, a portion of the interest on the Bonds earned by certain corporations may be subject to a corporate alternative minimum tax and interest on the Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In giving the opinion set forth in numbered paragraph 9. hereof, we have relied upon and assumed continuing compliance with the Authority's covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Authority contained in the Transcript. The accuracy of those representations and certifications, and the Authority's continuing compliance with those covenants, may be necessary for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes. Failure to comply with certain of those covenants subsequent to issuance of the Bonds may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. The Authority has covenanted to comply with the requirements of the Code to the extent permitted by the Constitution and laws of the Commonwealth. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico that would prevent the Authority from complying with the requirements of the Code.

In rendering the opinions set forth herein, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities and have not verified the accuracy or truthfulness thereof. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. As to questions of fact material to our opinion, we have relied on representations of the Authority furnished to us, without undertaking to verify such representations by independent investigation.

August 26, 2004
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It is to be understood that the rights of the holders of the Bonds and the enforceability of the Bonds may be subject to judicial discretion and valid bankruptcy, insolvency, reorganization, moratorium and other laws affecting creditors' rights generally, and subject to general principles of equity (regardless of whether considered in a proceeding in equity or at law).

Respectfully submitted,

[To be signed "Squire, Sanders & Dempsey L.L.P."]

Assuming, among other matters, no Change in Law as described in the Official Statement under “Delayed Delivery of the Series QQ Bonds” in “Plan of Financing”, upon delivery of the Series QQ Bonds, Squire, Sanders & Dempsey L.L.P. is prepared to render its final opinion with respect to the Series QQ Bonds in substantially the following form:

April 4, 2005

Puerto Rico Electric Power Authority
San Juan, Puerto Rico

Re: \$95,270,000 Puerto Rico Electric Power Authority Power Revenue Refunding Bonds,
Series QQ

Gentlemen:

We have served as bond counsel in connection with the issuance by the Puerto Rico Electric Power Authority (the “Authority”), a governmental instrumentality of the Commonwealth of Puerto Rico, of its \$95,270,000 aggregate principal amount of Power Revenue Refunding Bonds, Series QQ (the “Bonds”). The Bonds are dated, mature on July 1 of the years and in such principal amounts and bear interest at the rates, all as set forth in the Resolution referred to hereinbelow. The Bonds are issuable as fully registered bonds without coupons, in authorized denominations of \$5,000 or any multiple thereof, in the manner and in accordance with the terms and conditions of the Resolution.

In our capacity as bond counsel, we have examined the transcript of the proceedings (the “Transcript”) of the Authority relating to the issuance of the Bonds, including, without limitation, Act No. 83 of the Legislature of Puerto Rico, approved May 2, 1941, as amended and re-enacted by Act No. 19, approved April 8, 1942, as amended, creating the Authority (formerly called Puerto Rico Water Resources Authority) and Act No. 111, approved May 6, 1941, as amended by Act No. 153, approved May 14, 1943 (said Acts No. 83, No. 19, No. 111 and No. 153, as amended, being herein collectively referred to as the “Authority Act”); the Trust Agreement, dated as of January 1, 1974, as amended (the “Trust Agreement”), by and between the Authority and U.S. Bank Trust National Association, as successor trustee; Resolution No. 3206, duly adopted by the Authority on August 10, 2004 (the “Resolution”); and such other documents as we have deemed necessary to render this opinion. Capitalized words used herein without definitions have the meanings ascribed thereto in the Trust Agreement.

We have also examined a copy of each of a Bond, as executed and authenticated. We assume that all other Bonds have been similarly executed and authenticated.

From such examination, we are of the opinion that:

1. The Authority Act is valid.
2. Said proceedings have been validly and legally taken.

April 4, 2005

Page 2

3. The Bonds have been duly authorized and issued to provide funds to refund certain of the Authority's outstanding bonds, to wit: (i) from the Authority's \$223,845,000 aggregate principal amount of Power Revenue Refunding Bonds, Series Z, \$1,460,000 principal amount maturing July 1, 2005, \$13,945,000 principal amount maturing July 1, 2013, \$14,720,000 principal amount maturing July 1, 2014, \$31,900,000 principal amount maturing July 1, 2016 and \$35,470,000 principal amount of the \$95,960,000 aggregate principal amount maturing July 1, 2021 (said \$35,470,000 being the Amortization Requirements due on July 1, 2017 and July 1, 2018), and (ii) from the Authority's \$464,840,000 Power Revenue Bonds, Series AA, \$5,450,000 principal amount of the \$9,450,000 aggregate principal amount maturing July 1, 2005.

4. The Trust Agreement provides for the issuance of additional bonds, from time to time, under the conditions, limitations and restrictions therein set forth.

5. The Bonds are valid and binding special obligations of the Authority, payable solely from the Puerto Rico Electric Power Authority Power Revenue Bonds Interest and Sinking Fund established under the Trust Agreement, to the credit of which Fund the Authority has covenanted to deposit a sufficient amount of the revenues of the System, over and above the expenses of repair, maintenance and operation, to pay the principal of and the interest on all bonds issued under the provisions of the Trust Agreement as the same become due and payable and to create a reserve for such purpose, which Fund is pledged to and charged with the payment of the principal of and the interest on all bonds issued under the provisions of the Trust Agreement.

6. The Trust Agreement provides for the fixing and collecting by the Authority of rates and charges for the use of the services and facilities of the System sufficient for the payment of the expenses of the Authority incurred in the repair, maintenance and operation of the System and for the payment of the principal of and the interest on all bonds issued under the provisions of the Trust Agreement as the same become due and payable, including reserves for such purposes.

7. The bonds issued under the provisions of the Trust Agreement, including the Bonds, do not constitute a debt of the Commonwealth of Puerto Rico or of any of its municipalities or other political subdivisions, and neither the Commonwealth of Puerto Rico nor any such municipality or other political subdivision is liable thereon, and such bonds, including the Bonds, are payable only out of the revenues of the System, to the extent provided in the Trust Agreement.

8. The interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. The Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. We express no opinion as to any other tax consequences regarding the Bonds.

Under the Code, a portion of the interest on the Bonds earned by certain corporations may be subject to a corporate alternative minimum tax and interest on the Bonds may be subject

to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In giving the opinion set forth in numbered paragraph 8. hereof, we have relied upon and assumed continuing compliance with the Authority's covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Authority contained in the Transcript. The accuracy of those representations and certifications, and the Authority's continuing compliance with those covenants, may be necessary for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes. Failure to comply with certain of those covenants subsequent to issuance of the Bonds may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. The Authority has covenanted to comply with the requirements of the Code to the extent permitted by the Constitution and laws of the Commonwealth. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico that would prevent the Authority from complying with the requirements of the Code.

In rendering the opinions set forth herein, we have assumed the accuracy and truthfulness of all public records and of all certifications, documents and other proceedings examined by us that have been executed or certified by public officials acting within the scope of their official capacities and have not verified the accuracy or truthfulness thereof. We have also assumed the genuineness of the signatures appearing upon such public records, certifications, documents and proceedings. As to questions of fact material to our opinion, we have relied on representations of the Authority furnished to us, without undertaking to verify such representations by independent investigation.

It is to be understood that the rights of the holders of the Bonds and the enforceability of the Bonds may be subject to judicial discretion and valid bankruptcy, insolvency, reorganization, moratorium and other laws affecting creditors' rights generally, and subject to general principles of equity (regardless of whether considered in a proceeding in equity or at law).

Respectfully submitted,

[To be signed "Squire, Sanders & Dempsey L.L.P."]



CDC IXIS Financial Guaranty North America, Inc.
825 Third Avenue, Sixth Floor
New York, NY 10022
For information, contact (212) 909-3939
Toll-free (866) 243-4212

FINANCIAL GUARANTY INSURANCE POLICY

ISSUER:

Policy No.: CIFGNA-#

CUSIP:

Effective Date:

OBLIGATIONS:

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. ("CIFGNA"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY GUARANTEES to each Policyholder, subject only to the terms and conditions of this Policy (which includes each endorsement hereto), the full and complete payment by or on behalf of the Issuer of Regular Payments of principal of and interest on the Obligations.

For the further protection of each Policyholder, CIFGNA irrevocably and unconditionally guarantees:

- (1) payment of any amount required to be paid under this Policy by CIFGNA following CIFGNA's receipt of notice and instruments of assignment as described in Endorsement No. 1 hereto and
- (2) payment of the amount of any distribution of principal of and interest on the Obligations made during the Term of this Policy to such Policyholder that is subsequently avoided in whole or in part as a preference payment under applicable law (such payment to be made by CIFGNA in accordance with Endorsement No. 1 hereto).

CIFGNA shall be subrogated to the rights of each Policyholder to receive payments under the Obligations to the extent of any payment by CIFGNA hereunder. Upon disbursement in respect of an Obligation, CIFGNA shall become the owner of the Obligation, appurtenant coupon, if any, and all rights to payment of principal thereof or interest thereon.

The following terms shall have the meanings specified below, subject to and including any modifications set forth in any endorsement hereto, for all purposes of this Policy. "Policyholder" means, if the Obligations are in book-entry form, the registered owner of any Obligation as indicated on the registration books maintained by or on behalf of the Issuer for such purpose or, if the Obligations are in bearer form, the holder of any Obligation; *provided, however, that* any trustee acting on behalf of and for the benefit of such registered owner or holder shall be deemed to be the Policyholder to the extent of such trustee's authority. "Regular Payments" means payments of interest and principal which are agreed to be made during the Term of this Policy in accordance with the original terms of the Obligations when issued and without regard to any amendment or modification of such Obligations hereafter; payments which become due on an accelerated basis as a result of (a) a default by the Issuer or any other person, (b) an election by the Issuer to pay principal or other amounts on an accelerated basis or (c) any other cause, shall not constitute "Regular Payments" unless CIFGNA shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration. "Term of this Policy" shall have the meaning set forth in Endorsement No. 1 hereto.

This Policy sets forth in full the undertaking of CIFGNA, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto or to the Obligations, except a contemporaneous or subsequent agreement or instrument given by CIFGNA or to which CIFGNA has given its written consent, or by the merger, consolidation or dissolution of the Issuer. The premiums paid in respect of this Policy are nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Obligations prior to maturity. This Policy may not be cancelled or revoked during the Term of this Policy, including for nonpayment of premium due to CIFGNA. Payments under this Policy may not be accelerated except at the sole option of CIFGNA.

In witness whereof, CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.

By _____
Authorized Officer



Financial Guaranty Insurance Company
 125 Park Avenue
 New York, NY 10017
 T 212-312-3000
 T 800-352-0001

**Municipal Bond
 New Issue Insurance Policy**

Issuer:	Policy Number:
	Control Number: 0010001
Bonds:	Premium:

Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to U.S. Bank Trust National Association or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date for payment of interest. "Nonpayment" in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all



Financial Guaranty Insurance Company
 125 Park Avenue
 New York, NY 10017
 T 212-312-3000
 T 800-352-0001

**Municipal Bond
 New Issue Insurance Policy**

principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

Frank Bivona

SPECIMEN

President

Effective Date:

Authorized Representative

U.S. Bank Trust National Association, acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

Authorized Officer



Financial Guaranty Insurance Company
 125 Park Avenue
 New York, NY 10017
 T 212-312-3000
 T 800-352-0001

Endorsement
 To Financial Guaranty Insurance Company
 Insurance Policy

Policy Number: _____ **Control Number:** 0010001

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date:

Authorized Representative

Acknowledged as of the Effective Date written above:

Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent



1221 Avenue of the Americas
 New York, New York 10020
 Telephone: (212) 478-3400

MUNICIPAL BOND INSURANCE POLICY

ISSUER: []

Policy No: []

BONDS: []

Effective Date: []

XL Capital Assurance Inc. (XLCA), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. New York time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the Owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCA may, by giving written notice to the Trustee and the Paying Agent, appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy. From and after the date of receipt by the Trustee and the Paying Agent of such notice, which shall specify the name and notice address of the Insurer's Fiscal Agent, (a) copies of all notices required to be delivered to XLCA pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to XLCA and shall not be deemed received until received by both and (b) all payments required to be made by XLCA under this Policy may be made directly by XLCA or by the Insurer's Fiscal Agent on behalf of XLCA. The Insurer's Fiscal Agent is the agent of XLCA only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of XLCA to deposit or cause to be deposited sufficient funds to make payments due hereunder.

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

Name:
Title:

Name:
Title: