

**\$355,730,000****PUERTO RICO ELECTRIC POWER AUTHORITY**  
**Power Revenue Bonds, Series EEE (Issuer Subsidy Build America Bonds)**

The Power Revenue Bonds, Series EEE (Issuer Subsidy Build America 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, between the Authority and U.S. Bank National Association, New York, New York, successor trustee (the "Trust Agreement"). The Bonds, the outstanding bonds previously issued under the Trust Agreement and any additional bonds that the Authority may from time to time issue under the Trust Agreement are payable solely from the net revenues of the Authority's electric generation, transmission and distribution system.

The Authority will issue the Bonds as "Build America Bonds" that are subject to U.S. income taxes (except to bona fide residents of Puerto Rico to the extent described herein). Upon compliance with certain requirements of the U.S. Internal Revenue Code, the Authority will receive a subsidy payment from the federal government equal to 35% of the amount of each interest payment on the Bonds. This subsidy will be paid directly to the Authority and not to the holders of the Bonds. Under no circumstances will the owners of the Bonds be entitled to a credit against any taxes imposed by the U.S. Internal Revenue Code as a result of their ownership of the Bonds.

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 Bonds will be payable quarterly on each July 1, October 1, January 1, and April 1, commencing on April 1, 2011.
- The Bonds will be subject to redemption, commencing on July 1, 2020, as described herein. See *Mandatory Redemption* and *Optional Redemption* under THE BONDS for more information.
- Upon the occurrence of an Extraordinary Event the Authority may choose to redeem the Bonds at par. See *Extraordinary Redemption* under THE BONDS for more information.
- The inside cover page contains information concerning the maturity, interest rate and price of the Bonds.
- Prospective investors should consider the information appearing under INVESTMENT CONSIDERATIONS before making an investment decision.
- In the opinion of Special Puerto Rico Tax Counsel, as described herein, under existing statutes the Bonds, and the interest thereon, are exempt from Commonwealth of Puerto Rico income, municipal license and property taxes. Under most circumstances, interest on the Bonds will be exempt from United States Federal income taxation to (i) individuals who are bona fide residents of Puerto Rico during the entire taxable year in which such interest is received and (ii) Puerto Rico corporations. The Bonds are not otherwise exempt from United States Federal income taxation. See TAX MATTERS herein.
- The Authority expects that the Bonds will be available for delivery to DTC on or about December 29, 2010.
- The issuance of the Bonds and the purchase of the Bonds by the Underwriters are subject to the approval of legality by Nixon Peabody LLP, Bond Counsel, and certain other conditions. O'Neill & Borges, San Juan, Puerto Rico, will pass upon certain legal matters for the Underwriters and will act as Special Puerto Rico Tax Counsel.

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

*Joint-Lead Managers***UBS Financial Services**  
**Incorporated of Puerto Rico****BofA Merrill Lynch****Santander Securities**

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**Popular Securities****Barclays Capital**  
**Oriental Financial Services****BBVAPR MSD**  
**Raymond James****Citi**  
**Samuel A. Ramirez & Co.****FirstBank Securities**  
**Wells Fargo Securities, LLC**

**\$355,730,000**  
**Puerto Rico Electric Power Authority**  
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\$60,905,000	5.95%	Term Bonds due July 1, 2030; Price 100%	CUSIP* 74526QZR6
\$217,335,000	6.05%	Term Bonds due July 1, 2032; Price 100%	CUSIP* 74526QZS4
\$77,490,000	6.25%	Term Bonds due July 1, 2040; Price 100%	CUSIP* 74526QZT2

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**In connection with this offering, the Underwriters may overallocate 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. The Underwriters may offer and sell the Bonds to certain dealers and dealer banks and others at a price lower than the public offering price stated on the inside cover page and said offering price may be changed from time to time by the Underwriters.**

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 various tables may not add due to rounding of figures.

The Underwriters have provided the following sentence 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.

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 Underwriter. 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.

All quotations from and summaries and explanations of provisions of laws, trust agreements, the Bonds and other documents herein do not purport to be complete. Reference is made to said laws, trust agreements, the Bonds and other documents for a full and complete statement of their provisions. Copies of the above are available for inspection at the offices of the Authority and the Trustee.

**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 "estimates," "projects," "anticipates," "expects," "intends," "believes" 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 forward-looking statements.**

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**INTRODUCTORY STATEMENT**

The purpose of this Official Statement of the 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 Bonds, Series EEE (Issuer Subsidy Build America Bonds) (the “Bonds”).

Capitalized terms not defined elsewhere in this Official Statement are defined in *Appendix I—Definitions of Certain Terms*.

The Bonds will be issued under and secured by a Trust Agreement, dated as of January 1, 1974, as amended (the “Trust Agreement”), between the Authority and U.S. Bank National Association, successor trustee (the “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 Trust Agreement, are hereinafter collectively referred to as the “Power Revenue Bonds.”

In order to give potential purchasers of the Bonds general information on the economy of the Commonwealth of Puerto Rico (the “Commonwealth” or “Puerto Rico”), this Official Statement incorporates by reference Appendix A of the official statement of the Puerto Rico Sales Tax Financing Corporation dated June 24, 2010 relating to its \$1,619,404,596.60 Sales Tax Revenue Bonds, First Subordinate Series 2010C (the “Commonwealth’s Economic Report”). The Commonwealth’s Economic Report was filed by the Puerto Rico Sales Tax Financing Corporation with the Municipal Securities Rulemaking Board (“MSRB”) through the Electronic Municipal Market Access system (“EMMA”) (<http://emma.msrb.org>). Said Commonwealth’s Economic Report was not prepared by the Authority, and the Authority does not assume any responsibility for its accuracy or completeness.

Any official statement or appendix thereto of the Commonwealth or of any instrumentality of the Commonwealth that is filed with the MSRB through EMMA containing any revision to the Commonwealth’s Economic Report, or any new or revised Commonwealth’s Economic Report or other document that is filed with the MSRB through EMMA containing information that modifies or supersedes the information contained in the Commonwealth’s Economic Report, in each case after the date hereof and prior to the termination of the offering of the Bonds, shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in any of the above described documents 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 such subsequently filed document modifies or supersedes such statement. Any statement contained herein shall also be deemed to be modified or superseded to the extent that a statement contained in any such 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

### General

The Authority was created in 1941 as a public corporation and governmental instrumentality of the Commonwealth by Act No. 83 of the Legislative Assembly of Puerto Rico, approved May 2, 1941, as amended (the “Act”). The Authority supplies virtually all of the electric power consumed in the Commonwealth. The Authority is one of the largest municipal utilities in the United States, ranking first in number of customers and revenues among public power utilities. As of June 30, 2010, it served approximately 1.5 million clients and had utility plant in service totaling approximately \$10.3 billion, including \$3.9 billion of production plant in service and \$4.6 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 5,839 megawatts (“MW”). For the fiscal year ended June 30, 2010, the average percentage of the Authority’s generating capacity available for service (“equivalent availability”), which includes the two co-generation facilities, was 78%. As of September 30, 2010, the Authority had 2,450 circuit miles of transmission lines and 32,548 circuit miles of distribution lines.

Approximately 70% of the Authority’s energy generation is produced by Authority-owned and operated facilities. The Authority owns six major generating plants and a number of smaller facilities with a combined dependable generating capacity of 4,878 MW. Nearly all of these facilities are currently fired with fuel oil, although the Authority is currently converting several facilities to allow them to use either natural gas or fuel oil.

Approximately 30% of the Authority’s energy generation is purchased from EcoEléctrica, L.P. (“EcoEléctrica”) and AES Puerto Rico, L.P. (“AES-PR”), the owners and operators of two independent power production facilities. Under the long-term contract with EcoEléctrica, the Authority purchases 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 in March of 2000. Under the long-term contract with AES-PR, the Authority purchases 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 in November of 2002. These contracts have allowed the Authority to reduce its dependence on fuel oil while passing on to EcoEléctrica and AES-PR substantially all of the risks of operating the facilities.

Unless otherwise noted, this Official Statement presents Revenues, Current Expenses and Net Revenues of the Authority as defined in the Trust Agreement. The Authority calculates Revenues, Current Expenses and Net Revenues for purposes of the Trust Agreement on the accrual basis. Such calculations differ in several important respects from the Authority’s calculations of change in net assets prepared in accordance with generally accepted accounting principles (“GAAP”). For a discussion of some of the most significant differences between Net Revenues under the Trust Agreement and change in net assets under GAAP and the treatment of non-cash items under the Trust Agreement, see NET REVENUES AND COVERAGE and Schedule II to the Financial Statements for the fiscal years ended June 30, 2008 and 2009 in Appendix II, which includes a reconciliation of the Authority’s change in net assets under generally accepted accounting principles with its Net Revenues under the Trust Agreement.

The Authority’s fiscal year begins on July 1 and ends on the following June 30.



## Summary of Operating Results

### *Five-Year Period*

During the five-year period from fiscal year 2006 through fiscal year 2010, the Authority experienced a decrease in electric energy sales in kilowatt hours (“kWh”) mainly as a result of significant decreases in fiscal years 2008 and 2009, as shown in the table on the following page. The Authority’s sales during this period were adversely affected by significant volatility in oil prices, the principal source of fuel used in its generating facilities, and a reduction in the level of economic and business activity in the Commonwealth due to a prolonged recession, which commenced in the fourth quarter of fiscal year 2006.

From fiscal years 2006 through 2009, Net Revenues experienced a downward trend, decreasing from \$698.0 million for fiscal year 2006 to \$629.5 million for fiscal year 2009, primarily as a result of a decrease in electric energy sales and continued increases in administrative and general operating expenses. For fiscal year 2010, however, Net Revenues increased to \$736.6 million, or 17.0% compared to fiscal year 2009, primarily as a result of an increase of 3.9% in electric energy sales and a reduction of \$57.7 million in operating expenses (excluding fuel and purchased power) as the Authority implemented cost reduction initiatives included in the financial stabilization plan discussed below.

### *Fiscal Year 2010*

Net Revenues for fiscal year 2010 were \$736.6 million, the highest historical amount, representing an increase of \$107.1 million, or 17.0%, over Net Revenues for fiscal year 2009. The increase in Net Revenues was primarily the result of a 3.9% increase in electric energy sales (in kWh), primarily in the residential sector, and decreases in maintenance expenses of \$15.6 million, or 7.0%, and administrative and general expenses of \$43.5 million, or 19.6%. Revenues were \$4.2 billion, a 4.1% increase from the prior year, as a result of an increase in electric energy sales, while Current Expenses, which include fuel and purchased power, maintenance, administrative and general expenses, among others, were \$3.4 billion, a 1.5% increase. Fuel and purchased power expenses, the principal component of the Authority’s Current Expenses, are passed on to clients through a separate charge included in electric service rates. Other than fuel and purchased power expenses, Current Expenses decreased from \$786.1 million for fiscal year 2009 to \$728.4 million for fiscal year 2010, or 7.3%, as a result of reductions across most categories of operating expenses as part of the Authority’s financial stabilization plan.

During fiscal year 2010, net accounts receivable increased from \$993.1 million as of June 30, 2009 to \$1.02 billion as of June 30, 2010. Accounts receivable from government clients decreased from \$471.4 million as of June 30, 2009 to \$373.1 million as of June 30, 2010, while accounts receivable from general clients increased from \$545.1 million as of June 30, 2009 to \$630.6 million as of June 30, 2010, partly as a result of the increase in electric energy sales in the residential sector.

### *Three Months Ended September 30, 2010*

Revenues for the three months ended September 30, 2010 were \$1.067 billion, a 4.8% increase from the same period of the prior year, as a result of an increase in the price of fuel, while Current Expenses, which include fuel and purchased power, maintenance, administrative and general expenses, among others, were \$895 million for the period, a 6.5% increase from the same period of the prior year. As a result, Net Revenues for this period were \$172 million, a 3.8% decrease from the same period in the prior year. This decrease was primarily the result of a 2.1% decrease in electric energy sales (in kWh), primarily in the industrial and commercial sector. The decrease in energy sales was attributable to

significantly above average rainfall during the hurricane season, which resulted in lower average temperatures and lower energy use. The decrease in Net Revenues was also attributable in part to an increase in maintenance expenses of \$9.4 million or 16.7%, and an increase in transmission and distribution expenses of \$7.7 million or 18.8%, attributable to these same poor weather conditions. These higher expenses were partially offset by a decrease in administrative and general expenses of \$11.4 million or 20.6% attributable primarily to the Authority's financial stabilization plan.

The table appearing below summarizes the operating results of the Authority for the five fiscal years ended June 30, 2010 and the three months ended September 30, 2010 and 2009.

**Operating Results**  
**(dollars in thousands)**

	Years Ended June 30					Three Months Ended September 30	
	2006	2007	2008	2009	2010 <sup>(2)</sup>	2009 <sup>(2)</sup>	2010 <sup>(2)</sup>
Revenues.....	\$3,731,925	\$3,687,385	\$4,369,498	\$4,007,268	\$4,165,733	\$1,019,029	\$1,066,597
Less: Current Expenses .....	3,033,924	3,014,983	3,688,070	3,377,772	3,429,095	839,688	894,018
Net Revenues.....	<u>\$698,001</u>	<u>\$672,402</u>	<u>\$681,428</u>	<u>\$629,496</u>	<u>\$736,638</u>	<u>\$179,341</u>	<u>\$172,579</u>
Principal and Interest Requirements.....	\$449,318	\$455,022	\$419,569	\$435,042	\$397,579	(1)	(1)
Ratio of Net Revenues to Principal and Interest Requirements.....	1.55	1.48	1.62	1.45	1.85	(1)	(1)
Electric energy sales (in millions of kWh).....	20,620	20,672	19,602	18,516	19,235	5,078	4,970
Percentage change in electric energy sales from prior year .....	0.6%	0.3%	(5.2)%	(5.5)%	3.9%	1.1%	(2.1) %
Peak load (in MW).....	3,685	3,604	3,546	3,351	3,404	3,404	3,406
Percentage change in peak load from prior year .....	2.3%	(2.2)%	(1.6)%	(5.5)%	1.6%	1.6%	0.1%

<sup>(1)</sup> Calculated only for full fiscal year

<sup>(2)</sup> Unaudited

The Authority calculates Revenues, Current Expenses and Net Revenues on an accrual basis. The figures for Revenues and Net Revenues include (i) amounts billed to the Commonwealth's municipalities for electric energy sales that the Authority is legally entitled to collect but historically has not collected because it instead offsets such billings against the contribution in lieu of taxes ("CILT") that the Authority is required to pay the municipalities, and (ii) amounts attributable to a residential fuel subsidy and a hotel subsidy that the Authority does not collect because it is required by law to credit directly to customers in their electric energy bills. The amount of the required annual CILT is at least equal to the municipalities' annual electric energy consumption. The Revenues attributable to these subsidies and the municipalities' electric energy consumption for fiscal years 2009 and 2010 were \$224.7 million and \$232.4 million, respectively. For a discussion of the CILT and the subsidies provided by the Authority, see *Authority's Financial Condition – Subsidies and Contributions in Lieu of Taxes* under INVESTMENT CONSIDERATIONS, *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM, and *Projected Net Revenues* under NET REVENUES AND COVERAGE.

For a more detailed discussion of the Authority's operating results for the past five fiscal years, see *Management's Discussion and Analysis of Operating Results* under NET REVENUES AND COVERAGE.

## Capital Improvement Program

The total cost of the Authority's capital improvement program in years 2011 through 2015 is estimated to be approximately \$1.75 billion, which is \$893.6 million less than the cost of the capital improvement program for fiscal years 2006 through 2010. The Authority's capital expenditures in fiscal years 2007, 2008 and 2009 were at historically high levels principally due to the costs associated with certain production plant construction projects, which were completed in fiscal year 2009. Substantially all of the cost of the capital improvement program through 2015 is expected to be provided from the issuance of the Bonds, additional Power Revenue Bonds and other borrowings.

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, 2010 and the projected capital improvement program and financing sources for the five fiscal years ending June 30, 2015. For a more detailed discussion of the Authority's historical and projected capital improvement program, 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			
	2006-2010	% of Total	2011-2015*	% of Total
Production plant.....	\$1,232,548	46.6	\$ 638,050	36.5
Transmission facilities.....	670,478	25.4	441,896	25.2
Distribution facilities.....	566,980	21.4	409,800	23.4
Other <sup>(1)</sup> .....	173,552	6.6	260,254	14.9
Total.....	<u>\$2,643,558</u>	<u>100.0</u>	<u>\$1,750,000</u>	<u>100.0</u>
<b>Financing Sources*</b>				
Internally generated funds.....	\$139,316	5.6	\$ 159,309	9.1
Borrowed funds.....	2,504,242	94.4	1,590,691	90.9
Total.....	<u>\$2,643,558</u>	<u>100.0</u>	<u>\$1,750,000</u>	<u>100.0</u>

\* Preliminary, subject to change.

<sup>(1)</sup> Includes land and buildings, general equipment, preliminary surveys and investigations.

In addition to funding a portion of its capital improvement program, the Authority anticipates using a portion of the proceeds of the Bonds to fund a portion of the construction costs of the Via Verde natural gas pipeline (the cost of which is not currently included in the capital improvement program). The Authority preliminarily estimates that the construction costs of the Via Verde natural gas pipeline will be approximately \$450 million and the project is expected to be completed by February 2012. For more information on the Via Verde natural gas pipeline see *Adequacy of Capacity – Substitution of Generating Facilities* under THE SYSTEM.

For a more detailed description of the Authority's electric generation, transmission and distribution system and the Authority's historical and projected capital improvement program, see THE SYSTEM.

### Plans to Address the Authority's Challenges

The Authority faces a number of business challenges that have been exacerbated by the Commonwealth's economic recession and the volatility in oil prices. Its principal challenges, some of

which are interrelated, are: (i) addressing the decline in electric energy sales; (ii) addressing the volatility of oil costs; (iii) addressing high customer electric power rates; (iv) reducing government accounts receivables; and (v) improving its liquidity.

The Authority's management is focused on addressing these challenges by implementing a financial stabilization plan and other strategic initiatives. The principal component of the financial stabilization plan is the reduction of operating costs in line with the reduction in electric energy sales in order to maintain adequate operating margins. As a result of various cost reduction measures implemented, the Authority's operating expenses for fiscal year 2010 (excluding fuel and purchased power) decreased by \$91.7 million, or 11.2%, compared to fiscal year 2008 and by \$57.7 million, or 7.3%, compared to fiscal year 2009.

The principal cost reduction measures included in the plan are (i) reducing the number of employees through a combination of attrition from voluntary retirement and the elimination of temporary and vacant positions, (ii) reducing retiree health care benefits, as explained below, and (iii) reducing overtime and miscellaneous expenses. The Authority has already implemented measures that are expected to result in recurring annual savings of approximately \$121 million, consisting of (i) a reduction of 739 employees from January 1, 2009 through June 30, 2010 that is expected to result in annual savings of approximately \$52 million, (ii) changes to retiree health care benefits that are expected to result in annual savings of approximately \$46 million, and (iii) other cost reduction initiatives, such as the reduction of overtime and miscellaneous expenses, that are expected to result in annual savings of approximately \$23 million. For fiscal year 2011 and the next two fiscal years, the Authority expects to achieve additional headcount reductions through attrition of approximately 250 employees per fiscal year, which is expected to result in additional savings of approximately \$15 million per fiscal year.

On June 30, 2009, the Authority changed the health plan for retired employees from a defined benefit plan to a defined contribution plan. The changes to the health plan include the imposition of caps on the amount of monthly benefits for all current and future retirees and stricter eligibility requirements. The modifications to the health plan resulted in a reduction in the unfunded actuarial accrued liability from \$3.4 billion as of June 30, 2008 to \$531.1 million as of June 30, 2009 and reduced the Authority's annual required contribution under GASB No. 45 from \$259.3 million as of June 30, 2008 to \$24.4 million as of June 30, 2009, a \$234.9 million decrease. The annual required contribution is an amount actuarially determined in accordance with GASB No. 45 representing a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded liabilities over a period not to exceed thirty years. For fiscal year 2010, the Authority's annual required contribution was \$26.6 million.

An additional component of the financial stabilization plan has been to improve the Authority's liquidity by reducing past due receivables. The Authority has made significant progress in reducing accounts receivable from the government sector. As of June 30, 2010, the central government had paid all past due accounts owed as of June 30, 2009 and had an outstanding balance of approximately \$37.2 million, a reduction of \$73.1 million compared to June 30, 2009. Also, the Puerto Rico Aqueduct and Sewer Authority ("PRASA") and the Public Buildings Authority ("PBA"), two of the public corporations with the largest account balances, had outstanding balances of \$30.7 million and \$38.2 million, respectively, as of June 30, 2010, a reduction of \$32.6 million and \$20.2 million, respectively, compared to June 30, 2009. During the current fiscal year, PBA made another payment of \$20.2 million, the University of Puerto Rico made a payment of \$23.2 million, the Department of Education made payments amounting to \$39.0 million, and the Medical Services Administration made a payment of \$19.9 million. See *Management's Discussion and Analysis of Operating Results* under NET REVENUES AND COVERAGE.

The Authority is also implementing a theft reduction program through the use of “smart grid” technologies and an increase in unannounced door-to-door inspections, among other steps. During fiscal year 2010, theft recovery initiatives resulted in theft-related billings of approximately \$11 million. The Authority’s various theft recovery initiatives are expected to result in \$15 million of annual incremental revenues for fiscal year 2011 and \$20 million in annual incremental revenues for fiscal years 2012 through 2015. See *Transmission and Distribution Facilities – Operations* under THE SYSTEM.

The Authority has also reduced the size of and refocused its capital improvement program for fiscal years 2011 through 2015 away from the historical trend of capacity expansion and towards improving the reliability of its production capacity and the efficiency of its transmission and distribution system. As a result, the Authority has been able to reduce its capital improvement program from \$2.6 billion for fiscal years 2006 through 2010 to a projected \$1.75 billion for fiscal years 2011 through 2015. See *Transmission and Distribution Facilities* and *Projected Five-Year Capital Improvement and Financing Program* under THE SYSTEM.

In order to address the volatility of oil costs, the Authority’s management is focused on diversifying fuel sources, with the goal of reducing the dependence on oil for energy generation from 69% today to 48% by 2015 and 26% on a long-term basis. In order to achieve this reduction, the Authority plans to convert existing oil-fired facilities to allow them to use either oil or natural gas and to build a pipeline system to be known as “Vía Verde”, to transport natural gas to several of the Authority’s generating plants. The Authority is also reviewing the option of developing new coal-burning facilities. The Authority has also entered into power purchase agreements with developers of renewable energy projects with the long-term goal of increasing the use of renewable energy. See *Adequacy of Capacity* under THE SYSTEM.

For a discussion of certain considerations affecting an investment in the Bonds, see INVESTMENT CONSIDERATIONS.

## PLAN OF FINANCING

The Authority is issuing the Bonds pursuant to Section 208 of the Trust Agreement to finance a portion of its capital improvement program and a portion of the construction of the Via Verde pipeline. The Authority will designate the Bonds as “Build America Bonds” under Section 54AA of the Internal Revenue Code of 1986, as amended (the “Code”), and elect under Code Section 54AA(g) to receive a credit from the United States Treasury equal to 35% of the stated interest paid on such bonds as provided in Code Section 6431. The Authority expects to issue additional Power Revenue Bonds in fiscal years 2011 through 2015 to fund its capital improvement program. See *Projected Five-Year Capital Improvement and Financing Program* under THE SYSTEM. No assurance can be given that any such Power Revenue Bonds will be issued for such purposes.

### Estimated Sources and Uses of Funds for the Bonds

#### Sources

Principal Amount of the Bonds.....	\$355,730,000.00
Authority Contribution.....	150,000.00
	\$355,880,000.00
<b>Total Sources</b>	<b>\$355,880,000.00</b>

#### Uses

Repayment of Lines of Credit.....	\$ 50,150,000.00
Deposit to Construction Fund.....	284,466,001.56
Deposit to Reserve Account.....	14,050,231.00
Underwriters’ Discount and Other Costs of Issuance <sup>(1)</sup> .....	7,213,767.44
	\$355,880,000.00
<b>Total Uses</b>	<b>\$355,880,000.00</b>

<sup>(1)</sup> Includes legal, printing and other financing expenses.

## SECURITY

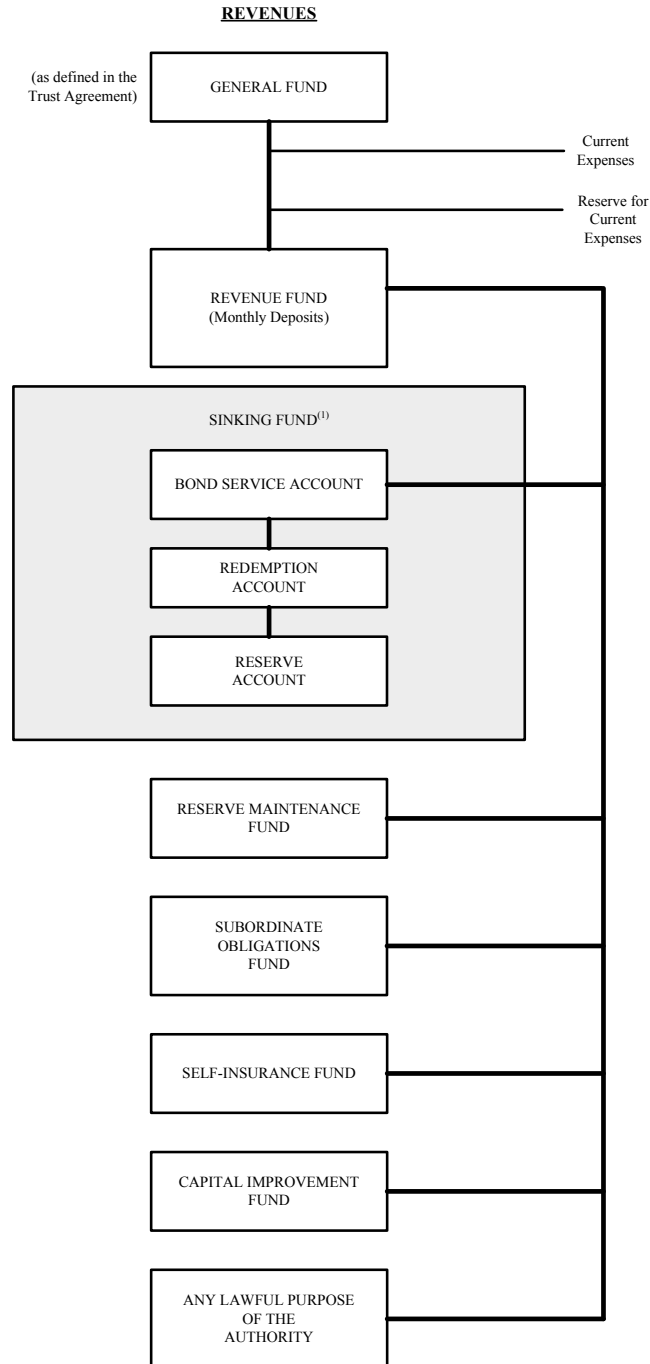
The Bonds are not a debt or obligation of the Commonwealth or any of its municipalities or other political subdivisions, other than the Authority, and neither the Commonwealth nor any such municipalities or other political subdivisions, other than the Authority, are liable thereon, nor shall the Bonds 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 Trust Agreement and this Official Statement, “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 Trust 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, including any income derived by the Authority from the sale of electricity generated or distributed by the System, any 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 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 Trust Agreement*, which should be read in conjunction herewith.

## Flow of Funds under Trust Agreement

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



(1) Monthly deposits to the Bond Service Account and the Redemption Account for all Power Revenue Bonds bearing interest at a fixed rate are capped at 1/6 of the interest due within the next six months and 1/12 of the principal due within the next twelve months and 1/12 of Amortization Requirements for the current fiscal year.

## **Rate Covenant**

The Authority has covenanted in the Trust 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 must 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 Trust Agreement, and for future issues of capital appreciation bonds will be determined as provided in the respective resolutions of the Authority authorizing such issues. In addition, interest payable with respect to Build America Bonds and other Federally Subsidized Bonds is calculated net of the Federal Subsidy Payment as described under “Reserve Account” below. See “Rate Covenant” in Appendix I—*Summary of Certain Provisions of the Trust Agreement*.

## **Reserve Account**

The Authority has covenanted in the Trust Agreement to accumulate in the 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 Trust 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 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 Trust Agreement on the valuation date therefor occurring on or after the first day of the twelfth month succeeding the date of calculation.

In connection with a series of Build America Bonds or other Federally Subsidized Bonds, the amount of interest deemed to be payable on such bonds within the next twelve months for purposes of the calculation of interest to be credited to the Reserve Account shall exclude the amount of interest to be paid from the Federal Subsidy Payment; provided, however, that if the Trustee does not receive the scheduled amount of the Federal Subsidy Payments on or before the date interest on such Federally Subsidized Bonds is payable or within 30 days of the date such Federal Subsidy Payments were scheduled to be received, then for purposes of such calculation the amount of interest to be credited to the Reserve Account shall be equal to the interest payable on the bonds within the next twelve months.

As of September 2, 2010, approximately \$361.3 million was on deposit to the credit of the Reserve Account. The amount required to be accumulated in the Reserve Account will be approximately \$370.4 million after giving effect to the issuance of Power Revenue Bonds issued for non-refunding purposes within the previous 60 months and the issuance of the Bonds. In accordance with the provisions of the Trust Agreement, the Authority will transfer any excess amount on deposit from time to time in the Reserve Account to the Bond Service Account of the Sinking Fund.



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

The Trust 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 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 Trust 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 Sinking Fund (including the Reserve Account) are insufficient for such purpose. As of June 30, 2010, the balances of the Reserve Maintenance Fund and the Self-insurance Fund were \$10.6 million and \$73.8 million, respectively. As of June 30, 2010 there was no money on deposit in the Capital Improvement Fund. See “Disposition of Revenues” in Appendix I—*Summary of Certain Provisions of the Trust Agreement*.

## **Additional Bonds**

Additional Power Revenue Bonds may be issued under the Trust 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 Trust 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 Trust 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 Trust Agreement” in Appendix I—*Summary of Certain Provisions of the Trust Agreement*.

Under the earnings coverage tests of the Trust Agreement, Net Revenues for the twelve months ended June 30, 2010 of \$736.6 million were 131% of the maximum aggregate annual Principal and Interest Requirements of \$563.4 million on all outstanding Power Revenue Bonds (including the Bonds). Estimated average annual Net Revenues for the five fiscal years ending June 30, 2016 of \$856.1 million would be 152% of the maximum aggregate annual Principal and Interest Requirements of \$563.4 million on all outstanding Power Revenue Bonds (including the Bonds). The amount of Principal and Interest

Requirements for fiscal years 2011, 2012 and 2013 has been reduced by the interest that was capitalized through the Authority's issuance of its Power Revenue Bonds, Series XX (the "Series XX Bonds"), Power Revenue Bonds, Series ZZ (the "Series ZZ Bonds"), Power Revenue Bonds, Series CCC (the "Series CCC Bonds") and Power Revenue Refunding Bonds, Series DDD (the "Series DDD Bonds") in the following amounts: approximately \$79.6 million due during fiscal year 2011, \$77.7 million due during fiscal year 2012, and \$35.7 million due during fiscal year 2013. See NET REVENUES AND COVERAGE.

### **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 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 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 Trust Agreement*.

As of November 30, 2010, the Authority had approximately \$127.2 million aggregate outstanding principal amount of subordinate obligations. See DEBT.

## **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 Bonds will be payable quarterly on each July 1, October 1, January 1 and April 1, commencing on April 1, 2011.

#### *Form of Bonds*

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 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 Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities 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 certificate will be issued for each stated maturity of the Bonds, each in the aggregate principal amount (initial principal amount in the case of the Capital Appreciation Bonds) of such maturity, and will be deposited with DTC. SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE FOR DTC, REFERENCES HEREIN TO BONDHOLDERS OR OWNERS OF THE BONDS (OTHER THAN UNDER THE CAPTION “TAX MATTERS”) SHALL MEAN CEDE & CO. AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS. If, however, the aggregate principal amount of any issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC, the world’s largest securities 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, as amended (the “Exchange Act”). DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 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 between 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 is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. 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 (“Indirect Participants”). DTC has S&P’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission (“SEC”). More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of the Bonds (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. 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 are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, the 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 the Bonds with DTC and their

registration in the name of Cede & Co. or such other DTC 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 Direct and Indirect 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 the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bonds documents. 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 registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's MMI 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 Trustee on payable dates 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 Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of 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 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.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority takes no responsibility for the accuracy thereof.

NONE OF THE AUTHORITY, THE TRUSTEE OR THE UNDERWRITERS WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT PARTICIPANTS, INDIRECT PARTICIPANTS OR ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY PARTICIPANT OR INDIRECT PARTICIPANT; (II) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF

ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON, THE BONDS; (III) ANY NOTICE WHICH IS PERMITTED OR REQUIRED TO BE GIVEN TO BONDHOLDERS; (IV) ANY CONSENT GIVEN BY DTC OR OTHER ACTION TAKEN BY DTC AS A BONDHOLDER; OR (V) THE SELECTION BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS.

### **Discontinuance of the Book-Entry Only System**

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

The Authority may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

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 interest 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 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 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 corporate trust office of the 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.

### **Mandatory Redemption**

The Bonds maturing on July 1, 2030 are not subject to any sinking fund requirement prior to their maturity date. The Bonds maturing on July 1, 2032 and 2040 will be redeemed in part on July 1, 2031, and 2037, respectively, and on each July 1 thereafter for which there is an Amortization Requirement in respect of such Bonds, in amounts equal to the Amortization Requirements for such Bonds (less the principal amount of any Bonds retired by purchase and otherwise subject to adjustment as provided in the Trust Agreement), from moneys in the Sinking Fund, at a redemption price equal to the principal amount of the Bonds to be redeemed plus accrued interest to the redemption date, without premium, in the years and amounts set forth below:

<b>Amortization Requirements</b>		
<b>Year</b>	<b>Term Bonds due 2032</b>	<b>Term Bonds due 2040</b>
2031	\$108,665,000	
2032	108,670,000*	
2033		
2034		
2035		
2036		
2037		\$ 19,370,000
2038		19,370,000
2039		19,375,000
2040		19,375,000*

\* Final Maturity.

## **Optional Redemption**

The Bonds may be redeemed at the option of the Authority prior to maturity, from any available moneys (except moneys deposited in the Sinking Fund in respect of an Amortization Requirement), upon not less than 30 days' prior notice by mail, either in whole or in part, in such order of maturity as directed by the Authority, on any date not earlier than July 1, 2020, at a redemption price equal to the principal amount of the Bonds to be redeemed plus accrued interest to the redemption date, without premium.

## **Extraordinary Redemption**

The Bonds are subject to redemption at the option of the Authority prior to their maturity, in whole or in part, upon the occurrence of an Extraordinary Event (defined below), at a redemption price equal to the principal amount of the Bonds to be redeemed plus accrued interest to the redemption date, without premium. An "Extraordinary Event" will have occurred if the Authority determines that a material adverse change has occurred to Section 54AA or 6431 of the Code (as such Sections were added by Section 1531 of the American Recovery and Reinvestment Act of 2009, pertaining to "Build America Bonds") or there is any guidance published by the Internal Revenue Service or the United States Treasury with respect to such Sections or any other determination by the Internal Revenue Service or the United States Treasury, which determination is not the result of any act or omission by the Authority to satisfy the requirements to qualify to receive the federal subsidy from the United States Treasury, pursuant to which the federal subsidy from the United States Treasury is reduced or eliminated.

## **Notice of Redemption**

Notice of redemption shall be mailed by the Trustee, not less than 30 days nor more than 60 days prior to the redemption date, to the Holders of Bonds called for redemption at their addresses appearing on the bond registration books of the Trustee. The Trustee shall also give notice of redemption by overnight mail or carrier service to the Authority, and such securities depositories and/or securities information services as shall be designated by the Authority.

## **Use of Federal Subsidy Received with Respect to the Bonds**

The Authority will irrevocably designate the Bonds as "Build America Bonds" subject to U.S. income taxes (except to bona fide residents of Puerto Rico to the extent described herein). Upon compliance with certain requirements of the Code, the Authority will receive a subsidy payment from the federal government equal to 35% of the amount of each interest payment on the Bonds. This subsidy will be paid directly to the Authority and not to the holders of the Bonds. The Authority will use this subsidy exclusively to pay interest on the Bonds. In connection with the issuance of the Bonds, the Authority and the Trustee will enter into a supplement to the Trust Agreement that provides in substance that so long as the Trustee receives the federal subsidy payment on a timely manner, the interest component of the "Principal and Interest Requirements" for the Bonds for purposes of the Trust Agreement shall exclude any interest payable from such federal subsidy. No assurance can be given by the Authority of the receipt of such cash subsidy payments. The Authority is obligated to make payments of the principal of and interest on the Bonds whether or not it receives such subsidy payments.

## **THE AUTHORITY**

The Authority was created as a body corporate and politic constituting a public corporation and governmental instrumentality of the Commonwealth by 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, ranking first in number of customers and revenues among public power utilities.

The executive offices of the Authority are located at 1110 Ponce de Leon Avenue, San Juan, Puerto Rico 00907, telephone number (787) 521-4666.

**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>
Luis García Passalacqua, P.E.	Engineer	February 2011
José A. Fernández-Polo, P.E.	Engineer	February 2011
Rubén A. Hernández-Gregorat, P.E.	Secretary of Transportation and Public Works	Ex Officio
José Luis Rodríguez-Homs, P.E.	Engineer	February 2011
Andrés Salas Soler, Esq.	Attorney	February 2014
Maria A. Veras-Fernández*	Education Administration Officer	September 2009
Luis R. Abbott Van Der Horst	Former Industrial Managing Director	February 2011
Marimar Pérez-Riera	Consultant	February 2013

\* Mrs. Veras Fernández will continue to serve as a member of the Governing Board until her 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.

*Miguel A. Cordero López* was appointed Executive Director on January 13, 2009. Mr. Cordero is a Professional Engineer with 35 years of experience. Mr. Cordero has held various positions within the Authority, including Executive Director from 1993 to 2000. Other positions he has held throughout his career include Executive Director of the City of San Juan, Executive Director of the Infrastructure Financing Authority, President of the Puerto Rico Government Infrastructure Council, Member of the Economic Development Council, President of the Authority’s Retirement System’s Board of Trustees, President of the Working Committee for the Transshipment Port, Member of the Board of Directors of the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, and Vice-President of Bermúdez & Longo, S.E.

Other principal officers of the Authority include the following:

*Martín V. Arroyo Feliciano*, Director of Finance, holds a Master Degree in Business Administration. He was Director of Finance from 1995 to 2000. Other positions he has held throughout his career include budget manager for the University of Puerto Rico System and Professor of finance and

accounting at the Department of Business Administration. He also served as the Director of Accounting for the School Board of Palm Beach County and Director of Accounting for Contracted Programs at the Miami-Dade County School Board.

*Raúl Burgos Santiago*, Director of Transmission and Distribution, is a Professional Electrical Engineer. During his 27 years of service with the Authority, Mr. Burgos has occupied various positions, such as Head of the Electrical Distribution Division, Regional Administrator of Technical Operations in Caguas and Ponce, and Superintendent – Distribution Engineer Department.

*Josué A. Colón Ortiz*, Director of Generation, is a Professional Mechanical Engineer with 23 years of service at the Authority. During that time, he has occupied various positions, including Mechanical Design Section Engineer, Maintenance Engineer, Assistant Project Manager, Outage Manager, Superintendent of the Mechanical Maintenance Machine Shops, Head of the Maintenance Projects, Head of the Palo Seco Power Plant and Director of the Electric System.

From January 13, 2009 to October 2010 he occupied the position of Generation, Transmission and Distribution Director, with a new organizational model that consolidated in one area the Engineering Directorate, the Electric System Directorate and the Transmission and Distribution Directorate. This area was responsible for the generation, transmission and distribution of the electric energy in Puerto Rico.

Since September 2010, he is the Generation Director in charge of the electric system, and member of the *Vía Verde* Project Committee.

*Otoniel Cruz Carrillo*, Director of Customer Service, holds a Master in Business Administration degree with a concentration in finance. He has 26 years of service with the Authority. During that time, he has occupied various positions in Client Service, Budget, Finance and the Retirement System.

*Angel L. Rivera Santana*, Director of Planning and Environmental Protection, is a Professional Engineer and a licensed planner with 33 years of service with the Authority. During his tenure, Mr. Rivera has occupied various positions at the Authority, including Director of Planning and Environmental Protection from 1993 to 2000.

*Elisa A. Fumero Pérez*, General Counsel, holds a Juris Doctor from the University of Puerto Rico Law School and a Bachelor of Arts Degree, *cum laude*, from Mount Holyoke College and has approximately 13 years of service with the Authority. During her tenure, she has occupied the position of Attorney with the Litigation Division for over 11 years. Prior to her employment with the Authority, Ms. Fumero was a general law practitioner for 14 years.

*Astrid I. Rodríguez Cruz*, Director of Human Resources and Labor Affairs, holds a Juris Doctor and a Bachelor's Degree in Business Administration, with a concentration in Industrial Management, and has approximately 13 years of service with the Authority. She has occupied various positions at the Authority, including Head of the Opinion, Legislation and Contract Division, Director of Human Resources, and Acting General Counsel.

The Authority retains the firm of URS Corporation, successor to the Washington Division of URS Corporation, as the consulting engineers (the "Consulting Engineers") to perform certain responsibilities under the Trust Agreement. Washington Division of URS Corporation was formed in November 2007 following the acquisition by URS Corporation of Washington Group International, Inc. In January 2010, URS Corporation elected to use only its corporate name to identify all its operating divisions. The Consulting Engineer's responsibilities include submitting an annual report to the Trustee by November 1 of each year 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 Trust Agreement for the purposes specified in the Trust Agreement, and (c) as to any advice and recommendations as they deem advisable. The Consulting Engineers have not delivered their report for fiscal year 2010, but expect to do so by February 2011.

Ernst & Young LLP has been engaged to audit the Authority's financial statements for fiscal year 2011.

## **Subsidiaries**

Pursuant to the Act, the Authority is authorized to create subsidiaries in order to, among other things, delegate or transfer any of its rights, powers, functions or duties. The Authority currently has five principal subsidiaries organized in a holding company structure. Currently, only one of the Authority's subsidiaries has significant operations.

PREPA Holdings, LLC, a wholly-owned subsidiary of the Authority, was created for the sole purpose of acting as a holding company and has no current operations. PREPA Holdings, LLC is the direct parent of the following entities: PREPA Networks, LLC, also known as PREPA.net; PREPA Utilities, LLC; PREPA Oil & Gas, LLC; and InterAmerican Energy Sources, LLC.

In 2002 the Authority completed the installation of a Backbone Fiber Optic Cable System which has modernized its internal communications by providing faster and more secure data transmission for operations, load management, system protection and security. This fiber optic system consists of a 663 mile fiber optic telecommunications network of which 386 miles are for the Authority's use and 277 miles are for the use of PREPA.net. The system is installed on the Authority's rights-of-way (mainly its transmission lines) and was financed through the issuance of \$43.7 million aggregate principal amount of subordinate obligations.

In addition to the Backbone Fiber Optic Cable System, the Authority has installed a Distribution Fiber Optic Cable System that consists of 691 miles of fiber optic cables, of which 399 miles are for the Authority's and PREPA.net's use and 292 miles are for the exclusive use of PREPA.net. The Authority created PREPA.net in order to commercially exploit the excess fibers of the installed fiber optic cable system. PREPA.net markets the excess communication capacity of the Authority's fiber optic cable system. PREPA.net currently offers next generation telecommunications services to carriers, internet service providers, and large commercial enterprises. These services include data transmission via Synchronous Optical Network (SONET), metro and long haul Ethernet transport services, wireless last mile, and internet protocol services optimized for voice over internet protocol. PREPA.net also offers international fiber optic cable capacity and satellite teleport facilities through the submarine fiber optic cable capacity acquired in 2008. As of June 30, 2010, PREPA.net had total assets of \$20.5 million (unaudited) and net income of \$1.9 million (unaudited). PREPA.net also has a revolving line of credit in a principal amount of \$10.1 million used for working capital purposes. PREPA.net continues to add customers to its portfolio and the Authority continues with the installation of fiber optic cables. The Authority expects that the commercial exploitation of the fiber optic system will provide a new source of revenues to its operations that will ultimately benefit its electric energy customers.

PREPA Utilities, LLC, was created for the purpose of investing, financing, constructing and operating industrial projects and other infrastructure relating to the optimization of the Authority's electric infrastructure. PREPA Oil & Gas, LLC, was created for the purpose of buying, selling, exchanging and otherwise trading or dealing with the export, import, manufacture, production, preparation, handling, storage, and distribution of oil and gas and any other fuels required to satisfy the

Authority's power generation needs. Finally, InterAmerican Energy Sources was created for the purpose of investing, developing, financing, constructing and operating renewable energy projects and other infrastructure related to the optimization of the Authority's electric infrastructure. PREPA Utilities, LLC, PREPA Oil & Gas, LLC, and InterAmerican Energy Sources, LLC are currently not operating.

## INVESTMENT CONSIDERATIONS

*Prospective investors should carefully consider the investment considerations set forth below regarding an investment in the Bonds as well as other information contained in this Official Statement. The following discussion of investment considerations is not meant to be a complete list of the considerations associated with the purchase of the Bonds and does not necessarily reflect the relative importance of various factors. Potential purchasers of the Bonds are advised to consider the following factors, among others, and to review the other information in this Official Statement in evaluating an investment in the Bonds. Any one or more of the factors discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Bonds. There can be no assurance that other investment considerations will not become material in the future.*

### Authority's Financial Condition

#### *Operating Losses*

For the three years ended June 30, 2010, 2009 and 2008, the Authority incurred losses before contributed capital of \$202.5 million (unaudited), \$163.0 million and \$323.7 million, in accordance with GAAP. These net losses have resulted in a significant reduction in the Authority's consolidated net assets, from \$471.4 million as of June 30, 2007, to \$186.7 million as of June 30, 2008 and \$39.2 million as of June 30, 2009. As of June 30, 2009 and June 30, 2010, the Authority had unconsolidated net assets (on a stand-alone basis, excluding the Authority's subsidiaries) of negative \$9.8 million and negative \$91.3 million (unaudited), respectively.

The Authority's net losses during these three fiscal years are mainly due to (i) the decrease in revenues resulting from consecutive decreases of 5.2% and 5.5% in the sale of electric energy (measured in kWh) during fiscal years 2008 and 2009, (ii) the recognition of other post employment health care benefits ("OPEB") expense upon the adoption in fiscal year 2008 of Statement No. 45 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("GASB No. 45"), and (iii) the Authority's CILT obligations and other subsidies during these years. The decreases in sales of electric energy during fiscal years 2008 and 2009 resulted in a decrease in revenue from basic charges (which excludes fuel adjustment and purchased power charges) of \$59.6 million from fiscal year 2008 to fiscal year 2009 and \$52.3 million from fiscal year 2007 to fiscal year 2008. For fiscal year 2010, however, the Authority's revenues from basic charges increased by \$48.9 million compared to fiscal year 2009. The Authority recorded an OPEB expense of \$189.5 million for fiscal year 2008 as a result of the adoption of GASB No. 45. GASB No. 45 requires, among other things, the systematic, accrual basis measurement and recognition of OPEB expenses over a period that approximates employees' years of service. The Authority's CILT obligations and other subsidies were \$218.4 million, \$224.8 million and \$235.8 million for fiscal years 2008, 2009 and 2010, respectively. For a discussion of the CILT and other subsidies, see the discussion below under *Subsidies and Contributions in Lieu of Taxes* and the discussion in *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM.

In order to address the Authority's losses, in January 2009 management began to implement a financial stabilization plan designed to adjust operating expenses in line with the Authority's projected sales and improve its financial metrics. As a result of the implementation of various measures under this

plan, the Authority's operating expenses for fiscal year 2010 (excluding the cost of fuel oil and purchased power) decreased by \$91.7 million, or 11.2%, compared to fiscal year 2008, and by \$57.7 million, or 7.3%, compared to fiscal year 2009. For a more detailed description of the Authority's financial stabilization plan, see *Plans to Address the Authority's Challenges* under OVERVIEW.

#### *Subsidies and Contributions in Lieu of Taxes*

The Authority includes in Revenues and Net Revenues (as calculated pursuant to the Trust Agreement) amounts billed to the Commonwealth's municipalities for electric energy sales to the municipalities that the Authority is legally entitled to collect but historically has not collected because it instead offsets such billings against its CILT obligation. The Authority also includes in Revenues and Net Revenues amounts attributable to a residential fuel subsidy and a hotel subsidy that the Authority does not collect because it is required by law to credit such amounts directly to the customers in their electric energy bills. For a detailed description of the Authority's obligation to make CILT payments and provide these and other subsidies, and the procedures followed by the Authority to comply with such obligations, see *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM.

The annual CILT is equal to, at a minimum, the municipality's actual electric energy consumption and is payable only from Net Revenues available after provision is made for debt service and other Trust Agreement obligations in each fiscal year. The Authority is legally entitled to collect the municipalities' electric energy consumption bills on a current basis and defer the payment of the CILT until November 30 following the end of the fiscal year. The Act provides that the Authority's obligations under the Trust Agreement have priority over the Authority's obligation to make any CILT payment. Historically, however, the municipalities have not been paying for their electricity on a current basis and the Authority has followed the practice of offsetting the outstanding bills against the CILT. This practice, which the Act provides is at the option of the Authority, has affected the Authority's liquidity. If the Authority were to change this practice and require the municipalities to pay their bills on a current basis, there is no assurance that the Authority would be able to collect such bills on a timely basis.

In fiscal years 2009 and 2010, the Authority's Revenues from sales of electricity to municipalities was \$187.7 million and \$196.5 million, respectively, and the aggregate amount of the residential fuel and hotel subsidies included in Revenues was \$37 million and \$36 million, respectively. The sum of the sales of electricity to municipalities and these subsidies (\$224.7 million for fiscal year 2009 and \$232.4 million for fiscal year 2010) represented approximately 35.7% and 31.2%, respectively, of the Authority's Net Revenues for the corresponding periods. That sum is expected to grow to \$274.9 million by fiscal year 2015. The historical and projected Revenues from sales of electricity to municipalities and the residential fuel and hotel subsidies are set forth in footnotes to the tables titled Historical Net Revenues and Coverage and Projected Net Revenues and Coverage appearing under NET REVENUES AND COVERAGE.

#### *Internal Funding of Capital Improvements*

During fiscal years 2006 through 2010, the Authority's capital expenditures funded from internally-generated funds were \$150.6 million, or approximately 5.7% of total capital expenditures. For fiscal year 2010, the Authority allocated \$74.7 million of internally generated funds for capital expenditures, representing approximately 19.3% of total capital expenditures. In the Authority's capital improvement program for the five fiscal years ending June 30, 2015, the Authority expects that approximately 9.6% of projected capital expenditures will be financed from internally generated funds. Thus, while the Authority has been increasing the allocation of internally generated funds to its capital improvement program, substantially all of the Authority's capital improvement program has been and will continue to be financed through the issuance of Power Revenue Bonds and other borrowings. The

Authority's Consulting Engineers have recommended that the Authority increase the amount of its capital improvement program funded from internally-generated sources.

#### *Liquidity; Government Accounts Receivable*

During the fiscal years 2008 and 2009, the Authority experienced a deterioration of its liquidity. Among the factors that affected the Authority's liquidity were the increase in the level of accounts receivable during fiscal years 2008 and 2009, in particular accounts receivable from the central government, and the Authority's practice of offsetting the municipalities' electric consumption receivables against the CILT. During fiscal year 2010, however, the Authority made significant progress in reducing accounts receivable from the government sector. From June 30, 2008 to June 30, 2010, accounts receivable from the central government and public corporations decreased to \$263 million, a 16% decrease, consisting of \$37.3 million from the central government and \$225.7 million from public corporations. As of June 30, 2010, the central government had paid all past due accounts owed as of June 30, 2009. As of November 30, 2010, accounts receivable from the central government and public corporations had decreased further to \$259.5 million, consisting of \$38.5 million from the central government and \$221.0 from public corporations.

In addition, the Authority agreed to an informal payment plan with PRASA, one of the public corporations with the largest account balance totaling \$30.7 million, or 13.6% of past due amounts from public corporations, as of June 30, 2010. As of June 30, 2010, PRASA's receivable had decreased by \$32.6 million from June 30, 2009 due to a payment of \$53.9 million made on June 10, 2010. As of June 30, 2010, PBA had also reduced the balance of its receivable to \$38.2 million from June 30, 2009 due to a \$25 million payment made in September 2009. The Authority received an additional \$20.2 million payment from PBA during the current fiscal year. As of June 30, 2010, the public corporation with the largest account balance was the Ports Authority, totaling \$44.8 million, or 19.8% of past due amounts from public corporations. The Authority is currently negotiating the possible acquisition of certain real estate from the Ports Authority to be used by the Authority in its day to day operations in exchange for a portion of its outstanding receivable.

The Authority has used lines of credit from Government Development Bank for Puerto Rico ("Government Development Bank") and private financial institutions for operational purposes and to finance capital improvements. As of November 30, 2010, the Authority had drawn lines of credit with an outstanding principal balance of \$221.5 million. See *Notes and Government Development Bank – Lines of Credit* under DEBT.

#### **Trends in Electric Energy Sales**

During fiscal years 2008 and 2009, the Authority experienced a decrease in electric energy sales (in kWh) as a result of the ongoing economic recession in Puerto Rico and the high rates charged to the Authority's clients, which are the result of the combination of the high cost of fuel oil and the Authority's dependence on fuel oil for 69% of its power production. For fiscal years 2008 and 2009, when Puerto Rico's real gross national product decreased by 2.8% and 3.7%, respectively, the Authority's electric energy sales decreased by 5.2% and 5.5%, respectively. Residential, industrial and commercial energy sales were all negatively impacted during these two fiscal years. During fiscal year 2010, however, the Authority experienced an increase in electric energy sales compared with fiscal year 2009. This increase has mainly occurred in the residential sector, which experienced an increase of 10.8%, partly attributable to lower fuel oil prices during the first six months of fiscal year 2010 compared with the historically high price of fuel oil during the first six months of fiscal year 2009 (which averaged \$97.35 per barrel).

The Authority is projecting declines in electric energy sales of 0.1% and 0.1% for fiscal years 2011 and 2012, respectively, and increases of 0.4%, 0.6% and 0.9% for fiscal years 2013, 2014 and 2015, respectively. To address the expected flat level of demand for electricity during the next two fiscal years, the Authority's management has been implementing the financial stabilization plan previously disclosed that aims to reduce operational costs to bring them in line with the expected energy sales.

For more information regarding the historical and projected sales and revenues of the Authority, see NET REVENUES AND COVERAGE.

### **Dependence on Fuel Oil; Fuel Cost Volatility**

Approximately 68.6% of the Authority's energy sales are generated by oil-fueled units. The Authority's main operating expense is the cost of fuel oil. Fuel oil expenses amounted to \$2.0 billion, or 58.5% of Current Expenses, for fiscal year 2010, and \$1.9 billion, or 56.8% of Current Expenses, for fiscal year 2009. During the last five fiscal years, there has been significant volatility in the price of oil. The average cost per barrel to the Authority was \$56.38 for fiscal year 2006, increasing to \$84.18 for fiscal year 2008 and then decreasing to \$76.55 for fiscal year 2010.

Since the cost of fuel is passed on to the Authority's clients on a current basis through a fuel adjustment charge, the Authority's dependence on fuel oil has resulted in overall increases and significant volatility in the cost of energy to the Authority's customers during the last five fiscal years. The increased cost of energy, in turn, has a negative impact on Puerto Rico's economy and has contributed to the reduced demand for electricity discussed above. The Authority's management is focused on diversifying fuel sources, with the goal of reducing the dependence on oil for energy generation from 69% today to 48% by 2015 and 26% on a long-term basis. In order to achieve this reduction, the Authority plans to convert existing oil-fired facilities to allow them to use either fuel oil or natural gas and to build a pipeline system to transport natural gas to several of the Authority's generating plants. The Authority is also reviewing the option of developing new coal-burning facilities. The Authority has also entered into power purchase agreements with developers of renewable energy projects with the long-term goal of increasing the use of renewable energy. See *Adequacy of Capacity* under THE SYSTEM.

For more information regarding the fuel used by the Authority for its generating units, see *Fuel* under THE SYSTEM.

### **Changes in Commonwealth Legislation and Market Developments**

The Government has identified high energy costs as one of the main factors affecting Puerto Rico's competitiveness and has made the adoption of a new energy policy an important part of its economic development initiatives. Act No. 73 of May 28, 2008, also known as the Economic Incentives Act, Puerto Rico's most recent tax incentives legislation, also created the Puerto Rico Energy Affairs Administration, a new government agency under the Department of Economic Development and Commerce in charge of developing and implementing an energy policy for Puerto Rico. The Economic Incentives Act provides, among other things, for tax credits against Puerto Rico income tax equal to a percentage of the payments made to the Authority for the net consumption of energy related to business operations. These credits are available to any business that is an industrial client of the Authority and has been designated as an eligible business by the Puerto Rico Treasury Department. These tax credits will be covered from moneys from the Commonwealth's General Fund and payments from the Authority.

The Economic Incentives Act provides that the Authority's cost of the tax credit will be absorbed by the Authority through a reduction in operational costs, increased efficiencies, revenues generated through "wheeling" and reductions in the cost of generating or purchasing energy. The Economic

Incentives Act expressly provides that the Authority's cost in providing the tax credit shall not be subsidized by or passed through, either directly or indirectly, to the customers of the Authority, nor shall such costs cause a reduction in employment or in the payroll of the Authority. If during the 10-year term of the tax credit the average cost of energy is reduced to 10 cents per kWh for a period of two consecutive years, the tax credit will terminate.

The Authority expects to pay its portion of the cost of the tax credit from Revenues in a given year, but only after the application of Revenues to pay Current Expenses and debt service on the Authority's outstanding bonds in such given year, and after certain debt service, maintenance, capital improvement and self-insurance reserves are funded as required under the Trust Agreement. The Authority estimates that it will incur costs related to the Economic Incentives Act of approximately \$44 million in the five years ending in fiscal year 2015.

The Economic Incentives Act mandated the introduction of "wheeling" by January 2, 2010 and created a committee in charge of the implementation of a wheeling system. Under a wheeling system, the Authority must make available its transmission and distribution system to third party power generators. Although the Authority did not meet the deadline established in the Economic Incentives Act, it is currently in the process of implementing a wheeling system. Among the issues being considered by the Authority are the tariffs that the Authority would charge to third parties for using the transmission and distribution system and the interconnection procedures. If the Authority and a third party power generator do not agree on the rates within a period of 60 days, the Economic Incentives Act provides that the Executive Director of the Administration for Energy Affairs has the authority to appoint an arbitrator to determine, approve and establish the rates to be paid by the Authority and the third party power generator, as applicable. See *Wheeling* under THE SYSTEM.

On July 10, 2010, the Government enacted Act No. 82, known as the Act for a Public Policy for Energy Diversification Through Sustainable and Alternative Renewable Energy. Act No. 82 requires the Authority to meet prescribed targets of energy generation from renewable sources by specified dates, as follows: 12% of energy sales from renewable energy production by 2015 and 15% of energy sales from renewable energy production by 2020, with a requirement to establish a plan to reach 20% of energy sales from renewable energy production by 2035. Act No. 82 also establishes Renewable Energy Certificates as a legally recognized asset that can be purchased, sold, traded and transferred separately from electric power and used to meet the renewable energy targets and creates a Renewable Energy Commission with the power to implement and supervise compliance with Act No. 82. Failure to comply with the renewable energy targets could result in the imposition of fines. Concurrently with the enactment of Act No. 82, the Government enacted Act No. 83 of July 19, 2010, known as the Green Energy Incentives Act, which provides incentives to promote the development of renewable energy projects. The Authority is taking measures to comply with Act No. 82, such as entering into power purchase agreements with developers of renewable energy projects, but it is too early to determine whether the Authority will be able to comply with the requirements of Act No. 82 and what impact Act No. 82 and Act No. 83 will have on the Authority.

In recent years, the Legislative Assembly has approved legislation providing incentives for the efficient use of electric energy and the adoption of systems that would help consumers to reduce their electric energy bill. For example, the Legislative Assembly approved legislation subsidizing the installation of photovoltaic cells in order to promote the use of solar power for the generation of electricity. Any new legislation that would reduce the Authority's electric energy sales could have a material impact on the Authority's operations and financial condition.

New methods of producing low cost electricity and self-generation by certain industrial or commercial customers are other factors that could affect the Authority. The Authority is currently subject

to “net metering” legislation, which allows residential and small business customers with their own generation to sell power back to the Authority. The Authority cannot determine with certainty what effects these factors will have on its business operations, but the effects are unlikely to be significant in the short-term. The Authority’s management, however, is focused on reducing the cost of power to its customers in order to make it more competitive in a market environment.

From time to time various bills are introduced in the Commonwealth’s Legislative Assembly. Any new legislation that promotes competition in the energy sector in Puerto Rico or affects the Authority’s rate-setting independence could have a material impact on the Authority’s operations and financial condition. The Authority cannot predict at this time whether any additional legislation or rules will be enacted by the Commonwealth that will affect the Authority’s operations or financial condition.

### **Changes in Federal Laws or Regulations**

The electric utility industry in the United States mainland has changed 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) ensure open access to transmission facilities to promote wholesale power supply competition and (ii) phase in retail competition. The requirements of FERC, including those regarding wholesale wheeling, are generally not applicable to the Authority because it is not engaged in transactions in interstate commerce. In addition, there are currently no wholesale clients in the Commonwealth, although the Authority is required to offer a wheeling service. As a result, the Authority has operated as a monopoly in the sale of electricity in Puerto Rico which has allowed it to charge rates determined by reference to their costs of service rather than by competitive forces. The Authority remains subject to the mandatory purchase obligation and other legal requirements in the Public Utility Regulatory Policies Act of 1978 (“PURPA”), which requires the Authority to purchase energy from certain generators at the Authority’s avoided costs. Changes in Federal legislation, market development and other factors, however, could expose the Authority to competition.

### **Climate Change and Possible Future Climate Change Legislation**

This section provides a brief summary of certain governmental actions taken or under consideration regarding the regulation and control of greenhouse gases (“GHGs”).

On April 2, 2007, the U.S. Supreme Court (the “Court”) issued a Clean Air Act (“CAA”) decision in Massachusetts v. Environmental Protection Agency, 549 U.S. 497 (2007) concluding that GHGs meet the CAA definition of an air pollutant and are subject to regulation under the CAA. More specifically, the Court found that the CAA authorizes the U.S. Environmental Protection Agency (the “EPA”) to regulate tailpipe greenhouse gas emissions if the EPA determines they cause or contribute to air pollution that may reasonably be anticipated to endanger public health or welfare. The Court remanded the case to the EPA to make such an “endangerment determination,” which is the statutory prerequisite to authorizing regulations.

In response to the decision, on July 30, 2008, the EPA issued an Advance Notice of Proposed Rulemaking titled “Regulating Greenhouse Gases under the Clean Air Act.” This Advance Notice sought comments regarding GHGs regulation under the CAA. The Advance Notice also suggested that the EPA in the future would consider using an existing provision of the CAA to impose energy efficiency standards on electric generating units to reduce greenhouse gases. The comment period closed in November 28, 2008, with parties filing thousands of comments both in favor of and opposed to using the CAA as a tool to address GHGs. Many parties filed comments that supported comprehensive climate

change regulation such as cap and trade to address GHGs, but opposed the EPA regulation under the existing CAA due to the unavoidable adverse consequences of using the CAA to regulate GHGs. On April 17, 2009, the EPA, in response to the Massachusetts decision, issued proposed “endangerment” and “cause or contribute” findings for greenhouse gases under Section 202(a) of the Clean Air Act. On May 19, 2009, the EPA issued a notice of intent to regulate GHG emissions for cars and trucks under section 202 of the CAA, following up on the Massachusetts decision discussed above.

On September 15, 2009, the EPA and the Department of Transportation’s National Highway Safety Administration proposed a national program that would dramatically reduce greenhouse gas emissions and improve fuel economy for new cars and trucks sold in the United States. On September 30, 2009, the EPA proposed new thresholds for greenhouse gas emissions that define when Clean Air Act permits under the New Source Review and Title V operating permits programs would be required. According to the EPA, the proposed thresholds would tailor these permit programs to limit which facilities would be required to obtain permits and would cover nearly 70% of the nation’s largest stationary source GHG emitters—including power plants, refineries, and cement production facilities, while shielding small businesses and farms from permitting requirements.

In recent months, the EPA has issued a number of rulemakings and announcements to lay a potential framework for GHG regulation under the CAA and future legislation. On October 30, 2009, the EPA issued a final rule requiring mandatory monitoring in 2010 and reporting of GHGs emissions beginning in 2011 for virtually all industrial source categories across the country. This final rule does not require control of greenhouse gases, rather it requires only that sources above certain threshold levels monitor and report emissions. Additionally, the EPA stated that this rulemaking does not indicate that the agency has made any final decisions on pending actions. The EPA stated that the mandatory GHG reporting program will provide the agency, other government agencies, and outside stakeholders with economy-wide data on facility-level (and in some cases corporate-level) GHG emissions, which should assist in future policy development. On December 7, 2009, the EPA issued the final “endangerment” and “cause or contribute” findings regarding greenhouse gases under section 202(a) of the Clean Air Act. The EPA has received several Petitions for Reconsideration of the Endangerment and Cause or Contribute Findings. Although the findings do not themselves impose any requirements on industry or other entities, this action is a prerequisite to finalizing the EPA’s proposed GHGs emission standards for light-duty vehicles, which the EPA proposed in a joint proposal including the Department of Transportation’s proposed standards on September 15, 2009.

At this time, the EPA has not made any further announcements to establish regulatory controls or emission standards regarding GHGs from electric generating units. However, the EPA is expected to phase-in permit requirements and regulation of GHGs for large stationary sources beginning calendar year 2011.

At the same time, the House Energy and Commerce Committee in the spring and summer of 2009 advanced a comprehensive climate change bill that would impose economy-wide cap and trade on virtually all industrial sectors, including electricity generation. The Energy and Commerce Committee approved H.R. 2454 on May 21, 2009, and the full House of Representatives passed H.R. 2454 on June 26, 2009. H.R. 2454 would require existing coal-fired power plants to obtain “allowances” for each ton of GHG emissions, and thus effectively create a “price of carbon.” The number of available allowances would decrease over future years, increasing the price. It is generally understood that newer facilities that are more energy efficient or which are adaptable to a mix of various conventional and alternative fuels as well as carbon capture and sequestration will be at a competitive advantage in a cap and trade framework compared to less efficient facilities. Further, H.R. 2454 would preempt much of—but not all of—the EPA’s authority to regulate GHG emission from coal-fired power plants under the CAA. Despite the approval of H.R. 2454 by the House, any timeline for actual passage by Congress is uncertain.



The Authority is unable to predict whether and when the EPA or the United States Congress ultimately will impose regulations and restrictions on GHGs, and if so, what their content and form or effect would be. At this time, there does not appear to be a consensus as to what the level of future regulation of emissions will be, or the costs associated with that regulation. However, any such costs could be material to the Authority.

### **Other Environmental Regulation**

Electric utilities are subject to continuing environmental regulation, which may change from time to time. Compliance with these regulations may impose additional costs to the Authority, and failure to comply with these regulations could result in penalties or in the shutdown of generating units that are not in compliance. In the past, there have been various instances of non-compliance by the Authority with U.S. federal and Commonwealth environmental laws and regulations, which have resulted in monetary penalties and criminal action against the Authority. The Authority is currently operating under a consent decree with the EPA.

For a more detailed description of the environmental matters affecting the Authority, see ENVIRONMENTAL MATTERS.

### **Limited Nature of Ratings; Reductions, Suspension or Withdrawal of a Rating**

Any rating assigned to the Bonds by a rating agency will reflect such rating agency's assessment of the likelihood of the payment of interest when due and principal of the Bonds on their respective maturity or mandatory redemption dates. Any rating of the Bonds is not a recommendation to purchase, hold or sell such Bonds and such rating will not address the marketability of such Bonds, their market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a rating agency if, in such rating agency's judgment, circumstances so warrant based on factors prevailing at the time, including, but not limited to, the evaluation by such rating agency of the financial outlook for the Authority. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market or the market prices for the Bonds. Finally, the Trust Agreement does not include a covenant by the Authority to maintain a specific rating with respect to outstanding Bonds.

## **THE SYSTEM**

The Authority is the supplier of virtually all of the electric power consumed in the Commonwealth. As of June 30, 2010, the Authority served approximately 1.5 million clients, representing a population of 4 million.

### **Generating Facilities**

As of June 30, 2010, investment in Authority-owned production plant in service totaled approximately \$3.9 billion based on original installed cost, the total nameplate rating of the Authority-owned generating facilities of the System was 4,937 MW and their total dependable generating capacity was 4,878 MW. In addition, the Authority purchases power under long-term power purchase agreements from two cogeneration facilities: EcoEléctrica and AES-PR. 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)

Generating Plants	Nameplate Rating (82 Units)	Dependable Generating Capacity					
		Total (82 Units)	Steam (16 Units)	Combined Cycle Power Blocks (13 Units)	Combustion Turbine (25 Units)	Hydro (21 Units)	Other (7 Units)
Aguirre .....	1,554	1,534	900 <sup>(1)</sup>	592 <sup>(2)</sup>	42 <sup>(3)</sup>	-	-
Costa Sur .....	1,030	1,032	990	-	42 <sup>(3)</sup>	-	-
Palo Seco .....	731	728	602	-	126 <sup>(4)</sup>	-	-
San Juan .....	870	840	400	440 <sup>(5)</sup>	-	-	-
Mayagüez .....	220	220	-	-	220 <sup>(6)</sup>	-	-
Arecibo .....	248	248	-	-	248 <sup>(7)</sup>	-	-
Other Locations .....	284	277	-	-	168 <sup>(8)</sup>	100	9 <sup>(9)</sup>
Subtotal .....	4,937	4,878	2,892	1,032	846	100	9
Peñuelas – EcoEléctrica	507	507	-	507 <sup>(10)</sup>	-	-	-
Guayama – AES-PR .....	454	454 <sup>(11)</sup>	454 <sup>(11)</sup>	-	-	-	-
Total .....	5,898	5,839	3,346	1,539	846	100	9

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

<sup>(2)</sup> Consists of two combined-cycle power blocks, each made up of four 50 MW combustion turbine units and one 96 MW steam-turbine unit.

<sup>(3)</sup> Consists of two 21 MW units.

<sup>(4)</sup> Consists of six 21 MW units.

<sup>(5)</sup> Consists of two combined cycle power block, each made up of one 160 MW combustion turbine unit and one 60 MW steam-turbine unit.

<sup>(6)</sup> Consists of eight 27.5 MW dual fuel aero-derivative combustion turbines.

<sup>(7)</sup> Consists of three 83 MW units.

<sup>(8)</sup> Consists of eight 21 MW units.

<sup>(9)</sup> Consists of five diesel units in the Municipality of Culebra and two in the Municipality of Vieques with an aggregate dependable capacity of approximately 9 MW held on standby reserve.

<sup>(10)</sup> Consists of one combined cycle power block, made up of two 165 MW combustion turbine units and a 177 MW steam turbine unit.

<sup>(11)</sup> 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 in March 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.

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.

The AES-PR plant is a co-generation facility located in the Municipality of Guayama. The plant commenced commercial operation in November of 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, including the compensation structure. Above a certain minimum amount, the Authority is only obligated to purchase energy actually produced by the facility. AES-PR is an affiliate of AES Corporation.

The AES-PR and EcoEléctrica projects contribute to the Authority's efforts towards fuel diversification and improved reliability of service. Prior to the commencement of operations of the EcoEléctrica and AES-PR facilities, 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 30% of the Authority's annual energy requirements are being provided by non-oil-fired generating facilities.

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 Trust 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.

Since the early 1990's, a substantial portion of the Authority's capital improvement program was directed at (i) improving its generating units in order to extend their life and increase their availability, thereby improving the System's equivalent availability, and (ii) expanding its generating capacity to improve its quality of service and meet forecasted increases in demand. As a result of the recent decreases in demand, however, the Authority believes that it now has sufficient capacity to meet current and future demand. Consequently, it has refocused its capital improvement program towards maintaining its existing generating units and improving its transmission and distribution network in order to enhance reliability and improve efficiency. The Authority expects this shift in its capital improvement program to result in a marked improvement in its economic dispatch schemes, energy transfer and transmission system losses, reliability, system security margins, voltage stability and system performance during double contingencies.

During the period from fiscal year 2006 to fiscal year 2010, the Authority invested \$1.2 billion (or 47% of its capital improvement program) in its transmission and distribution system. The capital improvement program for the five fiscal years ending June 30, 2015 includes \$851.7 million (or 49% of such program) for transmission and distribution facilities.

### *Transmission Facilities*

As of June 30, 2010, the Authority's transmission plant in service totaled \$1.6 billion based on original installed cost. The capital improvement program for the five fiscal years ending June 30, 2015 includes \$441.9 million, or 25.3% of total capital improvement program, for extensions and improvements to transmission lines. As of September 30, 2010, the Authority had 2,450 circuit miles of transmission lines, consisting of 364 circuit miles of 230 kV lines, 710 circuit miles of 115 kV lines and 1,375 circuit miles of 38 kV lines. The Authority has 25 miles of underground 115 kV cable, 63 miles of underground 38 kV cable and 55 miles of submarine 38 kV cable. The Authority also has 173 transmission and distribution switchyards and 129 transmission substations located at generating sites and at other sites throughout the island with a total transformer capacity of 18,535,250 kilovolt amperes ("kVA"). In addition, the Authority has 20 portable substations with a total capacity of 299,500 kVA and two capacitor banks with a total capacity of 36,000 kVar for substation maintenance without service interruptions.

As part of the Authority's refocused capital improvement program, it is constructing two new 230 kV transmission lines to complement the transmission loops in the center and western parts of Puerto Rico. These two 230 kV transmission lines will connect one of the Authority's principal generation complexes in the south with major switching and load centers in the northern and central parts of the island. The first project consists of a 38-mile long 230 kV transmission line between the South Coast steam plant and the switchyard at the Cambalache gas turbines plant. The first stage of this project consists of the reconstruction and conversion to 230 kV of an existing 115 kV circuit line between the South Coast Steam Plant and Dos Bocas hydroelectric power plant. The second stage of the project consists of the construction of a new 230 kV line from Dos Bocas to the Cambalache facilities. The construction of this project is expected to be completed during fiscal year 2015. 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 is expected to be completed during fiscal year 2015. Once in operation, these major infrastructure projects will significantly enhance the reliability and security margins of the transmission system, and will permit the increase of power transfers from the south coast of Puerto Rico to the northern, central and western regions. During fiscal year 2011, the Authority expects to complete the conversion to 230kV of the existing 115kV circuit line from Costa Sur to the Ponce transmission center. The Authority also expects to finalize the conversion of the fuel oil fired boilers of Costa Sur Units 5 and 6 to units that will be able to use either oil or natural gas by January of 2011.

The Authority has completed an underground 115 kV transmission circuit line around the San Juan metropolitan area in order to reduce power loss incidents in the aftermath of hurricanes and other major storms which strike Puerto Rico from time to time. The program to improve the 38 kV sub-transmission system continues in effect, including the construction of underground 38 kV lines in Carolina, Guaynabo and San Juan. Construction of the underground 38 kV lines in Vega Baja and Mayagüez has been completed. In addition, major reconstruction projects of aerial 38 kV lines in the central and western part of the island will significantly improve the reliability of the sub-transmission system.

During fiscal year 2009, the Authority commenced operations of the Palo Seco Gas Insulated Switchgear ("GIS"), one of the Authority's major gas insulated 115/38 kV switchyards with direct

interconnection to 600 MW of generating capability, and a 90 MVARs Static Var Compensator (SVC) at the 38 kV bus of Bayamón Transmission Center, which improves the System's dynamic reactive power response to major contingencies and outages in the generation or transmission system. The Authority also commenced the operation of a new air insulated 38 kV switchyard in the municipality of Cidra, which improves the reliability and efficiency of the System while increasing its power transfer capability and improving voltage regulation of the sub-transmission system under normal conditions and contingency situations. Finally, the Authority completed the installation of a new 115 kV capacitor bank in the Juncos transmission center, which is intended to improve the voltage regulation in major load centers, increase the transmission system's power factor and reduce its reactive power losses. During fiscal year 2010, the Authority commenced operations of a new air insulated 38 kV switchyard in Aguadilla.

During fiscal year 2011, the Authority expects to commence operations of a new 115 kV capacitor bank in the Canóvanas transmission center in order to continue improving the voltage regulation in major load centers, increase the transmission system's power factor and reduce its reactive power losses. The Authority also expects to complete a new 150 megavolt ampere ("MVA") 115/38 kV transmission center in the municipality of Bayamón (Hato Tejas TC), as well as major expansion projects that add 300 MVA of 115/38 kV transforming capacity in the transmission centers of Canóvanas and Victoria (Aguadilla). The Authority also expects to begin construction of a new 450 MVA 230/115 kV transmission center in Ponce TC, as well as an expansion project to add 150 MVA of 115/38 kV transforming capacity to existing facilities.

In fiscal year 2012, the Authority expects the San Juan GIS, one of the Authority's major gas insulated 115/38 kV switchyards with direct interconnection through the existing air insulated 115 kV bus to approximately more than 850 MW of generating capability, will enter into service.

#### *Distribution Facilities*

Investment in distribution plant in service as of June 30, 2010 totaled \$3.0 billion based on original installed cost. The capital improvement program for the five fiscal years ending June 30, 2015 includes \$409.8 million (or 23.4% 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 June 30, 2010, the electric distribution system included approximately 32,548 circuit miles of primary and secondary distribution lines and 1,128 distribution substations (795 are client-owned) with a total installed transformer capacity of 8,008,200 kVA.

The construction of new distribution substations is expected to improve the capacity and reliability of the Distribution System. Recently, the increase in capacity of Buen Pastor I 13.2 kV substation was energized at Guaynabo. The Juan Martín 13.2 kV (Yabucoa) and Santa Isabel 13.2 kV substations are in the commission process. Recently, the Mora TC 13.2 kV substation was energized at Isabela. The Factor 13.2 kV substation at Arecibo is currently in the commissioning process. Moreover, the new 13.2 kV distribution substation at Río Bayamón II is under construction. This substation is expected to enter into service during fiscal year 2012.

#### *Operations*

The Authority has digitized all the transmission and distribution facilities into a geographic information system. This allows the Authority to create a common database for all its transmission and distribution facilities.

The Authority's data management system integrates a work management system, a geographic information system and an outage management system that is known by its Spanish acronym of AIRE. The AIRE system is structured to maintain its databases as well as interface with existing computerized systems in other Authority divisions such as finance, human resources, and payroll. 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. Some of the AIRE system benefits include improved client service, reduced operations and management expenses, improved emergency response, better planning, improved and consistent engineering/design and estimating practices, archived maintenance records and real-time system status reporting.

The work management system of the AIRE system has been in service in all of the Authority's districts since 2001. During fiscal year 2009, the Authority began implementing a major upgrade to the software system, scheduled to be completed in two years. The upgrade of the work management system will also include the integration of the asset management system and the geographic information system with an expanded scope to include validating the location of client meters to improve the precision of the outage management system. The Authority estimates the client meter validation activity will be completed in fiscal year 2011.

The Authority also expanded its satellite-based vehicle locator system from 107 to 747 vehicles in order to improve the service fleet's efficiency. In addition, the Authority is in the process of upgrading its asset and work management system and implementing an automatic service outage detection system.

The Authority has also implemented energy theft recovery initiatives that resulted in theft-related billings of approximately \$11 million and actual collections of \$1 million during fiscal year 2010. As part of these initiatives, the Authority is in the process of deploying "smart grid" technology by replacing its current automated meter reading system with new "smart meters" that allow the Authority to identify areas where theft is prevalent, include more robust anti-tampering technology and permit service to be remotely shut off. The Authority has also significantly increased its theft detection and prevention program by using comparison of local/temporary meters on the distribution lines versus the aggregate of the served meters, a comparison of a client's present electricity usage versus historical data, and a toll free hotline for anonymous reporting of suspected electricity theft. During fiscal year 2010, the Authority increased its unannounced door-to-door monitoring program by visiting over 45,000 customers, an increase of 60% compared to actual visits performed during fiscal year 2008 and 28% compared to actual visits performed during fiscal year 2009. The Authority expects that these initiatives will result in \$15 million of annual incremental revenues for fiscal year 2011 and \$20 million of annual incremental revenues for fiscal years 2012 through 2015. The actual results from the theft recovery program may differ from the Authority's projections.

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. In addition, 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 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 79% in fiscal year 2010), 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.

The Authority's program to extend the life and increase the availability of its generating units has three components: formal operator training, comprehensive preventative maintenance, and design modification. The formal operator training part emphasizes safety, operating efficiency, and equipment integrity. The comprehensive preventative maintenance part of the program requires the Authority to remove all major generating units from service for maintenance at regularly scheduled intervals to ensure their reliability ("scheduled outages"). The design modification part of the program represents the Authority's commitment to improve the operation of generating units by installing redesigned, improved components, or by undertaking conversions of such generating units, in order to reduce the risk of units being forced out of service or being forced to operate at partial output ("forced or unscheduled outages"). About half of the \$1.2 billion in capital expenditures for the five fiscal years ended June 30, 2010 for production plant was spent for such scheduled maintenance program.

The Authority maintains some generating capacity as a reserve (referred to as a "controlled reserve") for frequency quality, in anticipation of unscheduled outages or other unforeseen events. The Authority controlled reserve criterion is 200 MW, but in order to maintain it, more than 500 MW of spinning reserve was needed. Based on its experience, however, the Authority implemented improvements in the System that allowed it to reduce its spinning reserve requirements while continuing to provide reliable service to clients and reducing its fuel cost.

In December 2006, a fire at the Authority's Palo Seco plant damaged one of the four oil-fired generating units. In a separate incident, a fire also damaged the control room that controls all four generating units. The Authority returned the first of the four Palo Seco units to service in November 2007. As of the end of the first quarter of fiscal year 2010, all Palo Seco generating units and the control room had returned to service.

The table on the following page 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 2006 through 2010.

### Electric Generation Equivalent Availability and Reliability

	<u>2006</u>	<u>2007<sup>(3)</sup></u>	<u>2008<sup>(3)</sup></u>	<u>2009<sup>(3)</sup></u>	<u>2010</u>
Equivalent availability <sup>(1)</sup> .....	87%	84%	80%	76%	78%
Equivalent forced outage rate <sup>(2)</sup> ...	4%	10%	15%	16%	12%

<sup>(1)</sup> Cogenerator data is included.

<sup>(2)</sup> Cogenerator data is not included.

<sup>(3)</sup> Variations over previous years was due primarily to Palo Seco steam plant outage.

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. The additional reserve capacity represented by the two co-generation facilities gives the Authority more flexibility in scheduling maintenance periods on its own generation facilities and favorably affects the System's equivalent availability. Total production plant availability, however, decreased consistently from 87% in fiscal year 2006 to 76% in fiscal year 2009 due primarily to the Palo Seco steam plant outage. For fiscal year 2010, total production plant availability increased to 78%. As the Palo Seco steam plant returned to full generating capacity, the Authority has removed other generating units from service for maintenance that the Authority was not able to perform during the time the Palo Seco steam plant was out of service. The Authority calculates that each percentage point increase of System availability is equivalent to adding approximately 60 MW of available capacity to the System.

#### *Projected Load Growth*

Projections of future load growth are a key component in the Authority's financial and capacity planning. As part of its planning process, the Authority receives information from three sources relating to economic activity: Advantage Business Consulting, Inter-American University, and the Commonwealth Planning Board. The Inter-American University uses a macroeconomic model developed in conjunction with Global Insight, a nationally recognized econometrics forecasting firm. The Commonwealth Planning Board also uses data provided by Government Development Bank. 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 (or the higher of two forecasts when the third is not available) 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 (or the lower of two forecasts when the third is not available) 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*.



### *Substitution of Generating Facilities*

The Authority's recent load growth projections show that the Authority's current capacity is sufficient to meet short- to medium-term load growth demands. As a result, the Authority's capital improvement program in connection with its generating facilities is concentrated on maintaining its generating units and substituting older, oil-fired generation units with more efficient generating units fired by fuels other than oil.

The Authority is currently finalizing the conversion of the Costa Sur oil-fired units to units that can burn both oil and natural gas, and is planning the conversion of the Aguirre Units #1 and #2, the Authority's largest generation units. The Authority also expects to begin the conversion of the San Juan combined cycle and the Mayagüez gas turbine into natural gas fired generation units.

In order to deliver natural gas to its generating units, the Authority plans to build the Via Verde project, a 91 miles long underground pipeline system to transport natural gas to the Costa Sur generating plant, in the South, and the San Juan, Palo Seco and Arecibo (Cambalache) generating plants, in the North. These generating plants represent an aggregate of 2,339 MW of dependable generating capacity that could be fueled with natural gas (in addition to the 507 MW of dependable generating capacity from the EcoEléctrica plant). The Authority's preliminary estimate of the cost of the project is approximately \$450 million and the project is expected to be completed by February 2012. The Authority has already received several of the Puerto Rico permits required for construction and is waiting for a federal permit from the U.S. Army Corps of Engineers to commence construction. The estimated cost of this project is not included in the Authority's projected capital improvement program presented in this Official Statement.

The Authority has also entered into contracts for the acquisition of renewable energy. Pursuant to these power purchase agreements, the Authority has agreed to purchase energy (not capacity) at a fixed price once a particular facility has commenced operations. These agreements, however, are subject to terms and conditions that must be met before the Authority is required to purchase any power produced.

### *The Authority's Capacity Expansion Plan*

The Authority periodically updates its capacity expansion plan as part of its efforts to ensure its ability to meet expected long term electric load growth, to provide reliable, cost-effective electric service to its clients, and to reduce its dependence on fuel oil. The Authority's current plan provides for a net increase of 100 MW in capacity during fiscal year 2013. Based on the Authority's current projections of peak load, the continued level of production plant equivalent availabilities of its generating units and the additional generating capacity to be integrated into its System, the Authority and the Consulting Engineers believe that reliable service will continue to be provided to the Authority's clients through fiscal year 2015.

The table on the following page summarizes the Authority's projected peak load, dependable capacity, reserve margin and dependable reserve margin through fiscal year 2015 under the peak load projections shown below. Projections of future peak load (for capacity planning purposes) from fiscal year 2011 to fiscal year 2015 prepared by the Authority show an average annual increase of less than 1%.

<b>Fiscal Years Ending June 30</b>	<b>Peak Load</b>	<b>Dependable Capacity</b>	<b>Reserve Margin</b>	<b>Dependable Reserve Margin (%)</b>
		(in MW, except percentages)		
2011	3,448	5,839	2,391	69
2012	3,448	5,839	2,391	69
2013	3,486	5,939	2,453	70
2014	3,517	5,939	2,422	69
2015	3,559	5,939	2,380	67

The Consulting Engineers have examined 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, 2010 and the three months ended September 30, 2010 and 2009. The information below includes 507 MW of capacity provided pursuant to the EcoEléctrica contract and 454 MW of capacity provided pursuant to the AES-PR contract.

### Statistical Information

	Years Ended June 30					Three Months Ended September 30	
	2006	2007	2008	2009	2010	2009	2010
Nameplate rating at end of period (in MW).....	5,388	5,388	5,402	5,898	5,898	5,898	5,898
Dependable generating capacity at end of period (in MW) <sup>(1)</sup> .....	5,365	5,365	5,372	5,839	5,839	5,839	5,839
Peak load, 60-minute (in MW).....	3,685	3,604	3,546	3,351	3,404	3,404	3,406
Reserve Margin (%).....	45.6	48.9	51.5	75.1	71.5	71.5	71.4
Average load (in MW).....	2,839	2,863	2,721	2,586	2,692	2,805	2,786
Load factor (%).....	77.0	79.4	76.7	77.2	79.1	82.4	81.8
Energy generated, purchased and sold (in millions of kWh):							
Electric energy generated and purchased <sup>(2)</sup> .....	24,870	25,082	23,838	22,651	23,579	6,194	6,152
Auxiliary equipment use.....	(1,116)	(1,020)	(914)	(888)	(1,020)	(243)	(271)
Net electric energy generated and purchased.....	23,754	24,062	22,924	21,763	22,559	5,951	5,881
Losses and unaccounted for.....	(3,134)	(3,390)	(3,322)	(3,247)	(3,324)	(873)	(912)
Electric Energy Sold.....	<u>20,620</u>	<u>20,672</u>	<u>19,602</u>	<u>18,516</u>	<u>19,235</u>	<u>5,078</u>	<u>4,970</u>
Electric Energy Sales (in millions of kWh):							
Residential.....	7,250	7,244	6,757	6,368	7,057	1,891	1,885
Commercial.....	8,734	8,910	8,744	8,498	8,759	2,288	2,252
Industrial.....	4,242	4,136	3,743	3,289	3,047	802	741
Other.....	394	382	358	361	372	97	92
Total.....	<u>20,620</u>	<u>20,672</u>	<u>19,602</u>	<u>18,516</u>	<u>19,235</u>	<u>5,078</u>	<u>4,970</u>
Electric Energy Revenues (in thousands):							
Residential.....	\$1,284,641	\$1,272,389	\$1,498,576	\$1,374,344	\$1,514,413	\$ 376,890	\$ 397,037
Commercial.....	1,656,770	1,666,358	2,015,375	1,897,022	1,959,953	472,929	500,563
Industrial.....	663,041	630,569	720,912	601,985	563,915	135,794	136,505
Other.....	104,486	101,650	115,652	112,830	116,134	28,595	28,985
Total.....	<u>\$3,708,938</u>	<u>\$3,670,966</u>	<u>\$4,350,515</u>	<u>\$3,986,181</u>	<u>\$4,154,415</u>	<u>\$1,014,208</u>	<u>\$1,063,090</u>
Average revenue per kWh (in cents):							
Residential.....	17.72	17.57	22.18	21.58	21.46	19.94	21.07
Commercial.....	18.97	18.70	23.05	22.32	22.38	20.67	22.23
Industrial.....	15.63	15.24	19.26	18.31	18.51	16.93	18.41
Other.....	26.55	26.60	32.28	31.21	31.19	29.31	31.52
All Classes.....	17.99	17.76	22.19	21.53	21.60	19.97	21.39
Average number of clients:							
Residential.....	1,315,345	1,317,454	1,314,454	1,324,752	1,335,928	1,340,903	1,340,185
Commercial.....	130,082	130,295	130,011	129,492	129,208	128,984	129,577
Industrial.....	1,618	1,576	1,514	898	808	826	789
Other.....	3,182	3,204	3,232	3,494	3,549	3,569	3,539
Total.....	<u>1,450,227</u>	<u>1,452,529</u>	<u>1,449,211</u>	<u>1,458,636</u>	<u>1,469,493</u>	<u>1,465,282</u>	<u>1,474,090</u>
Monthly average revenue per client:							
Residential.....	\$ 81.39	\$ 80.48	\$ 95.01	\$ 86.45	\$ 94.47	\$ 94.35	\$ 98.75
Commercial.....	1,061.36	1,065.76	1,291.80	1,220.81	1,264.08	1,222.19	1,287.68
Industrial.....	34,149.21	33,342.27	39,680.32	55,863.49	58,159.55	54,799.84	57,670.05
Other.....	2,736.38	2,643.83	2,981.95	2,691.04	2,726.92	2,670.68	2,730.06
All classes.....	\$ 213.12	\$ 210.61	\$ 250.17	\$ 227.73	\$ 235.59	\$ 230.74	\$ 240.39

(1) Includes generating capacity of the EcoEléctrica and AES-PR cogeneration facility.

(2) Includes power purchased from EcoEléctrica and AES-PR cogeneration facility.

## 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, 2010 is shown in the following table.

	Fiscal Years Ended June 30 (in thousands)					Total
	2006	2007	2008	2009	2010	
<b>Capital Improvements</b>						
Production plant.....	\$201,254	\$311,038	\$334,309	\$246,578	\$139,369	\$1,232,548
Transmission facilities.....	163,195	132,771	170,244	91,508	112,760	670,478
Distribution facilities .....	120,314	104,826	111,849	105,028	124,963	566,980
Other <sup>(1)</sup> .....	39,632	36,510	50,407	37,100	9,903	173,552
Total .....	<u>\$524,395</u>	<u>\$585,145</u>	<u>\$666,809</u>	<u>\$480,214</u>	<u>\$386,995</u>	<u>\$2,643,558</u>
<b>Financing</b>						
Internally generated funds .....	\$49,604	\$10,212	\$11,400	\$4,695	\$63,405	\$139,316
Borrowed funds <sup>(2)</sup> .....	474,791	574,933	655,409	475,519	323,590	2,504,242
Total .....	<u>\$524,395</u>	<u>\$585,145</u>	<u>\$666,809</u>	<u>\$480,214</u>	<u>\$386,995</u>	<u>\$2,643,558</u>
Allowance for funds used during construction .....	\$12,322	\$22,230	\$21,125	\$18,530	\$2,866	

<sup>(1)</sup> Includes general land and buildings, general equipment, preliminary surveys and investigations.

<sup>(2)</sup> 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 projected capital improvement program for the five fiscal years ending June 30, 2015 (excluding the Via Verde project) totals approximately \$1.75 billion. It is currently estimated that \$167.2 million, or approximately 9.6%, 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 \$638.1 million for production plant. Of this amount, the Authority projects that approximately \$104.4 million will be invested during fiscal year 2011 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 also includes \$441.9 million for transmission facilities and \$410 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 Consulting Engineers have noted that in fiscal year 2009, the Authority's internal funding of capital expenditures was 1% of the amount spent, whereas over the last five years the Authority's average annual contribution to such funding was 5.7%, and have recommended that the Authority increase its internal funding level. For fiscal year 2010, the Authority increased its internal funding of capital expenditures to 16.4%.

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, 2015 and its projected financing.

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

	Fiscal Years Ending June 30					Total
	2011	2012	2013	2014	2015	
<b>Capital Improvements</b>						
Production plant.....	\$109,799	\$ 90,250	\$115,001	\$161,500	\$161,500	\$ 638,050
Transmission.....	67,420	85,697	78,715	105,032	105,032	441,896
Distribution.....	80,348	75,519	89,937	81,998	81,998	409,800
Other <sup>(1)</sup> .....	42,433	48,534	66,347	51,470	51,470	260,254
Total .....	<u>\$300,000</u>	<u>\$300,000</u>	<u>\$350,000</u>	<u>\$400,000</u>	<u>\$400,000</u>	<u>\$1,750,000</u>
<b>Financing Sources*</b>						
Internal Funds.....	\$ 69,116	\$ 37,128	\$ 28,702	\$ 9,057	\$ 15,305	\$ 159,309
Borrowed Funds <sup>(2)</sup> .....	230,884	262,872	321,298	\$390,943	384,695	1,590,691
Total .....	<u>\$300,000</u>	<u>\$300,000</u>	<u>\$350,000</u>	<u>\$400,000</u>	<u>\$400,000</u>	<u>\$1,750,000</u>

\* Preliminary, subject to change

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

(2) Funded primarily with Power Revenue Bonds.

## Rates

Under the Act, 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 Legislative Assembly 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 Legislative Assembly by resolution to review rates of certain public corporations, including the Authority.

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 third party independent power producers such as the EcoEléctrica and AES-PR facilities. 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 table on the following page presents the electric sales revenues derived from basic charges, fuel adjustment charges and purchased power charges for the five fiscal years ended June 30, 2010 and the three months ended September 30, 2010 and 2009.

**Electric Sales Revenues  
(in thousands)**

	Fiscal Year Ended June 30,					Three Months Ended September 30	
	2006	2007	2008	2009	2010 <sup>(1)</sup>	2009 <sup>(1)</sup>	2010 <sup>(1)</sup>
Basic charges .....	\$1,165,961	\$1,183,862	\$1,131,535	\$1,071,967	\$1,120,904	\$ 292,413	\$287,294
Fuel adjustment charges .....	1,868,542	1,778,198	2,473,227	2,161,604	2,255,989	507,928	582,117
Purchased power charges .....	674,435	708,906	745,753	752,610	777,522	213,957	193,679
Total.....	<u>\$3,708,938</u>	<u>\$3,670,966</u>	<u>\$4,350,515</u>	<u>\$3,986,181</u>	<u>\$4,154,415</u>	<u>\$1,014,298</u>	<u>\$1,063,090</u>

(1) Unaudited

The fuel adjustment 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. See *Subsidies and Contributions in Lieu of Taxes* below for a more detailed description of this and other subsidies.

To promote an increase in industrial development, the Authority instituted five new special rates in June 2003 that were available for new customers until July 30, 2008. These special rates offered a discount of approximately 11%. Qualifying industrial clients receive this discount on their total electric bill, while existing industrial clients that expanded their operations prior to July 30, 2008 receive this discount on the demand, energy, and adjustment charges associated with the expansion. Customers billed at these rates receive the benefit of the reduced rate for a five year period. Actual industry savings over this five-year period were \$30.4 million.

During the first half of fiscal year 2010, the Authority approved a reduction in the load factor requirement applicable to Large Industrial Service 115 kV and Large Industrial Service 115 kV – Special rates in order to provide certain industries with additional operation flexibility without affecting overall electric utility charges. According to the approved modifications, the load factor requirement was reduced from 80% to 50%; provided, that if a customer does not achieve a load factor of 50% during a specific month, such customer would be billed for the additional kilowatt-hours required to achieve the 50% load factor requirement. The Authority implemented this reduced load factor requirement in order to take advantage of the excess generation capacity resulting from falling demand as a result of the extended economic recession affecting Puerto Rico.

The Authority, in its commitment to public safety, joined municipalities and communities in their efforts to improve public safety and facilitate the use of new communication technologies. For this reason, on July 2007, the Authority temporarily adopted the Unmetered Service for Small Loads Rate (“USSL”). This rate was approved permanently on January 2008. The USSL was designed to address the requests of various municipalities for the installation of security camera surveillance systems and wireless telecommunication equipment on the Authority’s poles and structures.

Pursuant to the 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 Sinking Fund, the Reserve Maintenance 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, its public corporations and the municipalities (included primarily in the commercial category), accounted for approximately 13.3% of kWh sales and 15.6% of revenues from electric energy sales for fiscal year 2010.

The ten largest industrial clients accounted for 4.0% of kWh sales and 3.2% of revenues from electric energy sales for fiscal year 2010. No single client accounted for more than 1% of electric energy sales or more than 1% of revenues from electric energy sales.

In September 1997, the Authority established a 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 rate is designed to provide large clients with an incentive to buy more electricity from the Authority. As of June 30, 2010, one of the Authority's industrial clients was using such rate.

## Fuel

For the fiscal year ended June 30, 2010, fuel oil expenses amounted to \$2 billion, or 58.5% of total Current Expenses (\$1.9 billion or 56.8% of total Current Expenses for the preceding fiscal year). For the five fiscal years ended June 30, 2010, fuel oil averaged 58.1% of average total Current Expenses for the same period. See *Management's Discussion and Analysis of Operating Results* under NET REVENUES AND COVERAGE.

The thermal generating units owned by the Authority, which produced approximately 68.6% of the net electric energy generated by the System in fiscal year 2010, are fueled by No. 6 fuel oil, except for the twenty-six smaller combustion-turbine units, the two Aguirre combined-cycle units, the 249 MW combustion turbine plant in Arecibo, and the new San Juan combined-cycle units, which burn No. 2 distillate fuel oil.

The Authority's fuel requirements for its generation facilities are covered by one-year contracts, which expire at various times and are usually renewable at the option of the Authority. The Authority's contracted fuel oil prices consist of a market based escalation factor plus a fixed price differential. 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. The Authority regularly explores alternatives to reduce its exposure to the volatility of fuel prices, such as entering into fixed price fuel supply contracts or hedging strategies.

The Authority's customary inventory of fuel oil covers 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 4.7 million barrels. On October 23, 2009, the Authority's inventory of fuel oil decreased by 400,000 barrels due to an explosion at the Caribbean Petroleum Corp. oil storage facility, which stored this inventory on behalf of the Authority. The Authority's operations were not affected as a result of this explosion and it was immediately able to replace the lost inventory. As of June 30, 2010, the Authority had an inventory of 1.85 million barrels of fuel oil.

Average fuel oil costs and related costs of production for the five fiscal years ended June 30, 2010 and the three months ended September 30, 2010 and 2009 are shown in the following table:

### Fuel Costs

	Fiscal Year Ended June 30					Three Months Ended September 30	
	2006	2007	2008	2009	2010	2009	2010
Average fuel oil cost per barrel (net of handling costs) .....	\$56.38	\$57.55	\$84.18	\$76.23	\$76.55	\$67.24	\$79.40
Number of barrels used (in millions) .....	29.55	29.83	27.36	25.18	26.22	6.70	6.48
Fuel oil cost (in millions)	\$1,665.9	\$1,717.0	\$2,303.0	\$1,919.8	\$2,006.9	\$450.6	\$516.7
Net kWh generated (excluding purchased power from 2006 to 2010) (in millions)....	16,933.1	16,974.2	15,626.3	15,099.4	15,652.1	4,006.9	3,874.3
Average net kWh per barrel .....	573.0	569.0	571.1	599.7	597.0	598.0	597.9
Average fuel oil cost per net kWh generated (in cents) .....	9.84	10.12	14.74	12.71	12.82	11.25	13.34

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 30% of its annual energy requirements are now being provided by non-oil-fired generating facilities.

### Subsidies and Contributions in Lieu of Taxes

Under the Act, the Authority is required to set aside 11% of the Authority's gross revenues from electric energy sales to fund certain government subsidy programs (those provided by laws in effect as of June 30, 2003), pay CILT to the municipalities and, if there is any remaining amount, fund the Authority's capital improvement program. In addition, the Authority is required to provide certain other subsidies consisting principally of a residential fuel subsidy, a residential rate subsidy and a subsidy for hotels, as described below.

#### *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. 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. 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. As of the end of fiscal year 2010, there were approximately 293,000 clients, or 22% of the total residential classification, who qualified for this subsidy. For fiscal year 2010, the cost of the subsidy was \$29.6 million. For fiscal years 2011 thru 2015, the annual average cost of the residential subsidy is expected to be \$22.8 million.

Act No. 69 of August 11, 2009 provides residents of public housing units the alternative of receiving electric power at a fixed rate. According to the provisions of Act No. 69, the Authority is required to establish a fixed rate for electric power consumption for residents of public housing and provide a payment plan for all residents with past due amounts. Once the Authority has established its fixed rate, residents of public housing that are current with their payments may opt-out of this fixed rate program if their current rate is lower and the Authority may eliminate all state subsidy programs currently in effect. The Authority is also prohibited from suspending service to these residents unless they fail to comply with their payment plan or the payment of the fixed rate. The Authority estimates that



approximately 14,000 residential units that currently do not have active accounts could take advantage of this fixed rate. The Authority has approved a fixed rate from \$30 to \$50 (depending on the number of rooms) for a maximum consumption of 425 kWh. Under these assumptions, the Authority expects to collect an additional \$3.2 million per year as a result of the incremental active accounts that would take advantage of this new fixed rate.

Hotels receive a subsidy in an amount equal to 11% of their monthly billing, which has averaged approximately \$6.3 million per year for the five fiscal years ended June 30, 2010. In order to receive this subsidy, hotels must maintain the hotel's electric service accounts on a current basis.

The Authority provides the residential fuel and hotel subsidy in the form of a credit against the recipient's electric bills and not as a reimbursement of a portion of their electric bills. As a result, the Authority never receives the amount corresponding to these subsidies

In addition, the Authority has recently been offering certain discounts and incentives in the form of credits to certain industrial clients, as discussed under *Rates* above.

#### *Contributions In Lieu of Taxes*

The CILT is intended to compensate the municipalities for foregone tax revenues. The Act provides that the Authority's obligations under the Trust Agreement have priority over the Authority's obligation to make any CILT. The amount of the CILT payable to the municipalities is the greater of the following amounts: (1) 20% of the Authority's Net Revenues (as defined in the Trust Agreement), after deducting from Net Revenues the cost of certain government subsidy programs; (2) actual electric power consumption by the municipalities; and (3) the prior five year average of the CILT paid to the municipalities. The CILT is payable only from Net Revenues available in each fiscal year. The Authority is required to pay the CILT no later than November 30 following the end of the fiscal year to which the CILT applies. The Act further provides that the Authority may, at its option, deduct any municipality's receivable that is outstanding at the end of any fiscal year from the CILT payable to such municipality. If the Authority does not have sufficient Net Revenues available in any fiscal year to pay the CILT to the municipalities, the difference is carried forward for a maximum of three years, at the end of which the Authority is required to pay the remaining balance, subject to the Authority's compliance with its obligations under the Trust Agreement.

While the Authority has the legal right to collect from the municipalities their electric energy consumption bills, historically the Authority has followed the practice of offsetting such bills against the CILT. At the end of each fiscal year, the Authority determines the amount of Net Revenues for that fiscal year available to cover the CILT. The amount so determined is applied against any CILT payable from prior fiscal years, beginning with any CILT that has then become immediately due and payable due to the three fiscal year limitation. Any remaining amount of Net Revenues is applied against the CILT for the current fiscal year. At the same time, the Authority reduces its municipalities' receivable by an amount equal to the aggregate amount of the CILT being reduced from its payables.

For fiscal year 2010, the total amount of the CILT due to the municipalities, based on the value of power consumed by the municipalities, was \$196.5 million. Of this amount, the CILT paid to the municipalities corresponding to fiscal year 2010 was \$181.4 million, which was applied by reducing the outstanding municipal accounts receivable balances by that amount. The remaining balance of the CILT for fiscal year 2010 (\$15.1 million) is being carried forward for payment over the next three years. During fiscal year 2010, the Authority also paid to the municipalities \$42.3 million of outstanding unpaid CILT that had been carried forward for fiscal years 2007, 2008 and 2009 and \$9 million to amortize the outstanding balance of a note issued to the municipalities as part of the settlement of a lawsuit brought by

the municipalities against the Authority. These payments to the municipalities were all made by offsetting the municipalities' electric energy consumption receivables.

*Rural Electrification and Irrigation Systems*

The Authority provides certain technical and maintenance services for dams that supply PRASA and some irrigation users. The cost of these services is treated by the Authority as a subsidy.

The following table sets forth the amount of CILT that the Authority paid during fiscal year 2010 and expects to pay during the five fiscal years ending on June 30, 2015, and the residential fuel, hotel and rural electrification subsidies that the Authority incurred during fiscal year 2010 and expects to incur during the five fiscal years ending on June 30, 2015. The amounts appearing on this table for municipalities for fiscal years 2011 through 2015 represent the municipalities' expected electric power consumption in such fiscal years.

Description	Fiscal Years Ending June 30 (in thousands)					
	2010	2011	2012	2013	2014	2015
Municipalities (CILT) .....	\$190,352	\$213,300	\$218,400	\$215,600	\$229,900	\$243,800
Hotel Subsidies.....	6,306	7,227	7,451	7,335	7,496	7,822
Subsidies:						
Rural Electrification and Irrigation						
Systems .....	5,377	4,456	4,545	4,636	4,729	4,823
Residential Customers .....	29,624	22,095	22,925	22,616	13,007	23,253
Total .....	<u>\$231,669</u>	<u>\$247,078</u>	<u>\$253,321</u>	<u>\$250,187</u>	<u>\$255,132</u>	<u>\$279,698</u>

**Wheeling**

Act No. 73 provides that the Authority shall identify and implement a system that permits the operation of a wheeling service mechanism by January 2, 2010. Act No. 73 also provides for the creation of a Committee of Wheeling, which Committee is responsible for the implementation of the wheeling system. The Committee of Wheeling engaged Christensen Associates Energy Consulting, LLC, based in Wisconsin, to prepare the Puerto Rico Wheeling System Implementation Plan Study that was delivered to the Authority in December 2009. This study, which included various regulatory proposals regarding the establishment of the system and the applicable tariffs, was reviewed by the Authority and substantial changes were made.

Public Hearings were held on June 1 and 2, 2010 to consider the following documents: Wheeling System Tariffs, Wheeling Transmission Regulation and Wheeling Interconnection Procedure. The public hearing examiner submitted a final report to the Authority's Governing Board on June 30, 2010. In the report, the examiner recommends approval of the Wheeling Transmission Regulation and Wheeling Interconnection Procedure, but rejected approval of the Wheeling System Tariffs based on lack of information to the public. The Tariffs have to be submitted to the public hearings procedure again with enough time for public evaluation. See *Changes in Commonwealth Legislation and Market Developments* under INVESTMENT CONSIDERATIONS.

## DEBT

The following table sets forth the bonds and notes of the Authority outstanding as of November 30, 2010.

	<b>Outstanding as of November 30, 2010</b>	<b>As adjusted for the Issuance of the Bonds</b>
	(in thousands)	
Power Revenue Bonds.....	\$7,425,160	\$7,780,890
Notes.....	221,525	221,525
Total.....	\$7,646,685	\$8,002,415

### Notes

The Authority has a line of credit and three term loans provided by financial institutions. As of November 30, 2010, the Authority has an approved aggregate principal amount of approximately \$200 million under the line of credit, of which approximately \$94.3 million was outstanding, and approximately \$100.8 million aggregate principal amount outstanding under the term loans. The term loans are subordinated in payment priority to the Authority’s Power Revenue Bonds and are payable from the subordinate obligations fund established under the Trust Agreement, which is funded from the annual Revenues of the Authority remaining after all deposits to the Sinking Fund and the Reserve Maintenance Fund required by the Trust Agreement have been made. The line of credit, which is used to finance the purchase of fuel oil and power, is not subordinate to the Authority’s Power Revenue Bonds and is considered a Current Expense payable prior to the payment of the Authority’s Power Revenue Bonds.

### Government Development Bank – Lines of Credit

The Authority has available two lines of credit from Government Development Bank with an aggregate principal amount not to exceed \$175.4 million. The Authority has used one of these lines of credit to finance a portion of its capital improvement program. The other line of credit is a revolving line of credit in the aggregate principal amount of \$150 million to be used to cover certain collateral posting requirements under the Authority’s basis swap, described below. As of the date of this Official Statement, no amounts were outstanding under these lines of credit.

In addition to the two lines of credit described in the preceding paragraph, the Authority also has a line of credit from the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (“AFICA”), an affiliate of Government Development Bank, used to finance a portion of the termination and settlement agreement with Skanska Energy Services LLC related to the construction of the Gasoducto del Sur (natural gas pipeline) project in the aggregate principal amount of \$35 million, of which \$26.4 million was outstanding as of November 30, 2010. The credit agreement provides that prior to the maturity date of the line of credit in August 2011, AFICA intends to sell to PRASA certain assets related to the pipeline, in which case PRASA would assume the Authority’s obligations under the line of credit.

### Swap Agreements

As of July 1, 2008, the Authority entered into a basis swap agreement in the notional amount of \$1.375 billion (the “Basis Swap Agreement”) with an amortization schedule matching certain maturities of the Authority’s outstanding power revenue and power revenue refunding bonds from 2027 to 2037. Under the terms of a master swap agreement, the Authority receives from Goldman Sachs Bank USA (as successor to Goldman Sachs Capital Markets, an affiliate of Goldman, Sachs & Co.) quarterly payments,

commencing on October 1, 2008, equal to a floating amount applied to said notional amount at a rate equal to 62% of the 3-month London Inter-Bank Offering Rate (“LIBOR”) index reset each week plus 29 basis points (hundredths of a percent) and a fixed rate payment of 0.4669% per annum (the “basis annuity”), quarterly for the term of the swap in return for quarterly payments by the Authority on such notional amount at a rate based on the Securities Industry and Financial Markets Association (“SIFMA”) municipal swap index. The terms of the master swap agreement also require the Authority to post collateral (in cash or securities) in the event the fair value of the swap is negative and exceeds a threshold amount of \$50 million. Recently, Goldman Sachs Capital Markets transferred the Basis Swap Agreement to its affiliate, Goldman Sachs Bank U.S.A.

This basis swap provides the Authority the cash flow benefit of the basis annuity in exchange for the Authority taking tax and other basis risks tied to the change in the relationship between LIBOR and the SIFMA municipal swap index. Pursuant to the Trust Agreement, regularly scheduled payments to the counterparty by the Authority and payments relating to the termination or other fees, expenses, indemnification or other obligations to the counterparty under the Basis Swap Agreement are subordinate to the Power Revenue Bonds, including the Bonds.

During fiscal years 2009 and 2010, the Authority received \$7.9 million and \$9.5 million, respectively, from the counterparty to the basis swap, net of the Authority’s payments to the counterparty. For the first five months of fiscal year 2011, the Authority has accrued a net receivable of \$4.0 million from the counterparty. Since inception, the Authority has had a maximum collateral posting requirement of \$84.2 million in November 2008. As of November 30, 2010, the basis swap had a negative fair value to the Authority of \$37.9 million, which is below the collateral posting requirement threshold of \$50 million. As of the date of this Official Statement, the fair value of the basis swap was below the collateral posting threshold and the Authority had no collateral posted.

In connection with the issuance of its Power Revenue Refunding Bonds, LIBOR Bonds Series UU (the “LIBOR Bonds”) and Power Revenue Refunding Bonds, Muni-BMS Bonds Series UU (the “Muni-BMS Bonds”), the Authority entered into certain interest rate swap agreements (the “Interest Rate Swap Agreements”). The Interest Rate Swap Agreements have a current aggregate notional amount of \$411.8 million, matching the principal amount of the associated Power Revenue Refunding Bonds, Series UU. Under the terms of the master swap agreement, the Authority receives from JPMorgan Chase Bank, N.A. and UBS AG (an affiliate of UBS Securities, Inc.) quarterly payments equal to a floating amount based on a rate equal to 67% of LIBOR reset each every third month plus a fixed basis point spread (hundredths of a percent), for the term of the swap in return for quarterly payments by the Authority equal to a fixed amount based on a fixed rate, in each case based on a notional amount equal to the principal amount of LIBOR Bonds outstanding. The Authority also receives from JPMorgan Chase Bank, N.A. quarterly payments equal to a floating amount based on a rate equal to 100% of SIFMA municipal swap index for the term of swap in return for quarterly payments by the Authority equal to a fixed amount based on a fixed rate, in each case based on a notional amount equal to the principal amount of Muni-BMS Bonds outstanding. As of November 30, 2010, the Interest Rate Swap Agreements had a negative fair value of approximately \$62.0 million.

For the fiscal year ended June 30, 2010, the Authority adopted Governmental Accounting Standards Board Statement No. 53 – Accounting and Financial Reporting for Derivative Instruments, which requires that the fair value of derivatives be reported in a government entity’s financial statements. In order to comply, a journal entry for the amount of \$109.9 million was booked to register a Swap Liability and a Deferred Outflow, resulting from a change in the fair market value of the derivative instruments.

## Principal and Interest Requirements

Principal and Interest Requirements, as used herein and as defined in the Trust 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 Bonds. The figures for interest and total debt service have been reduced by the interest that was capitalized through the issuance of the Series XX Bonds, the Series ZZ Bonds, the Series CCC Bonds and the Series DDD Bonds in the following amounts: approximately \$79.6 million due during fiscal year 2011, \$77.7 million due during fiscal year 2012, and \$35.7 million due during fiscal year 2013. The Amortization Requirements are subject to adjustment as provided in the definition thereof. See Appendix I—*Summary of Certain Provisions of the Trust Agreement*.

### Debt Service Requirements

Year Ending Jun 30	The Bonds					
	Outstanding Bonds Debt Service	Principal	Interest <sup>(1)</sup>	Build America Bonds Subsidy	Total Debt Service <sup>(2)</sup>	Total Outstanding Bond Debt Service <sup>(3)</sup>
2011	\$473,130,014	-	\$ 10,927,957	\$ (3,824,785)	\$ 7,103,172	\$ 480,233,186
2012	471,293,212	-	21,615,740	(7,565,509)	14,050,231	485,343,443
2013	513,295,623	-	21,615,740	(7,565,509)	14,050,231	527,345,854
2014	548,953,789	-	21,615,740	(7,565,509)	14,050,231	563,004,020
2015	548,953,968	-	21,615,740	(7,565,509)	14,050,231	563,004,199
2016	548,952,356	-	21,615,740	(7,565,509)	14,050,231	563,002,587
2017	548,953,079	-	21,615,740	(7,565,509)	14,050,231	563,003,310
2018	548,952,555	-	21,615,740	(7,565,509)	14,050,231	563,002,786
2019	549,312,882	-	21,615,740	(7,565,509)	14,050,231	563,363,113
2020	549,316,267	-	21,615,740	(7,565,509)	14,050,231	563,366,498
2021	549,316,264	-	21,615,740	(7,565,509)	14,050,231	563,366,495
2022	549,314,457	-	21,615,740	(7,565,509)	14,050,231	563,364,688
2023	549,316,970	-	21,615,740	(7,565,509)	14,050,231	563,367,202
2024	549,313,988	-	21,615,740	(7,565,509)	14,050,231	563,364,219
2025	549,292,818	-	21,615,740	(7,565,509)	14,050,231	563,343,049
2026	549,317,479	-	21,615,740	(7,565,509)	14,050,231	563,367,710
2027	549,316,696	-	21,615,740	(7,565,509)	14,050,231	563,366,927
2028	536,913,284	-	21,615,740	(7,565,509)	14,050,231	550,963,515
2029	327,578,989	-	21,615,740	(7,565,509)	14,050,231	341,629,220
2030	327,523,575	\$ 60,905,000	21,615,740	(7,565,509)	74,955,231	402,478,806
2031	285,204,031	108,665,000	17,991,893	(6,297,162)	120,359,730	405,563,762
2032	265,304,630	108,670,000	11,417,660	(3,996,181)	116,091,479	381,396,109
2033	265,305,130	-	4,843,125	(1,695,094)	3,148,031	268,453,161
2034	226,149,180	-	4,843,125	(1,695,094)	3,148,031	229,297,211
2035	225,916,292	-	4,843,125	(1,695,094)	3,148,031	229,064,323
2036	226,210,492	-	4,843,125	(1,695,094)	3,148,031	229,358,523
2037	299,261,655	19,370,000	4,843,125	(1,695,094)	22,518,031	321,779,686
2038	300,828,803	19,370,000	3,632,500	(1,271,375)	21,731,125	322,559,928
2039	275,892,089	19,375,000	2,421,875	(847,656)	20,949,219	296,841,308
2040	274,978,728	19,375,000	1,210,938	(423,828)	20,162,109	295,140,838
Total	\$12,983,369,295	\$355,730,000	\$482,517,507	\$(168,881,128)	\$669,366,380	\$13,652,735,675

- (1) Total amount of interest payable by the Authority This amount has not been reduced by the amount of the Federal Build America Bonds subsidy, equal to 35% of the interest payable on the Bonds.
- (2) This amount has been reduced by the amount of the Federal Build America Bonds subsidy.
- (3) After giving effect to the issuance of the Bonds. This amount has been reduced by the amount of the Federal Build America Bonds subsidy.

## NET REVENUES AND COVERAGE

The following table presents the Net Revenues of the Authority under the provisions of the Trust Agreement for the five fiscal years ended June 30, 2010 and the ratio of such Net Revenues to Principal and Interest Requirements on the Power Revenue Bonds. The Authority calculates Revenues, Current Expenses and Net Revenues on the accrual basis. These calculations of Net Revenues differ in several important respects from the Authority's calculations of changes in net assets prepared in conformity with GAAP. For example, the calculations of Net Revenues do not include depreciation, interest expense on the Power Revenue Bonds, other post-employment benefits actuarial accruals, and CILT as a deduction in calculating Net Revenues. The figures for Revenues and Net Revenues in this table include the revenues attributable to the residential fuel and hotel subsidies (see footnotes 2 and 3), which the Authority does not collect because it is required by law to provide a credit for such amounts in its recipients' billing, and the electric consumption charges of the municipalities, which the Authority does not collect because it is applied as an offset against the CILT (see footnote 3).

### Historical Net Revenues and Coverage

	Fiscal Year Ended June 30				
	2006	2007	2008	2009	2010 <sup>(1)</sup>
Average number of clients.....	1,450,227	1,452,529	1,449,211	1,458,636	1,469,493
Electric energy sales (in millions of kWh) .....	20,620	20,672	19,602	18,516	19,235
<b>Source of Net Revenues</b>					
<b>(dollars in thousands)</b>					
Revenues:					
Sales of electric energy:					
Residential <sup>(2)</sup> .....	\$1,284,641	\$1,272,389	\$1,498,576	\$1,374,344	\$1,514,413
Commercial <sup>(3)</sup> .....	1,656,770	1,666,358	2,015,375	1,897,022	1,959,953
Industrial .....	663,041	630,569	720,912	601,985	563,915
Other.....	104,486	101,650	115,652	112,830	116,134
Sub-Total.....	<u>\$3,708,938</u>	<u>\$3,670,966</u>	<u>\$4,350,515</u>	<u>\$3,986,181</u>	<u>\$4,154,415</u>
Revenues from Commonwealth for rural electrification.....	116	76	26	19	-
Other operating revenues .....	11,373	11,068	22,210	14,641	15,915
Other (principally interest earned).....	11,498	5,275	(3,253)	6,427	(4,597)
Total Revenues.....	<u>\$3,731,925</u>	<u>\$3,687,385</u>	<u>\$4,369,498</u>	<u>\$4,007,268</u>	<u>\$4,165,733</u>
Current Expenses:					
Operations:					
Fuel .....	1,665,866	1,716,965	2,303,036	1,919,789	2,006,931
Purchased power.....	603,169	624,653	661,097	671,849	693,724
Fuel Extra Expense Claimed <sup>(4)</sup> .....	-	(114,261)	(96,273)	-	-
Other production.....	57,918	56,170	57,507	62,271	62,697
Transmission and Distribution .....	162,956	157,569	171,585	162,334	160,796
Customer accounting and Collection .....	106,927	109,361	118,196	111,126	114,542
Administrative and General .....	198,509	212,530	220,553	222,477	178,982
Maintenance <sup>(5)</sup> .....	236,633	250,563	248,406	225,107	209,516
Other .....	1,946	1,433	3,963	2,819	1,907
Total Current Expenses	<u>\$3,033,924</u>	<u>\$3,014,983</u>	<u>\$3,688,070</u>	<u>\$3,377,772</u>	<u>\$3,429,095</u>
Net Revenues <sup>(3)</sup> .....	<u>\$ 698,001</u>	<u>\$ 672,402</u>	<u>\$ 681,428</u>	<u>\$ 629,496</u>	<u>\$ 736,638</u>
<b>Coverage</b>					
Principal and Interest Requirements.....	\$449,318	\$455,022	\$419,569	\$435,042	\$397,579
Ratio of Net Revenues to Principal and Interest Requirements.....	1.55	1.48	1.62	1.45	1.85

(1) Unaudited

(2) Includes residential fuel subsidies of \$20 million, \$27 million, \$24.3 million, \$30.6 million and \$29.6 million for fiscal years 2006, 2007, 2008, 2009, and 2010, respectively. See *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM.

(3) Includes electric energy consumption by municipalities of \$154.9 million, \$159.8 million, \$187.3 million, \$187.6 million and \$196.5 million for fiscal years 2006, 2007, 2008, 2009, and 2010, respectively. Also includes hotel subsidies of \$5.7 million, \$5.6 million, \$6.7 million, \$6.5 million and \$6.3 million for fiscal years 2006, 2007, 2008, 2009, and 2010, respectively. See *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM.

(4) Represents amounts claimed by the Authority under its insurance policies in connection with the Palo Seco steam plant fire.

(5) Includes, for maintenance of generating facilities, \$133.6 million, \$134.5 million, \$128.6 million, \$117.3 million and \$104.1 million for fiscal years 2006, 2007, 2008, 2009, and 2010, respectively.

## Management's Discussion and Analysis of Operating Results

The following represents the Authority's analysis of its operations for the five fiscal years ended June 30, 2010 and the three months ended September 30, 2010 and 2009. 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.

### *Three months ended September 30, 2010 compared to three months ended September 30, 2009*

Revenues for the three months ended September 30, 2010 were \$1.067 billion, an increase of \$48.8 million or 4.8% from the same period of the prior year, as a result of an increase in the price of fuel. Current Expenses, which include fuel and purchased power, maintenance, administrative and general expenses, among others, were \$894 million for the period, an increase of \$54.3 million or 6.5% from the same period in the prior year. As a result, Net Revenues for this period were \$173 million, a decrease of \$6.8 million, or 3.8%, from the same period in the prior year. This decrease was primarily the result of a 2.1% decrease in electric energy sales (in kWh), primarily in the industrial and commercial sector. The decrease in energy sales was attributable to significantly above average rainfall during the hurricane season, which resulted in lower average temperatures and lower energy use. The decrease in Net Revenues was also attributable in part to an increase in maintenance expenses of \$9.4 million or 16.7%, and an increase in transmission and distribution expenses of \$7.7 million or 18.8%, attributable to these same poor weather conditions. These higher expenses were partially offset by a decrease in administrative and general expenses of \$11.4 million or 20.6%.

### *Fiscal Year 2010 compared to fiscal year 2009*

For the fiscal year ended June 30, 2010, as compared to the fiscal year ended June 30, 2009, Net Revenues increased by \$107.1 million, or 17.0%. This increase was mainly due to an increase of 3.9% in electric energy sales (kWh), which resulted in an increase of \$158.5 million, or 4.0%, in Revenues. Although Current Expenses increased by \$51.3 million, or 1.5%, administrative and general expenses decreased by \$43.5 million, or 19.6%. Accounts receivable increased from \$1.019 billion as of June 30, 2009 to \$1.12 billion as of June 30, 2010. Of this total, \$373.1 million were due from the Commonwealth central government and the public corporations, a decrease from \$471.4 million as of June 30, 2009.

### *Fiscal year 2009 compared to fiscal year 2008*

For the fiscal year ended June 30, 2009, as compared to the fiscal year ended June 30, 2008, Net Revenues decreased by \$52 million, or 7.6%. This decrease was mainly due to a reduction of 5.5% in electric energy sales (kWh). Revenues decreased by \$362 million, or 8.3%, as a result of the reduction in energy sales and a reduction in the price of fuel from \$84.18 per barrel in 2008 to \$76.23 per barrel in 2009. Current Expenses decreased by \$310 million, or 8.4%. Fuel and purchased power expenses, the largest component of Current Expenses, were down by \$372 million or 12.6%, partly because of the reduction in the price of fuel, but also because in 2008 the Authority incurred additional fuel expense resulting from the Palo Seco fire that occurred in December 2006. A portion of this extra cost (\$96 million in 2008) is being claimed by the Authority from its insurers and is shown as a separate line item. Maintenance expenses also declined by \$23 million or 9.4% when compared with 2008. Accounts receivable as of June 30, 2009, decreased by 3.1%, to \$1.019 billion, when compared by 2008. Of this total, \$471.3 million were due from the Commonwealth central government and the public corporations, an increase of 31.9% from the previous year.

*Fiscal year 2008 compared to fiscal year 2007*

For the fiscal year ended June 30, 2008, as compared to the fiscal year ended June 30, 2007, Net Revenues increased by \$9 million, or 1.3%, despite a 5.2% decrease in electric energy sales (kWh). The increase in Net Revenues was primarily due to a 46.3% increase in the price of fuel, which resulted in an increase of \$623 million, or 26.6%, in fuel and purchased power expense, an increase of \$673 million, or 22.3%, in Current Expenses, and an increase of \$682 million, or 18.5%, in Revenues. Administrative and general expenses, another component of Current Expenses, increased by \$8 million, or 3.8%. The Authority incurred additional fuel expense in both 2007 and 2008 as a result of the Palo Seco fire that occurred in December 2006. A portion of this extra cost (\$114 million in 2007 and \$96 million in 2008) is being claimed by the Authority from its insurers and is shown as a separate line item. Accounts receivable of the Authority increased from \$835.9 million on June 30, 2007 to \$1.061 billion on June 30, 2008. Accounts receivable due from the Commonwealth central government and the public corporations increased from \$316.6 million on June 30, 2007 to \$357.3 million on June 30, 2008.

*Fiscal year 2007 compared with fiscal year 2006*

For the fiscal year ended June 30, 2007, as compared to the fiscal year ended June 30, 2006, Net Revenues decreased by \$26 million, or 3.7%. Although electric energy sales (kWh) increased slightly by 0.3%, Revenues decreased by \$45 million, or 1.2%, while fuel and purchased power expenses increased by \$73 million, or 3.2%, mainly due to extraordinary fuel expenses incurred in connection with alternate generation capacity required as a result of the Palo Seco Steam Plant fire. The Authority assumed this cost instead of recovering it from clients through the fuel and purchased power adjustment clauses. (A portion of this extra cost (\$114 million in 2007) is being claimed by the Authority from its insurers and is shown as a separate line item.) In addition, maintenance expenses increased by \$14 million, or 5.9% and administrative and general expenses increased by another \$14 million, or 7.1%, resulting (after taking into consideration the insurance claim) in an overall reduction in Current Expenses of \$19 million, or 0.6%. Accounts receivable of the Authority increased slightly from \$796.1 million on June 30, 2006 to \$835.9 million on June 30, 2007. Accounts receivable due from the Commonwealth central government and the public corporations increased from \$265.9 million on June 30, 2006 to \$316.6 million on June 30, 2007.

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

Disposition of Net Revenues	Fiscal Year Ended June 30				
	2006	2007	2008	2009	2010
Sinking Fund:					
Interest .....	\$257,464	\$257,457	\$255,593	\$261,486	246,072
Principal .....	191,854	197,565	164,492	173,040	151,507
Reserve Account .....	-	-	-	(29,523)	-
Reserve Maintenance Fund .....	-	-	-	-	-
Self-insurance Fund .....	-	-	(20,438)	10,000	10,000
Capital Improvement Fund .....	49,604	10,212	11,400	4,695	63,405
Interest on Notes .....	11,427	38,922	44,291	28,434	33,985
Contributions in lieu of taxes and other uses <sup>(1)</sup> .....	187,652	168,246	226,090	181,364	231,669
Net Revenues .....	<u>\$698,001</u>	<u>\$672,402</u>	<u>\$681,428</u>	<u>\$629,496</u>	<u>\$736,638</u>

(1) Includes the following amounts attributable to the residential fuel subsidy and the subsidy granted to the hotel industry: \$25.6 million, \$32.6 million, \$31 million, \$37.1 million and \$35.9 million for fiscal years ended June 30, 2006, 2007, 2008, 2009 and 2010, respectively. See *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM.



## 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 that sales will decline by 0.2% and 0.1% for fiscal years 2011 and 2012, respectively, and increase by 0.4%, 0.6% and 0.9% for fiscal years 2013, 2014 and 2015, respectively.
- Fuel - Projected fuel oil prices are based upon an analysis prepared by the Authority, which takes into consideration the Annual Energy Outlook issued by the United States Department of Energy and the Authority's historical fuel data. The Authority passes through the cost of fuel oil to its consumers. The following table sets forth projected average per barrel fuel prices:

### Projected Fuel Oil Prices

Fiscal Year Ending June 30	Average Price Per Barrel <sup>(1)</sup>
2011	88.20
2012	90.34
2013	89.18
2014	95.09
2015	100.03

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

The following table presents the Authority's estimates of Net Revenues for the five fiscal years ending June 30, 2015, in accordance with the provisions of the Trust Agreement, and the ratio of Net Revenues to Principal and Interest Requirements for Power Revenue Bonds. The figures for Revenues and Net Revenues in this table include the revenues attributable to the residential fuel and hotel subsidies (see footnotes 2 and 3), which the Authority does not collect because it is required by law to provide a credit for such amounts in its recipients' billing, and the electric consumption charges of the municipalities, which the Authority does not collect because it is applied as an offset against the CILT (see footnote 2). See *Authority's Financial Condition - Subsidies and Contributions in Lieu of Taxes* under INVESTMENT CONSIDERATIONS and *Subsidies and Contributions in Lieu of Taxes* under THE SYSTEM. The figures for Principal and Interest Requirements in this table for fiscal years 2011, 2012 and 2013 are reduced by the interest that was capitalized through the issuance of the Authority's Series XX Bonds, Series ZZ Bonds, Series CCC Bonds and Series DDD Bonds and the interest that is expected to be capitalized due to the issuance of the Bonds in the following preliminary amounts: approximately \$79.6 million due during fiscal year 2011, \$77.7 million due during fiscal year 2012, and \$35.7 million due during fiscal year 2013.

The estimates set forth in the following table do not take into consideration the full cost of financing the Vía Verde project, the impact of such project on Net Revenues (which are expected to increase as lower fuel costs stimulate demand for electricity), the impact of such project resulting in reductions in the Authority's existing capital improvement program, or the resulting impact on the ratio of Net Revenues to Principal and Interest Requirements. To the extent that the costs of financing the Vía Verde project that are not reflected in these estimates are not offset by higher Net Revenues, the actual coverage ratio would be lower than that set forth below.

## Projected Net Revenues and Coverage

	Fiscal Year Ending June 30				
	2011	2012	2013	2014	2015
Average number of clients .....	1,480,465.0	1,491,217.0	1,501,958.0	1,512,711.0	1,523,573.0
Electric energy sales (in millions of kWh) .....	19,205.4	19,189.5	19,263.8	19,379.6	19,560.4
Authority generation (gross)(in millions of kWh) .....	16,693.6	16,653.1	16,765.4	16,907.8	17,121.0
Purchased generation (gross)(in millions of kWh) .....	6,913.0	6,934.0	6,913.0	6,913.0	6,913.0
<b>Sources of Net Revenues</b>					
Revenues:					
Sales of electric energy:					
Residential <sup>(1)</sup> .....	1,613,290	1,670,343	1,656,026	1,700,316	1,779,238
Commercial <sup>(2)</sup> .....	2,169,576	2,236,988	2,202,121	2,250,452	2,348,286
Industrial .....	581,550	594,240	579,295	587,533	609,049
Other .....	124,562	128,107	126,064	127,498	130,619
Theft Recovery <sup>(3)</sup> .....	15,000	20,000	20,000	20,000	20,000
Sub-Total .....	4,503,978	4,649,678	4,583,506	4,685,799	4,887,192
Revenues from Commonwealth for					
Rural Electrification .....	-	-	-	-	-
Other Operating Revenues .....	-	-	-	-	-
Other (principally interests earned) .....	18,135	18,135	18,135	18,135	18,135
Total Revenues .....	<u>4,522,113</u>	<u>4,667,813</u>	<u>4,601,641</u>	<u>4,703,934</u>	<u>4,905,327</u>
Current Expenses <sup>(4)</sup> :					
Operations:					
Fuel .....	2,239,021	2,360,260	2,283,124	2,470,589	2,622,577
Purchased Power .....	736,171	753,266	768,292	665,655	683,413
Production .....	59,667	60,374	60,515	60,659	60,987
Transmission and Distribution .....	144,207	145,916	146,257	146,605	147,398
Maintenance .....	223,545	226,194	226,722	227,262	228,491
Client accounting and collection .....	113,931	115,281	115,550	115,826	116,452
Administration and general .....	165,282	167,240	167,631	168,031	168,939
Interest Charges .....	4,098	4,180	4,265	4,349	4,525
Total Current Expenses .....	<u>3,685,922</u>	<u>3,832,711</u>	<u>3,772,356</u>	<u>3,858,976</u>	<u>4,032,782</u>
Net Revenues <sup>(1) (2)</sup> .....	<u>\$836,191</u>	<u>\$835,102</u>	<u>\$829,285</u>	<u>\$844,958</u>	<u>\$872,545</u>
<b>Coverage</b>					
Principal and Interest Requirements <sup>(5)</sup> .....	\$473,131	\$471,985	\$514,067	\$558,027	\$568,464
Ratio of Net Revenues to Principal and Interest					
Requirements .....	1.77	1.77	1.61	1.51	1.53

(1) Includes residential fuel subsidies of \$22.1 million, \$22.9 million, \$22.6 million, \$23.0 million and \$23.3 million for fiscal years 2011, 2012, 2013, 2014 and 2015, respectively. See Subsidies and Contributions in Lieu of Taxes under THE SYSTEM.

(2) Includes electric energy consumption by municipalities of \$213.3 million, \$218.4 million, \$215.6 million, \$229.9 million and \$243.8 million for fiscal years 2011, 2012, 2013, 2014 and 2015, respectively. Also includes hotel subsidies of \$7.2 million, \$7.5 million, \$7.3 million, \$7.5 million and \$7.8 million for fiscal years 2011, 2012, 2013, 2014 and 2015, respectively. See Subsidies and Contributions in Lieu of Taxes under THE SYSTEM.

(3) Projections based on the Authority's theft recovery initiatives. See Transmission and Distribution Facilities – Operations under THE SYSTEM.

(4) The Current Expenses (excluding fuel oil and purchased power) and payroll projections assume an annual growth of 2%. The projection for payroll assumes that employee headcount will be reduced by approximately 1,000 from 2011 to 2014 through attrition and a voluntary retirement program. The projection also takes into account salary increases due to collective bargaining agreement negotiations.

(5) Includes debt service requirements for (i) the outstanding Power Revenue Bonds, (ii) the Bonds, and (iii) Power Revenue Bonds expected to be issued in each of fiscal years 2011-2015 to fund the Authority's capital improvement program (which does not include the Via Verde project) at an assumed interest rate of 6% with interest capitalized for approximately three years. The figures for Principal and Interest Requirements in this table for fiscal years 2011, 2012 and 2013 are reduced by the interest that was capitalized through the Authority's issuance in 2010 of its Series XX Bonds, its Series ZZ Bonds, the Series CCC Bonds and the Series DDD Bonds in the following amounts: approximately \$79.6 million due during fiscal year 2011, \$77.7 million due during fiscal year 2012, and \$35.7 million due during fiscal year 2013. See *Projected Five-Year Capital Improvement and Financing Program* under THE SYSTEM. Actual Principal and Interest Requirements will vary based on the actual principal and interest on the future Power Revenue Bonds and Power Revenue Refunding Bonds issued and no assurance can be given that the assumed reductions in Principal and Interest Requirements or any other level of reductions will actually be achieved.

The Authority's estimates of Net Revenues, which were made as part of the adoption of its budget of Current Expenses for fiscal year 2010, 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 Trust Agreement, which differs in several important respects from the Authority's net income prepared in conformity with GAAP in that they do not include, for example, depreciation, other post-employment benefits actuarial accrual and the CILT 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, 2015, in accordance with the provisions of the Trust Agreement.

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

	Fiscal Year Ended June 30				
	2011	2012	2013	2014	2015
<b>Disposition of Net Revenues</b>					
Principal and Interest Requirements.....	\$473,131	\$471,985	\$514,067	\$558,027	\$568,464
Interest on Notes .....	12,662	12,505	12,158	11,850	11,795
Reserve Maintenance Fund .....	5,000	5,000	-	-	-
Self-insurance Fund.....	10,000	10,000	-	-	-
Capital Improvement Fund.....	69,116	37,128	28,702	9,057	15,305
Total.....	<u>\$569,909</u>	<u>\$536,618</u>	<u>\$554,927</u>	<u>\$578,934</u>	<u>\$595,564</u>
Contributions in lieu of taxes and other uses	<u>266,282</u>	<u>298,484</u>	<u>274,358</u>	<u>266,024</u>	<u>276,981</u>
Net Revenues.....	<u><u>\$836,191</u></u>	<u><u>\$835,102</u></u>	<u><u>\$829,285</u></u>	<u><u>\$844,958</u></u>	<u><u>\$872,545</u></u>

\* Preliminary, subject to change.

## ENVIRONMENTAL MATTERS

The Authority's Environmental Protection and Quality Assurance 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 (the "EPA") and any other environmental agencies.

### **Environmental Litigation and Administrative Proceedings**

#### *Consent Decree*

In 1992, the EPA conducted a multimedia inspection of the Authority's facilities and identified several alleged instances of non-compliance related to the Authority's air, water and oil spill prevention control and countermeasures compliance programs. As a result of negotiations between the Authority and the EPA relating to these findings, the Authority and the EPA reached an agreement that resulted in a consent decree (the "Consent Decree") approved by the United States federal court in 1999. Under the terms and conditions of the Consent Decree, the Authority paid a civil penalty of \$1.5 million, and implemented additional compliance projects amounting to \$4.5 million. 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 2004, the United States federal court approved a modification to the Consent Decree agreed by the Authority and the EPA under which the Authority reduced, in two steps, the sulfur content in the No. 6 fuel oil used in certain generating units of its Costa Sur and Aguirre power plants (to 0.75% or less by March 1, 2005 and to 0.5% or less by March 1, 2007), and used No. 6 fuel oil with sulfur content of not more than 0.5% through July 18, 2009 at its Palo Seco and San Juan power plants. Additionally, the Authority has completed a nitrogen oxide emissions reduction program and modified the optimal operating ranges for all its units under the Consent Decree. The Authority also paid a \$300,000 civil fine and reserved \$200,000 to fund certain supplemental environmental projects and programs under the Consent Decree. Since September 2004, there has been no legal action in the United States federal court or any administrative proceeding against the Authority regarding the Consent Decree or its modification. The Consent Decree includes stipulated penalties for certain events of noncompliance. Noncompliance events must be disclosed to EPA in the corresponding report. Ordinarily, when a covered noncompliance event occurs, the Authority pays the stipulated penalty in advance in order to benefit from a 50% discount of the applicable stipulated penalty.

#### *Other Proceedings*

In 1997, as a result of an inspection carried out by the EPA and the Puerto Rico Environmental Quality Board (the "EQB") at the Authority's Palo Seco power plant, the EPA issued an Administrative Order for the investigation and possible remediation of seven areas identified by the EPA at the Palo Seco power plant and the Palo Seco General Warehouse (Depot). The Administrative Order required the Authority to carry out a Remedial Investigation/Feasibility Study ("RI/FS"). The RI/FS required under the order is designed to: (1) determine the nature and extent of contamination and any threat to the public health, welfare, or environment caused by any release or threatened release of hazardous substances, pollutants, or contaminants at or from the site; and (2) determine and evaluate alternatives for the remediation or control of the release or threatened release of hazardous substances, pollutants or contaminants at or from the site. The RI/FS was submitted to the EPA for evaluation. The Authority is currently waiting for the EPA's evaluation.

The information gathered in the RI/FS indicated the presence of free product (Separate Phase Hydrocarbons) in several monitoring wells. The analysis of this product reflected a low concentration of polychlorinated biphenyls (PCBs). The Authority and the EPA entered into an Administrative Order on Consent (CERCLA-02-2008-2022) requiring the Authority to perform a removal action under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). Once the removal is complete, the Authority expects to resolve both the Administrative Order and the Removal Order. PCB recovery activities are ongoing at the site. The remaining costs to achieve compliance have been estimated at \$500,000. The Authority is also required to reimburse the EPA for any costs incurred in connection with the site. The Authority, however, has not received a request for reimbursement from the EPA.

In 2002, the Authority received a “Special Notice Concerning Remedial Investigation/Feasibility Study for Soil at the Vega Baja Solid Waste Disposal Superfund Site.” The EPA has identified the Authority and six other entities as “potentially responsible parties,” as defined in the CERCLA. In 2003, the Authority agreed to join the other potentially responsible parties in an Administrative Order on Consent (“AOC”) for an RI/FS, with the understanding that such agreement did not constitute an acceptance of responsibility. Under the AOC, the Authority committed up to \$250,000 as its contribution to partially fund the RI/FS. At this time, the RI/FS has been completed. The work proceeded in accordance with the schedule established by the Authority and the other designated potentially responsible parties. In July 2010, the Authority issued a proposed plan identifying its preferred alternative for addressing soil contamination at the Vega Baja Solid Waste Disposal Site. The EPA held a public hearing on August 3, 2010 to discuss the alternatives to address soil contamination and is expected to issue a Record of Decision (ROD) in the near future determining how soil contamination will be addressed.

In 2004, the EPA filed a complaint against the Authority regarding an alleged Resource Conservation and Recovery Act (RCRA) violation at its Aguirre power plant related to an oil sheen observed during an EPA inspection in 2000. The Authority filed an answer to the complaint disputing the allegations. The Authority paid a \$67,000 penalty and carried out certain activities at the Aguirre power plant designed to prevent future, similar violations.

In December 2004, the EPA sent a request for information to the Authority and to other potentially responsible parties that did business with certain recycling companies regarding the release of pollutants by these recycling companies in a Toa Baja superfund site. The EPA has stated that it is particularly interested in entities that disposed of batteries at this site. The Authority has responded to the request for information, stating that it only sold scrap metal to these recycling companies. The Authority does not believe it has any liability regarding this site. At this time, we have no knowledge that the EPA has initiated, or intends to initiate, any action against the Authority concerning this matter.

## **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*

In general, the Authority is consistently maintaining a 99% or better level of compliance with in-stack opacity requirements. The Authority continues its efforts to use No. 6 fuel oil with a sulfur content equal to or less than 0.5% in all of its power plants, which should contribute to maintaining air quality. These efforts are in compliance with the requirements of the Consent Decree, as modified in June 2004.

As required by the Consent Decree's Clear Air Act Compliance Program, the Authority also submitted and performed all quarterly reports regarding opacity monitors. As of October 2009, when the last quarterly report was submitted, the Authority had achieved a level of compliance with the Air Quality Compliance Program in excess of 99%. The Authority is currently engaged in the renewal of the Title V permits for its gas turbine facilities at Daguao, Vega Baja and Jobos. On May 14, 2010, EQB issued a final permit for the Daguao gas turbine facility.

#### *Water Quality Compliance*

As of December 2009, when the last quarterly report was submitted, the Authority had achieved a level of compliance with the Clean Water Act regulations in excess of 99%. As required by the Consent Decree, the Authority has completed compliance plans for abating water pollution at its four major power plants - Aguirre, San Juan, South Coast, and Palo Seco.

The largest of the Authority's projects relating to Clean Water Act compliance entail the refurbishment of the cooling water intake system at the South Coast power plant and the rerouting of that station's cooling water thermal effluent discharge system. Pursuant to an agreement between the EPA and the Authority, the Authority prepared a Detailed Engineering and Environmental Review (DEER) of alternatives for the cooling water discharge that meets the water temperature standard or otherwise qualifies for a waiver request under Section 316(a) of the Clean Water Act. Following review, the EPA approved a plan for submerged discharge through the north side of the CORCO peninsula with provisions for any operational adjustments to avoid any recirculation issues.

Recently, the Authority submitted an updated request under Section 316(a) of the Clean Water Act to the EPA in connection with the proposed discharge of thermal effluent into the Caribbean Sea by the South Coast power plant. The Authority and the EPA have agreed to perform a Detailed Engineering and Environmental Review (DEER) of alternatives for the cooling water discharge that meets the water temperature standard or otherwise qualifies for a waiver request under Section 316(a) of the Clean Water Act. Although the EPA has issued a draft permit for the discharge of thermal effluent by the South Coast power plant, the comment period related to such draft permit is currently on hold until the DEER is finished. The Implementation Plan is currently under discussion with EPA. The estimated capital cost is approximately \$60 million. Additional impact studies are being prepared for submission to the United States Army Corps of Engineers, which include an aquatic habitat study in progress at Guayanilla Bay.

The EPA included, as a compliance requirement in the new San Juan Power Plant NPDES Permit, the performance of thermal plume studies and a biological monitoring program under the Section 316(a) of the Clean Water Act and the performance of a Comprehensive Demonstration Study (CDS) under the Section 316(b) of the Clean Water Act, which requires complying with performance standards for entrainment and impingement at the power plants cooling water intake water structures. On March 13, 2010, the Authority submitted the plans for the thermal plume study and the biological monitoring program to the EPA and is currently awaiting its approval. On March 31, 2008, the Authority submitted an Impingement and Entrainment Characterization Study and Current Status Report for the EPA's evaluation. The Authority also submitted a Post-Repowering Verification Study Work Plan on June 30, 2008. The Authority is waiting for the EPA's approval of such plans.

#### *Underground Injection Control Regulation*

The Authority has prepared a compliance plan in order to comply with EQB's underground injection control regulations. The compliance plan contemplates the closing of septic systems where sanitary discharges can be connected to the facilities of PRASA. As of December 2009, the Authority had completed the connection of sanitary discharges to PRASA's system at the San Juan, Aguirre and

Palo Seco power plants. The South Coast power plant's sanitary discharge system was connected to PRASA's system at the beginning of fiscal year 2010. As a result, the Authority is currently engaged in the closing of septic tanks at its power plants and is in the process of sampling and analyzing the septic systems at Aguirre, San Juan and Palo Seco.

#### *Spill Prevention Control and Countermeasures Plan*

Pursuant to the terms of the Consent Decree and in order to meet its obligations under the Spill Prevention Control and Countermeasures ("SPCC"), a program under the Oil Pollution Control Act of 1990, the Authority continues to implement corrective measures at all of its facilities. This program included major overhauls to dikes and fuel tanks. As of December 2009, the Authority completed all compliance projects under the SPCC program of the Consent Decree in accordance with the established scope of work.

The Authority has been inspecting its oil filled equipment substations and evaluating the impact of the new SPCC requirements that became effective on November 10, 2010. The Authority has completed most of the work required for the facilities to timely meet the new SPCC requirements and anticipates that it will be able to complete the remaining work on or before January of 2011. The cost of this project is currently estimated at \$3.6 million.

#### *PCB Program*

The Authority has completed a ten-year EPA-mandated program to sample and test its oil-filled transformers and other equipment in order to identify and dispose of transformers with more than 49 parts per million (ppm) of PCB. Pursuant to this program, the Authority has completed the removal and disposal of PCB transformers with PCB concentrations of more than 500 ppm. The Authority continues with the removal and disposal of transformers with PCB concentrations of between 50 and 499 ppm. As of December 2010, the Authority had 194 PCB contaminated transformers remaining to be disposed of.

#### *Asbestos Abatement*

The Authority continues to work to encapsulate or gradually remove asbestos-containing insulation from its power plants. This program has been and continues to be updated to conform to new regulatory requirements.

#### *Capital Improvement Program*

The Authority's capital improvement program for the fiscal year which ended June 30, 2010 included \$12.8 million in order to comply with existing Commonwealth and federal environmental laws and regulations, including the South Coast water related projects in compliance with the Clean Water Act 316(a) and 316(b) sections previously discussed. Actual expenditures totaled approximately \$9.6 million. The Authority's five-year capital improvement program for fiscal years 2011 through 2015 include approximately \$44.0 million for environmental projects. The Authority believes it is taking the necessary steps to comply with all applicable environmental laws and regulations and the terms of the 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 \$750 million, consisting of a maximum of \$200 million under the all-risk property insurance policy, \$175 million under the boiler and machinery insurance policy, an excess layer of \$100 million under an all-risk and 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 \$75 million, respectively, and \$2 million for all other covered risks. The boiler and machinery insurance policy has a \$25 million deductible.

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 Trust Agreement.

The Authority's business interruption insurance covers up to \$200 million, with the Authority covering the costs of the first 30 days.

The 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. The general liability policy has a \$1 million deductible per occurrence with a \$2 million aggregate.

As with all 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 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 Trust Agreement to create a Self-insurance Fund, which is funded from Net Revenues (after deposits to the Sinking Fund and the Reserve Maintenance Fund) in the amounts recommended from time to time by the Consulting Engineers. The Authority has no obligation to make deposits to, or to replenish, the Self-insurance Fund in the event of withdrawals therefrom, except to the extent recommended by the Consulting Engineers. Amounts on deposit in the Self-insurance Fund are also available for the payment of principal of and interest on the Power Revenue Bonds. As of June 30, 2010, approximately \$73.9 million was on deposit in the Self-Insurance Fund. See "Disposition of Revenues" under *Summary of Certain Provisions of the Trust Agreement* in Appendix I.



## **LABOR RELATIONS**

As of November 30, 2010, the Authority had 8,782 employees. Four local unions represented 6,127 employees. The remaining 2,655 employees were members of the executive, managerial, and administrative staff. The Electrical Industry and Irrigation Workers Union or “UTIER” represented 4,829 employees engaged in operations and maintenance. The Insular Union of Industrial and Electrical Construction Workers or “UITICE” represented 916 construction workers. The Professional Employees Independent Union or “UEPI” represented 376 professional employees. The Electric Power Authority Pilots Union or “UPAEE” represented the 6 pilots employed by the Authority.

The Authority has in effect collective bargaining agreements with each of these unions. The Authority believes that labor relations are stable. The Authority is currently honoring all collective bargaining agreements. The UTIER agreement expires on August 24, 2012 and the UITICE agreement expires on January 26, 2011. The UEPI agreement expired on December 13, 2010 and the UPAEE agreement expired on July 2, 2010. The Authority is currently negotiating a new contract with UPAEE and with UEPI. Both negotiations are in advanced stages. On October 19, 2010, the Authority discussed negotiation rules and opened negotiations with UITICE; the negotiation is in its preliminary stages. All negotiations are proceeding in an orderly and constructive manner.

Of the Authority’s 8,782 employees as of November 30, 2010, 5,988 are employed in the generation, transmission and distribution facilities directorate, 1,547 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 illegal drug abuse 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 service that is more reliable to 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 most recent actuarial valuation was conducted as of June 30, 2009. As of June 30, 2009, the Retirement System had 20,168 members, consisting of 10,917 retirees and beneficiaries currently receiving benefits, 150 terminated employees entitled to but not yet receiving benefits and 9,101 active members. The Authority’s contributions consist of normal contributions, set at 6.03% of covered payroll, and accrued liability contributions. The accrued liability contributions are determined based on a percentage of covered payroll recommended by the Retirement System’s actuaries to liquidate the unfunded actuarial accrued liability over a 40-year period that commenced on June 30, 1996. The amortization period remaining as of June 30, 2010 is 26 years. Covered payroll includes all elements of compensation paid to active employees on which contributions to the Retirement System are made.

The contributions recorded by the Authority for fiscal years 2009 and 2010 were \$78.5 million and \$69.9 million, respectively, which included approximately \$56.1 million and \$48.5 million, respectively, for accrued liability contributions in accordance with the recommendations of the Retirement System’s actuaries. All of these contributions have been paid. For fiscal years 2009, the recorded contributions represented 21.1% of covered payroll (consisting of 6.03% of covered payroll for normal cost and 15.1% of covered payroll for the amortization of the unfunded actuarial accrued liability). For fiscal year 2010, the recorded contributions represented 19.7% of covered payroll

(consisting of 6.03% of covered payroll for normal cost and 13.7% of covered payroll for the amortization of the unfunded actuarial accrued liability). For fiscal year 2011, the Authority's contributions to the Retirement System will be approximately 23.8% of covered payroll, consisting of 6.03% of covered payroll for normal cost and 17.8% of covered payroll for the amortization of the unfunded actuarial accrued liability, as recommended by the Retirement Systems actuaries in the last actuarial valuation. Employee contributions and other withholdings are being paid to the Retirement System on a current basis. As of June 30, 2009, the present value of the Authority's future contributions on account of benefits was approximately \$1.2 billion.

Unfunded actuarial accrued liability to be borne entirely by the Authority was approximately \$980.3 million as of June 30, 2009. The actuarial valuation for fiscal year 2009 used a closed amortization period based on a level percent of pay, assumed an investment return of 8.5%, a payroll growth rate of 4%, projected salary increases of 4.10% to 5.40%, an inflation rate of 3.0%, and a remaining amortization period of 27 years for the unfunded accrued liability.

The following table shows the Retirement System's actuarial accrued liability, unfunded actuarial accrued liability, covered payroll and the ratio of the unfunded actuarial accrued liability to covered payroll.

<b>Fiscal Years Ending June 30</b>	<b>Actuarial Accrued Liability</b>	<b>Unfunded Actuarial Accrued Liability ("UAAL")</b>	<b>Covered Payroll</b>	<b>UAAL as a Percentage of Covered Payroll</b>
2006	\$2,279,988,278	\$877,400,654	\$349,182,982	251.3%
2007	2,313,124,627	825,592,169	348,928,666	236.6%
2008	2,336,944,425	765,743,108	362,892,937	211.0%
2009	2,497,639,122	980,288,838	364,402,800	269.0%

The following table shows the Retirement System's actuarial value of assets and market value of assets and the historical funded ratios using the actuarial and market value of assets. A five-year smoothing of the market value of assets is used for actuarial valuation purposes. Thus, in a declining market, such as in 2008 and 2009, the actuarial value of assets exceeds the market value of assets as there are unsmoothed losses that are not yet reflected in the actuarial value of assets.

<b>Fiscal Years Ending June 30</b>	<b>Actuarial Value of Assets</b>	<b>Market Value of Assets</b>	<b>Funded Ratio (actuarial value)</b>	<b>Funded Ratio (market value)</b>
2006	\$1,402,587,624	\$1,458,002,168	61.5%	63.9%
2007	1,487,532,458	1,598,941,337	64.3%	69.1%
2008	1,571,201,317	1,447,914,296	67.2%	62.0%
2009	1,517,350,284	1,130,680,373	60.8%	45.3%

The increase in the ratio of the unfunded actuarial accrued liability to covered payroll for fiscal year 2009, compared to fiscal year 2008, and the decrease in the funded ratios shows a deterioration in the financial strength of the Retirement System partly as a result of the effect on the Retirement System's investment portfolio of the general market decline during that year. As of June 30, 2010, the market value of assets increased to \$1.14 billion, a 0.9% increase from fiscal year 2009. As a result of the

decrease in the funded ratio, unless other changes are made to the pension plan, the Authority may have to increase its contribution to the Retirement System to amortize the unfunded actuarial accrued liability.

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 seeking to restrain or enjoin the sale of the Bonds or contesting or affecting the validity of the Bonds, the proceedings of the Authority taken with respect to the authorization, issuance or sale of the Bonds, or the pledge or application of any moneys under the Trust 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 of 2000, Abengoa, Puerto Rico, S.E., 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 counterclaim for breach of contract and for all damages caused to the Authority by the contract termination. On October 31, 2007 the Regional Administrating Judge for the Superior Court of San Juan certified the case as complex civil litigation pursuant to the Authority's petition. The case is in the discovery stage and more than 100,000 documents have been electronically exchanged to date. The Authority continues to defend this claim vigorously, 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 entered into an agreement with Washington Engineers P.S.C. for the completion of such generating units, which units entered into service in 2009.

In 2004, Aljoma Lumber, Inc. ("Aljoma Lumber") filed suit against various defendants, including the Authority, to recover damages suffered from a 2003 fire at its facilities in Ponce, Puerto Rico allegedly caused by electrical defects. Aljoma Lumber's insurers filed suit against the same defendants based on claims they had paid to Aljoma Lumber arising out of the fire. Aljoma Lumber claimed damages of \$25 million, while its insurers claimed \$6.925 million. The cases were recently favorably settled for \$25,000.

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. 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 denied that any overcharges were 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 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. After this report was made public, seven lawsuits were filed separately by different plaintiffs against the Authority demanding the reimbursement of such alleged overcharges, but the court ordered that all cases be consolidated. Plaintiffs sought certification of

a class in order to proceed as a class action, but such request was denied by the trial court and the denial affirmed by the Court of Appeals (and certiorari was denied by the Puerto Rico Supreme Court). Following denial of certiorari, several of the plaintiffs voluntarily dismissed their cases. Given the failure of the plaintiff to certify a class, it is anticipated that if the suits of the remaining plaintiffs continue to trial, the total amounts awarded would not exceed \$1 million. The court also ordered that the case be classified as a complex litigation. The Authority believes that the allegations of the complaints are similar to those made in a previous lawsuit in which the Authority prevailed on the merits of the case.

In 2009, a large fire at a tank farm owned by Caribbean Petroleum Corp. (“CAPECO”) caused major damage to surrounding areas. The Authority stored some of its fuel at this facility. In the aftermath of the fire, numerous claims were filed against CAPECO. Some of the plaintiffs included the Authority as a defendant in these suits, alleging that the Authority failed in its duty (as the owner of fuel stored at the site) to properly monitor CAPECO’s operations in the tank farm. All cases are in the initial stages and the Authority intends to vigorously defend against these claims. On August 12, 2010, CAPECO filed for bankruptcy. As a result thereof, all proceedings against CAPECO have been stayed. The proceedings against the Authority continue.

In 2008, Power Technologies Corp. filed suit against the Authority, alleging that the Authority had withdrawn from a contracting process for a new energy facility, in which Power Technologies was involved, without explanation or justification. Power Technologies seeks damages of \$51.4 million. The case is currently in the discovery stage.

In 2007, 2008 and 2009, six cases were filed against the Authority, the Puerto Rico Aqueduct and Sewer Authority, and other entities alleging damages resulting from landslides in a neighborhood in Ponce. The complaints allege that the Authority caused or contributed to the landslides based on its construction of transmission lines in the area. In total, the six plaintiffs have claimed approximately \$19.5 million in damages. These cases are in the discovery stage and continue to be defended vigorously by the Authority.

In addition to these cases, the Authority is involved in litigation typical for an electrical utility of its size and nature, including claims for damages due to electrified wires, failure to supply power and fluctuations in the power supply.

## **TAX MATTERS**

The following is a summary of the opinion of O’Neill & Borges, counsel to the Underwriters and Special Puerto Rico Tax Counsel, regarding certain Puerto Rico and United States federal tax consequences of the ownership of the Bonds by Puerto Rico residents.

**This section does not purport to cover all of the Puerto Rico and United States federal tax consequences arising from the purchase and ownership of the Bonds. The following is based upon laws, regulations, judicial decisions and administrative pronouncements now in effect and subject to change, and any change may apply retroactively and affect the accuracy of the opinions, statements and conclusions set forth in this discussion. You should consult your independent tax advisor as to the application to your particular situation of the tax discussion described below, as well as the effect of any foreign, state or other laws.**

An opinion of counsel represents only such counsel’s best legal judgment and is not binding on the Treasury Department, any municipality or agency of Puerto Rico, the United States Internal Revenue Service or the courts. Accordingly, there can be no assurance that the opinions set forth herein, if challenged, would be sustained.

## **Puerto Rico Tax Considerations**

In the opinion of O'Neill & Borges, based on the laws of Puerto Rico now in force:

1. Interest on the Bonds is exempt from Puerto Rico income and withholding taxes, including the individual alternate basic tax and the corporate alternative minimum tax imposed by Sections 1011 and 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code");

2. The Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended;

3. The transfer of the Bonds by (i) gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of Puerto Rico at the time the gift is made and (ii) death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico;

4. Gain recognized from the sale or exchange of a Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of Puerto Rico;

5. The Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments; and

6. Interest on the Bonds constitutes "industrial development income" under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, the Puerto Rico Tax Incentives Act of 1998 and the Economic Incentives for the Development of Puerto Rico Act, as amended, (collectively, the "Acts"), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the Bonds with "eligible funds," as such term is defined in the Acts.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a Bond over its initial offering price (the "Accretion Amount"). Under the current administrative practice followed by the Puerto Rico Department of the Treasury, the Accretion Amount is treated as interest.

Prospective owners of the Bonds, including but not limited to financial institutions, should be aware that ownership of the Bonds may result in having a portion of their interest and other expenses attributable to interest on the Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

A comprehensive Tax Reform Bill, which would adopt a new Puerto Rico Internal Revenue Code, was submitted on November 22, 2010 by the Governor of Puerto Rico for the consideration of the Puerto Rico Legislature. The proposed Tax Reform Bill does not substantially alter the provisions of the P.R. Code covered in the above discussion. It is currently anticipated that the new Puerto Rico Internal

Revenue Code will be approved in January 2011 and will be generally effective for taxable years commencing after December 31, 2010.

## United States Federal Tax Considerations

**Disclosure pursuant to U.S. Internal Revenue Service Circular No. 230: This tax discussion is not intended or written to be used, and cannot be used by any taxpayer, for purposes of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service. This tax discussion was written in connection with the promotion or marketing of the Bonds. Each prospective purchaser of the Bonds should seek tax advice from an independent tax advisor based on its particular circumstances.**

The following is a general discussion of the anticipated material federal income tax consequences of the purchase, ownership and disposition of the Bonds. This discussion does not address the tax consequences to persons other than initial purchasers who are Puerto Rico U.S. Holders (as defined below), and Puerto Rico Corporations (as defined below) that hold their Bonds as capital assets within the meaning of Section 1221 of the United States Internal Revenue Code, as amended (the “Code”) and it does not address all of the tax consequences relevant to investors that are subject to special treatment under the United States federal income tax laws (such as life insurance companies, retirement plans, regulated investment companies, persons who hold transition bonds as part of a “straddle,” a “hedge” or a “conversion transaction,” persons that have a “functional currency” other than the U.S. dollar, investors in pass-through entities and tax-exempt organizations). This summary also does not address the consequences to holders of the bonds under state, local or foreign tax laws.

As used herein, the term “Puerto Rico U.S. Holder” means a beneficial owner of the Bonds that is a Puerto Rico individual that is a bona fide resident of Puerto Rico, within the meaning of Section 937 of the Code and the regulations thereunder during the entire taxable year. As used herein, the term “Puerto Rico Corporation” means a beneficial owner of the Bonds that is a corporation organized under the laws of the Commonwealth of Puerto Rico.

*Interest on the Bonds.* Interest on the Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, an individual who is a Puerto Rico U.S. Holder during the entire taxable year in which such interest is received or “original issue discount” is accrued will constitute gross income from sources within Puerto Rico and, therefore, is excludable from gross income for purposes of the Code pursuant to section 933(1) thereof. In addition, for U.S. federal income tax purposes, no deduction or credit will be allowed that is allocable to or chargeable against amounts so excluded from the Puerto Rico U.S. Holder’s gross income.

Interest on the Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, a Puerto Rico Corporation, is not subject to income taxation under the Code provided such interest or “original issue discount” is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation.

*Sale or Retirement of Bonds.* In general, pursuant to the provisions of Sections 1.937-2 of the Regulations issued under the Code, the source of the income from the disposition of personal property by a Puerto Rico U.S. Holder shall be determined under the rules of Section 865 of the Code. Accordingly, the gain on the sale or exchange of the Bonds (excluding “original issue discount” under the Code as of the date of the sale or exchange), recognized by a Puerto Rico U.S. Holder will constitute Puerto Rico source income and therefore, qualify for the income exclusion under in Section 933(1) of the Code, provided, (i) that such Bonds do not constitute inventory in the hands of such individual, (ii) the gain is not attributable to an office or fixed place of business of such individual in the U.S., and (iii) the Puerto

Rico U.S. Holder was a bona fide resident of Puerto Rico for the 10 years preceding the year of the gain. The regulations provide a special rule under which a Puerto Rico U.S. Holder who was not a resident of Puerto Rico for the entire 10 year period preceding the year of the gain may elect to treat the portion of the gain attributable to the period of Puerto Rico residency as Puerto Rico source income excludable under Section 933(1) of the Code.

A Puerto Rico Corporation generally will not be subject to income or withholding tax under the Code on a gain realized on the sale or exchange of the Bonds, provided such gain is not effectively connected or treated as effectively connected with the conduct by the Puerto Rico Corporation of a trade or business in the United States.

*Estate and Gift Taxes.* The transfer of the Bonds by death or gift will not be subject to estate and gift tax under the U.S. Code in the case of decedents or donors who, at the time of death or gift, are (i) residents of Puerto Rico and (ii) (x) United States citizens who acquired such citizenship solely by reason of birth or residence in Puerto Rico or (y) not United States citizens.

The opinion of Special Puerto Rico Tax Counsel regarding the tax consequences under Puerto Rico law and the Code arising from ownership of, receipt or accrual of interest on, or disposition of the Bonds is limited to the above. Special Puerto Rico Tax Counsel does not express any opinion as to the laws of jurisdictions other than Puerto Rico and the United States federal laws applicable to Puerto Rico, or as to any other laws of any other jurisdiction or compliance therewith by any party. It also does not express an opinion as to the tax consequences arising from the beneficial ownership of the Bonds by anyone other than a Puerto Rico U.S. Holder or a Puerto Rico Corporation.

### **Backup Withholding**

Backup withholding of the United States federal income tax may apply to payments made in respect of the Bonds to registered owners who are not “exempt recipients” and who fail to provide certain identifying information (such as the registered owner’s taxpayer identification number) in the required manner. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Payments made in respect of the Bonds to a Puerto Rico U.S. Holder must be reported to the IRS, unless the Puerto Rico U.S. Holder is an exempt recipient or establishes an exemption. A Puerto Rico U.S. Holder can obtain a complete exemption from the backup withholding tax by filing Form W-9 (Payer’s Request for Taxpayer Identification Number and Certification).

Any amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or a credit against such beneficial owner’s United States federal income tax provided the required information is furnished to the IRS.

The United States Treasury Department has recently published the General Explanation of the Administration’s Fiscal Year 2011 Revenue Proposals. Said proposals include extending the information reporting requirement to payments of interest to corporations in excess of \$600 per calendar year and requiring backup withholding in certain circumstances not currently contemplated in the Code. As of this date, no bills have been filed at the United States Congress to adopt these proposals.

Prospective owners of the Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as “controlled foreign corporations,” “personal holding companies,” “foreign personal holding companies,” or “passive foreign investment companies,” as such terms are defined by the Code.

## **Build America Bonds**

The Bonds will be issued as “Build America Bonds” and the Authority will elect to receive cash subsidy payments from the United States Treasury equal to thirty-five percent (35%) of the interest payable by the Authority on the Bonds. Under no circumstances will the owners of the Bonds be entitled to a credit against the taxes imposed by the Code. The Authority has no obligation to the owners or prospective purchasers of the Bonds to maintain the status of the Bonds as Build America Bonds. The Code imposes certain requirements that must be met subsequent to the issuance and delivery of the Bonds in order for the Authority to receive the cash subsidy payments. If the Authority does not comply with these requirements, the Authority may not be entitled to receive the cash subsidy payments. Prospective owners of the Bonds who are not Puerto Rico U.S. Holders should consult their own independent tax advisors regarding the tax consequences of owning the Bonds.

## **UNDERWRITING**

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Bonds from the Authority at an aggregate discount of \$5,889,348.44 from the initial public offering prices of such bonds. The obligation of the Underwriters to purchase the Bonds is subject to certain conditions precedent. The Underwriters will be obligated to purchase all the 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 LLC (“JPMS”) entered into an agreement with FirstBank Puerto Rico Securities Corp. to assist the Commonwealth, its public corporations, agencies, instrumentalities, and municipalities in structuring and facilitating the issuance of certain municipal securities. Pursuant to the terms of the agreement and in compliance with applicable rules, compensation with respect to the underwriting of such municipal securities will be allocated between the parties.

Citigroup Inc. and Morgan Stanley, the respective parent companies of Citigroup Global Markets Inc. (“Citigroup”) and Morgan Stanley & Co. Incorporated (“Morgan Stanley”), have entered into a retail brokerage joint venture. As part of the joint venture each of Citigroup (an underwriter of the Bonds) and Morgan Stanley will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, each of Citigroup and Morgan Stanley will compensate Morgan Stanley Smith Barney LLC for its selling efforts in connection with their respective allocations of Bonds.

Santander Securities Corporation (“SSC”) and Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill”) have entered into an agreement pursuant to which they will provide services and advice to each other related to the structuring and execution of certain municipal finance transactions for the Commonwealth’s governmental entities in the global capital markets and in the United States market and in the Puerto Rico market if issued in connection with such global or U.S. issuances. SSC and Merrill will be entitled to receive a portion of each other’s revenues from the underwriting of the Bonds as consideration for their professional services.

Oriental Financial Services Corp. (“Oriental”) and Raymond James & Associates, Inc. (“Raymond James”) have entered into an agreement under which the parties provide services and advice



to each other to assist the Commonwealth and its issuers in the structuring and execution of their municipal securities offerings. As part of the agreement, Oriental and Raymond James share in the risk from the underwriting of the Bonds as part of the consideration for their professional services.

BBVAPR División de Valores Municipales (“BBVAPR MSD”) and RBC Capital Markets Corporation (“RBC”) have entered into an agreement under which the parties provide services and advice to each other to assist the Commonwealth and its issuers in the structuring and execution of their municipal securities offerings. As part of the agreement, BBVAPR MSD and RBC share in the risk from the underwriting of the Bonds as part of the consideration for their professional services.

Wells Fargo Securities is the trade name for certain capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Securities, LLC, member NYSE, FINRA, and SIPC.

### **MATERIAL RELATIONSHIPS**

URS Corporation serves as the Consulting Engineers to the Authority under the provisions of the Trust Agreement. The Authority entered into a professional services agreement with Washington Engineers P.S.C., an affiliate of URS Corporation, to provide services to the Authority in connection with the construction of the San Juan 5 and 6 combined cycle generating units completed during fiscal year 2009.

Citibank, N.A., an affiliate of Citigroup, an underwriter for the Bonds, has provided to the Authority a revolving line of credit for the purchase of fuel oil and power with an approved aggregate principal amount of \$200 million.

Banco Popular de Puerto Rico, an affiliate of Popular Securities, Inc., an underwriter for the Bonds, has provided various term loans to the Authority in an aggregate principal amount of approximately \$64.2 million as of December 1, 2010, a portion of which is currently syndicated. FirstBank Puerto Rico, the parent of FirstBank Puerto Rico Securities Corp., an underwriter for the Bonds, has an interest in the syndicated term loans.

FirstBank Puerto Rico, the parent of FirstBank Puerto Rico Securities Corp., an underwriter for the Bonds, provided a term loan facility to the Authority in a principal amount of \$50 million for the construction of the Via Verde pipeline. This term loan will be repaid from the proceeds of the Bonds.

See also GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO.

### **LEGAL MATTERS**

The proposed form of opinion of Nixon Peabody LLP, Bond Counsel, is set forth in Appendix IV to this Official Statement. Certain legal matters will be passed upon for the Underwriters by O’Neill and 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 AUDITORS**

The financial statements of the Authority as of and for the years ended June 30, 2009 and 2008 included in Appendix II hereto have been audited by Ernst & Young LLP, San Juan, Puerto Rico, independent auditors, 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 2009 and 2008 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, “BBB+” by Standard & Poor’s, a division of The McGraw-Hill Companies, Inc. and “BBB+” by Fitch Ratings. 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 any or all of such rating agencies, if in the judgment of any or all, 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. A securities rating is not a recommendation to buy, sell, or hold securities. Each security rating should be evaluated independently of any other security rating. For an explanation of the limitations inherent in ratings, see *Limited Nature of Ratings; Reductions, Suspension or Withdrawal of a Rating* under INVESTMENT CONSIDERATIONS. The Trust Agreement does not include a covenant by the Authority to maintain a specific rating with respect to 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 EMMA (<http://emma.msrb.org>) established by the MSRB, 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's Economic Report incorporated by reference herein); and

(b) to file in a timely manner not in excess of 10 business days of the occurrence of the event, with EMMA, 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:

- (1) principal and interest payment delinquencies;
- (2) non-payment related defaults, if material;
- (3) unscheduled draws on debt service reserves reflecting financial difficulties;
- (4) unscheduled draws on credit enhancements reflecting financial difficulties;
- (5) substitution of credit or liquidity providers, or their failure to perform;
- (6) adverse tax opinions or the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax-exempt status of the Bonds;
- (7) modifications to rights of the holders (including Beneficial Owners) of the Bonds, if material;
- (8) bond calls, if material, and tender offers;
- (9) defeasances;
- (10) release, substitution, or sale of property securing repayment of the Bonds, if material;
- (11) rating changes;
- (12) bankruptcy, insolvency, receivership or similar events;
- (13) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions other than pursuant to its terms, if material; and
- (14) appointment of a successor or additional trustee or the change of name of a trustee, if material.

With respect to event (4) and (5), 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.

With respect to event (6) and the tax status of the Bonds, see TAX MATTERS.

With respect to event (8), the Authority does not undertake to provide notice of a mandatory scheduled redemption not otherwise contingent upon the occurrence of an event if (i) the terms, dates and amounts of redemption are set forth in detail in this Official Statement under *Redemption* under THE BONDS above, (ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Beneficial Owners as required under the terms of the Bonds, (iv) public notice of the redemption is given pursuant to the Release Number 34-23856 of the SEC under the 1934 Act, even if the originally scheduled amounts are reduced by prior optional redemptions or bond purchases.

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 event is material with respect to the Bonds, but the Authority does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

The Authority has made similar continuing disclosure covenants in connection with prior bond issuances, and has complied with all such covenants, except that the Authority's audited financial statements for the fiscal year ended June 30, 2009 and material quantitative historical data on the Authority's System and finances were inadvertently not timely filed with EMMA by the deadline of April 1, 2010. The Official Statement for the Series XX Bonds, dated March 26, 2010, contained all the information required to comply with the Authority's continuing disclosure obligation and was filed with EMMA on April 5, 2010 to comply with MSRB rules and on April 13, 2010 specifically to comply with the Authority's continuing disclosure obligation. Notwithstanding the foregoing, no challenge to the adequacy of the information provided by the Authority in accordance with the filings mentioned in paragraph (a) above may be prosecuted by any beneficial owner except in compliance with the remedial and enforcement provisions of Article VIII of the Trust Agreement.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the continuing disclosure undertaking (the "Undertaking") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Authority evidence of ownership and a written notice of and request to cure such breach, the Authority shall have refused to comply within a reasonable time and such Beneficial Owner stipulates that (a) no challenge is made to the adequacy of any information provided in accordance with the Undertaking and (b) no remedy is sought other than substantial performance of the Undertaking. All Proceedings shall be instituted only as specified herein, in any Commonwealth court located in the Municipality of San Juan, Puerto Rico, and for the equal benefit of all beneficial owners of the outstanding bonds benefited by the same or a substantially similar covenant, and no remedy shall be sought or granted other than specific performance of the covenant at issue.

An amendment to the Undertaking may only take effect 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 Undertaking, as amended, would have complied with the requirements of the Rule at the time of award of a series of bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Beneficial Owners of bonds, as determined by parties unaffiliated with the Authority (such as, but without limitation, the Authority's financial advisor or bond counsel); or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the issue of a series of bonds ceases to be in effect for any reason, and the Authority elects that the Undertaking shall be deemed terminated or amended (as the case may be) accordingly.

For purposes of the Undertaking, a beneficial owner of a bond includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such bond, subject to certain exceptions as set forth in the Undertaking. Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.



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**DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF CERTAIN PROVISIONS  
OF THE TRUST AGREEMENT**

*This Appendix contains summaries of certain provisions of the Authority's Trust Agreement. This summary is not to be considered a full statement of the terms of the Trust Agreement and accordingly is qualified by reference to such Trust Agreement and subject to the full text thereof. Capitalized terms not otherwise defined herein have the meanings set forth in the Trust Agreement or the Official Statement.*

**DEFINITIONS OF CERTAIN TERMS**

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

“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 Trust 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 Amortization 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 Trust 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 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 or 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 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.

“Annual Budget” means the Authority’s budget of Current Expenses and Capital Expenditures for a fiscal year adopted pursuant to the provisions of the Trust Agreement.

“Board” means the governing board of the Authority as constituted from time to time and defined in the Act, or if said Board shall be abolished then the Board, body or officer succeeding to the principal functions thereof or to whom the powers of the Authority shall be given by law.

“Build America Bonds” means a series of bonds designated as “Build America Bonds” by the Authority for purposes of Section 54AA of the Code and for which the Authority has irrevocably elected pursuant to Section 54AA(g) of the Code to receive the Federal Subsidy from the United States Treasury in connection therewith under Section 6431 of the Code and apply it in accordance with the provisions of the resolution or resolutions adopted by the Board authorizing the issuance of such bonds.

“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 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 Trust 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 Sinking Fund, the Reserve Maintenance Fund, the Subordinate Obligations Fund, the Self-insurance Fund and the Capital Improvement Fund.

“Deposit Day” means the date specified in the Trust Agreement as 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 Trust Agreement and shall otherwise be deemed to be, and be payable as, interest and Amortization Requirements on bonds for purposes of the Trust 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.

“Federally Subsidized Bonds” means either Build America Bonds or Other Subsidy Bonds or both, as the case may be.

“Federal Subsidy” means a payment made by the Secretary of the Department of Treasury to or for the account of the Authority pursuant to the Code in respect of a series of bonds constituting Federally Subsidized Bonds. Any Federal Subsidy to be received by the Authority in respect of such series of bonds shall be identified as such in the resolution authorizing the issuance of such series of bonds to which it relates.

“Federal Subsidy Payments” means the amount of Federal Subsidy actually paid to and received by the Trustee in respect of an interest payment for the series of Federally Subsidized Bonds to which it relates. Such Federal Subsidy Payments shall be deposited directly into the Bond Service Account in the Sinking Fund.

“Government Obligations” means (i) direct obligations of, or obligations the principal of and the 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 an agency or person controlled or supervised by and acting as an instrumentality of the United States Government pursuant to authority granted by the Congress.

“Improvements” means improvements, renewals and replacements of the System or any part thereof and such extensions and additions thereto as may be necessary or desirable, in the judgment of the Board, to keep the same in proper condition for the safe, efficient and economic operation thereof and to integrate into the System any unit or part thereof, and shall include such electric-power projects as may be authorized to be acquired or constructed by the Authority under the provisions of the Act and such improvements, renewals and replacements of such properties and the System and such extensions and additions thereto as may be necessary or desirable for continuous and efficient service to the public, which shall be financed in whole or in substantial part from the proceeds of bonds issued under the provisions of the Trust Agreement or from moneys deposited to the credit of the Construction Fund or the Renewal and Replacement Fund.

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

“Investment Obligations” means (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, on the date of investment therein, in any of the three highest grades by a nationally recognized rating agency or which are collateralized by any other Investment Obligations described in the Trust Agreement

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

“Other Subsidy Bonds” means bonds for which a subsidy or other payment made by the Secretary of the Department of Treasury may be made in respect of such bonds other than under Section 6431 of the Code.

“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 the Trust 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 the Trust 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 Trust 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 Trust 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 Trust Agreement shall be determined, as required from time to time, by the Trustee. In computing the Principal and Interest Requirements for any fiscal year for the bonds of any Series, the 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.

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 Trustee) or from Investment Obligations irrevocably set aside or deposited irrevocably for such purpose with is bank or trust company (which may include the Trustee) or Time Deposits, secured in the manner set forth in the Trust 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 Sinking Fund from the proceeds of bonds to pay interest to accrue thereon. The Executive Director or his designee shall deliver to the 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 as described in 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 Trustee, the Authority shall cause to be delivered to the 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.

For purposes of determining the maximum Principal and Interest Requirements for purposes of the Trust Agreement and the aggregate Principal and Interest Requirements in the covenant as to rates contained in the Trust Agreement, on the date of issuance of a Federally Subsidized Bonds and for so long as the Trustee shall receive the scheduled amount of the Federal Subsidy Payments on or before such interest is payable, all or a portion of the interest in respect of one or more series of Federally Subsidized Bonds shall be excluded from the calculation of the Principal and Interest Requirement if, and to the extent that the interest thereon is payable from a Federal Subsidy. Notwithstanding the foregoing, if the Trustee shall not receive the scheduled amount of the Federal Subsidy Payments on or before the date interest on such Federally Subsidized Bonds is payable or within thirty (30) of the date such Federal Subsidy Payments were scheduled to be received under the then current applicable law and regulations, then from and after the occurrence of such failure to receive such Federal Subsidy and until such Federal Subsidy Payments shall resume and all prior deficiencies are cured, the exclusion from the calculation of the Principal and Interest Requirement set forth in the preceding sentence shall no longer be effective for purposes of determining the maximum Principal and Interest Requirements for purposes of the Trust Agreement and the aggregate Principal and Interest Requirements in the covenant as to rates contained in the Trust Agreement.

“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 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 Reserve Account under the Trust 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 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 Trust Agreement, except income from the investment of moneys in the 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.

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

“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 Trust 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 Trust Agreement or from moneys deposited to the credit of the 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.

“Time Deposits” means time deposits, certificates of deposit or similar arrangements with the 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.

## **Security for the Power Revenue Bonds**

The Power Revenue Bonds are secured by a pledge from the Authority to the Trustee of the Revenues of the System and other moneys to the extent provided in the Trust Agreement as security for the payment of the Power Revenue Bonds and the interest and the redemption premium, if any, thereon and as security for the satisfaction of any other obligation assumed by it in connection with such Power Revenue Bonds. (Trust Agreement, Section 701).

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. (Trust Agreement, Section 701).

## **Issuance of Bonds Other than Refunding Bonds**

The Trust Agreement provides for the issuance of Power Revenue Bonds for Improvements, including the repayment of advances therefor, to provide moneys for deposit to the Reserve Account in the Sinking Fund (the "Reserve Account") and for any proper corporate purpose of the Authority (other than for the purpose of refunding outstanding Power Revenue Bonds), subject to the conditions and limitations in the Trust Agreement. Power Revenue Bonds may be issued, 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, 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. (Trust Agreement, Sections 208 and 209).

## **Issuance of Refunding Bonds**

The Trust Agreement provides for the issuance of Power Revenue Bonds to refund or redeem prior to or at their maturities all or any part of the outstanding bonds of any Series issued under the Trust 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 Reserve Account, subject to the conditions and limitations set forth in the Trust Agreement. Power Revenue Refunding Bonds may be issued under the Trust Agreement if, among other things, either (i) the earnings tests described above under the caption "Issuance of Bonds Other than Refunding Bonds" for the issuance of bonds under the Trust 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). The proceeds of Power Revenue Refunding Bonds shall, to the extent practicable, be invested and reinvested by the Trustee, with the approval of the Executive Director, in Government Obligations, Prerefunded Municipals or in Time Deposits, secured in the manner set forth in the Trust Agreement, and the moneys so invested shall be available for use when required. (Trust Agreement, Section 210).

## **Funds and Accounts**

### *General Fund*

A special fund is created pursuant to the Trust Agreement and designated the “Puerto Rico Electric Power Authority General Fund” (the “General Fund”). The Authority covenants that all Revenues, other than income from investments made under the provisions of the Trust Agreement, will be deposited as received in the General Fund. The Authority covenants that moneys in the 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 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. (Trust Agreement, Sections 503 and 505).

### *Revenue Fund*

A special fund is created pursuant to the Trust Agreement and designated the “Puerto Rico Electric Power Authority Power Revenue Fund” (the “Revenue Fund”). The Treasurer of the Authority is required to transfer, on or before the 15<sup>th</sup> day of each month, from the General Fund to the Revenue Fund an amount equal to the amount of all moneys held in the 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 one-sixth (1/6<sup>th</sup>) 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. (Trust Agreement, Section 506).

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

A special fund is created pursuant to the Trust Agreement and designated the “Puerto Rico Electric Power Authority Power Revenue Bonds Interest and Sinking Fund” (sometimes referred to in this Appendix I as the “Sinking Fund”). There are three separate accounts created in the Sinking Fund and designated the “Bond Service Account,” “Reserve Account” and “Redemption Account.” Four additional special funds are created pursuant to the Trust Agreement and designated the “Puerto Rico Electric Power Authority Reserve Maintenance Fund” (sometimes referred to in this Appendix I as the “Reserve Maintenance Fund”), the “Puerto Rico Electric Power Authority Self-insurance Fund” (sometimes referred to in this Appendix I as the “Self-insurance Fund”), the “Puerto Rico Electric Power Authority Capital Improvement Fund” (sometimes referred to in this Appendix I as the “Capital Improvement Fund”) and the “Puerto Rico Electric Power Authority Subordinate Obligations Fund” (sometimes referred to in this Appendix I as the “Subordinate Obligations Fund”). (Trust Agreement, Section 507).

**Disposition of Revenues**

On or before the 25th day of each month, the Treasurer shall withdraw from the Revenue Fund, all the moneys then in such Fund (less any amount equal to the amount of Federal Subsidy Payments that have not been received as of the 25th of the month preceding the Interest Payment Date to which such Federal Subsidy Payments relate, which amount will be held in the Revenue Fund and (x) if the Federal Subsidy Payment has not been received by the Authority by such Interest Payment Date, transferred to the Bond Service Account on the Interest Payment Date and applied to the payment of interest on Bonds or (y) if the Federal Subsidy Payment has been received by the Authority on or before such Interest Payment Date, remain on deposit in the Revenue Fund for application in accordance with the provisions below in the following calendar month) and deposit the moneys so withdrawn to the credit of the following Accounts and Funds in the following order:

1. to the credit of the Bond Service Account such amount thereof (or the entire sum so withdrawn if less than the required amount) as may be required to make the total amount then to the credit of the Bond Service Account 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. to the credit of the Redemption Account such amount, if any, of any balance remaining after making the deposit as described in Paragraph 1 above, (or the entire balance if less than the required amount) as may be required to make the amount then to the credit of the Redemption Account 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. to the credit of the Reserve Account such amount, if any, of the balance remaining after making the deposits described in paragraphs 1 and 2 above (or the entire balance if less than the required amount) as may be required to make the amount then to the credit of the Reserve Account, including the amount of any Reserve Account Insurance Policy or any Reserve Account Letter of Credit therein, 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, other than refunding bonds, issued under the Trust 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 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 provided, however, that in the case of Federally Subsidized Bonds, the amount of interest deemed to be payable on such bonds from the date of issuance of such Federally Subsidized Bonds and for so long as the Trustee shall receive the scheduled amount of the Federal Subsidy Payments on or before such interest shall be payable shall exclude the amount of interest to be paid from the Federal Subsidy and provided further, however, that if the Trustee shall not receive the scheduled amount of the Federal Subsidy Payments on or before the date interest on such Federally Subsidized Bonds is payable or within thirty (30) of the date such Federal Subsidy Payments were scheduled to be received under the then current applicable law and regulations,, then for purposes of the calculation of interest to be credited to the Reserve Account, the amount shall be equal to the interest payable on the bonds of each Series issued hereunder within the next twelve (12) months;

4. to the credit of the Reserve Maintenance Fund, such amount, if any, of any balance remaining after making the deposits described in paragraphs 1, 2 and 3 above (or the entire balance if less than the required amount) 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. to the credit of one or more special accounts in the Subordinate Obligations Fund, such amount, if any, of any balance remaining after making the deposits described under paragraphs 1, 2, 3 and 4 above (or the entire balance if less than

the required amount) that together with funds 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 pursuant to the Trust Agreement 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 described under paragraphs 1, 2, 3, 4 or 5 above (or the entire balance if less than the required amount) 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. to the credit of the Self-insurance Fund, any balance remaining after making the deposits described in paragraphs 1, 2, 3, 4, 5 and 6 above as the Consulting Engineers shall from time to time recommend; and

8. to the credit of the Capital Improvement Fund such amount of any balance remaining after making deposits described under paragraphs 1, 2, 3, 4, 5, 6 and 7 above as the Consulting Engineers shall from time to time recommend; 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. (Trust Agreement, Section 507).

If amounts applied to the payment of interest and principal 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. (Trust Agreement, Section 509).

Moneys in the Reserve Account shall be used by the 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 deposits to the Redemption Account described in paragraph 2 above whenever the withdrawals from the Renewal and Replacement Fund or the Revenue Fund, as the case may be, are insufficient for such purpose. Excess moneys in the Reserve Account shall be transferred to the Bond Service Account or may be used to reduce any Reserve Account Insurance Policy or Reserve Account Letter of Credit.

The Authority may deposit a Reserve Account Insurance Policy or Reserve Account Letter of Credit into the Reserve Account, in lieu, or in partial satisfaction, of any required deposit into the Reserve Account. Any reimbursement obligation in respect of a drawing under a Reserve Account Insurance Policy or Reserve Account Letter of Credit may be secured by a lien on Revenues not inconsistent with the provisions of the Trust 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 Reserve Account pursuant to the Trust 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 Reserve Account moneys, in accordance with the provisions of the Trust 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 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 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 Reserve Account with moneys or a Reserve Account Insurance Policy, or a combination of such alternatives. Any moneys on deposit in the 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 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 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 Reserve Account. (Trust 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 Bond Service Account, Redemption Account and the Reserve Account are insufficient for such purpose. (Trust 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 Trust 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

Bond Service Account, Redemption Account and the Reserve Account and in the Reserve Maintenance Fund are insufficient for such purpose. (Trust 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 issued under the provisions of the Trust Agreement. 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 Bond Service Account, Redemption Account and the Reserve Account, in the Reserve Maintenance Fund and in the Self-insurance Fund are insufficient for such purpose. (Trust Agreement, Section 512B).

### *Construction Fund*

A special fund is created and designated the “Puerto Rico Electric Power Authority Power System Construction Fund” (the “Construction Fund”). The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of 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 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 Construction Fund and by the Authority in trust. (Trust Agreement, Sections 208 and 401).

Payments from the Construction Fund are made by the Executive Director or by any officer or employee of the Authority designated by him for such purpose. (Trust 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. (Trust Agreement, Section 502).

## **Build America Bonds**

With respect to Build America Bonds, including the Bonds, the Authority covenants to file, or cause to be filed, a Form 8038-CP with the Internal Revenue Service not less than 45 days and not more than 90 days prior to the date interest on the Build America Bonds shall be payable, as provided in Notice 2010-26 issued by the Internal Revenue Service, so long as filing such form is a condition to receipt of the Federal Subsidy prior to the date such interest shall be payable. In the event that the Internal Revenue Service shall amend or revise the guidance provided in Notice 2010-26, the Authority agrees that it shall take all such actions as are necessary to ensure receipt of the Federal Subsidy. The only effect of any failure to comply with Section 713 of the Trust Agreement shall be that the Federal Subsidy to which such failure relates shall no longer be excluded from the calculation of Principal and interest Requirements. (Trust Agreement, Section 713).

## **Investment of Funds**

The Trust Agreement provides for the following types of investments:

- (a) Government Obligations;
- (b) Investment Obligations; and
- (c) Time Deposits.

Moneys in the Bond Service Account, the Redemption Account and the Revenue Fund shall be invested and reinvested by the 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 Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the Reserve Account shall be invested and reinvested by the 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 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 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 pursuant to the Trust Agreement. In lieu of such investments, moneys in the Construction Fund, the Reserve Maintenance Fund, the Self-insurance Fund, the Capital Improvement Fund and the 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. (Trust 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 smaller 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 pursuant to the Trust Agreement 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 moneys held for credit of the Self-insurance Fund and shall advise the Trustee in writing of those investments other than Investment Obligations that are authorized by said investment policy. (Trust Agreement, Section 602).

### **Accounting**

The Authority covenants that its accounts will be kept 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 and each integral unit of 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 of suitable experience and responsibilities and widely known in the United States and approved by the Trustee. (Trust Agreement, Section 710).

### **Release of Property**

The Authority covenants that so long as any Power Revenue Bonds shall be outstanding under the Trust Agreement and except as permitted under the Trust Agreement 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 issued under and secured by the Trust Agreement. The Authority may, however, from time to time, sell machinery, fixtures, apparatus, tools, instruments 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 Construction Fund at the option of the Authority; provided that in connection with the issuance of bonds the Authority may secure its obligations to the provider of a credit or liquidity facility securing such bonds on a parity with the bonds. Other property forming part of the Systems, 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 Construction Fund and the rentals be deposited in the Revenue Fund.

Notwithstanding the immediately preceding 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 Power Revenue Bonds outstanding and if the 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 among other things the transferee agrees to assume the Authority's obligations under the Trust 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 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 Revenue Fund.

In addition, the Authority may lease portions of the System or grant licenses, easements and other rights or make contracts or other arrangements for 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 arrangements shall be deposited to the credit of the Revenue Fund. (Trust 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 its engineers to prepare plans and specifications for repairing, replacing or reconstructing the damaged or destroyed 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. Proceeds of all insurance shall be deposited in the Redemption Account or, at the option of the Authority, the Construction Fund 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 under the Trust Agreement shall otherwise direct. (Trust Agreement, Section 707).

## **Consulting Engineers and Independent Consultant**

The Authority covenants that so long as any of the Power Revenue Bonds are outstanding under the Trust Agreement it will employ as Consulting Engineers an independent engineer or engineering firm or corporation 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 and file an annual report with the Authority and the Trustee on or before the 1<sup>st</sup> day of each November setting forth their recommendations as to any necessary or advisable revisions of rates and charges and such other advices and recommendations as they may deem desirable. 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. (Trust Agreement, Section 706).

The Authority covenants that so long as any Power Revenue Bonds are outstanding under the Trust Agreement 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 and file with the Authority and the Trustee at least biennially on or before the first day of November a report setting forth its recommendations, based on a review of the insurance then maintained by the Authority in accordance with the Trust 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. (Trust Agreement, Sections 706 and 707).

## **Modifications**

The Authority and the 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 Trust Agreement, (i) to cure any ambiguity, to correct or supplement any provision in the Trust 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 Trust Agreement, provided such action shall not adversely affect the interest of the bondholders, or (ii) to grant to or confer upon the 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 Trustee, or (iii) to add to the conditions, limitations and restrictions on the issuance of bonds under the provisions of the Trust Agreement other conditions, limitations and restrictions thereafter to be observed, or (iv) to add to the covenants and agreements of the Authority in the Trust 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 Trust Agreement.

At least thirty (30) days prior to the execution of any supplemental agreement for any of the purposes described in the immediately preceding paragraph, the Trustee shall cause a notice of the proposed execution of such supplemental agreement to be mailed to all registered owners of Power Revenue Bonds and to all bondholders of record. Such notice shall briefly set forth the nature of the proposed supplemental agreement and shall state that copies thereof are on file at the principal office of the Trustee for inspection by all bondholders. A failure on the part of the



Trustee to mail the notice required by the Trust Agreement shall not affect the validity of such supplemental agreement. (Trust 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 Trust Agreement to the contrary notwithstanding), to consent to and approve the execution by the Authority and the Trustee of such agreement or agreements supplemental to the Trust Agreement 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 Trust Agreement or in any supplemental agreement; provided, however, that nothing contained in the Trust Agreement shall permit, or be construed as permitting, (a) an extension of the maturity of principal or interest on 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 any lien and pledge created by the Trust 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. (Trust Agreement, Section 1102).

#### **Events of Default and Remedies of Bondholders**

Among the events described in the Trust 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 on any of the Power Revenue Bonds 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 Trust Agreement, or
- (d) the Authority shall default in the due and punctual performance of any other of the covenants, conditions, agreements and provisions contained in the Power Revenue Bonds or in the Trust Agreement on the part of the Authority to be performed, including meeting any Amortization Requirement, and such default shall continue for thirty (30) days after written notice specify such default and requiring same to be remedied shall have been given to the Authority by the Trustees which may give such notice in its discretion and shall give such notice at the written request of 10% in aggregate principal amount of the bonds then outstanding, or
- (e) if notice has been received by the Trustee and the Authority from the bank or lending institution providing a credit or liquidity facility or other entity insuring, guaranteeing or providing for payments of principal or interest in respect of any Power Revenue Bonds that an event of default has occurred under the agreement underlying said facility or a failure of said bank or other financial or lending institution or other entity to

make said facility available or to reinstate the interest component of said facility in accordance with its terms, to the extent said notice or failure is established as an event of default under the terms of the resolution authorizing the issuance of Power Revenue Bonds secured by the credit or liquidity facility). (Trust Agreement, Section 802)

In the event of the happening and continuance of any event of default specified in the Trust Agreement the 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 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 Trust 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 Trustee shall deem most effectual to protect and enforce the rights aforesaid; provided, however, that the 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. (Trust Agreement, Sections 803, 804 and 902).

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

### **Defeasance**

The Trust 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 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 the Trust Agreement, the principal of and the interest on which when due will provide sufficient moneys, shall be held by the Trustee or the Paying Agents for such purpose under the provisions of the Trust 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 Trustee under the Trust Agreement shall cease, determine and become void, and the Trustee in such case, on demand of the Authority, shall release the Trust Agreement. (Trust Agreement, Section 1201).

### **Bonds Not Deemed Outstanding**

The Power Revenue Bonds and portions of Power Revenue Bonds which have been duly called for redemption pursuant to the Trust Agreement, or with respect to which irrevocable instructions to call for redemption or payment at or prior to maturity have been given to the 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 the Trust Agreement, shall be held in separate accounts by the 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 Trust Agreement, shall not thereafter be deemed to be outstanding under the provisions of the Trust Agreement. (Trust Agreement, Section 307).

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FINANCIAL STATEMENTS, REQUIRED  
SUPPLEMENTARY INFORMATION AND  
SUPPLEMENTAL SCHEDULES

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)  
Years Ended June 30, 2009 and 2008  
With Report of Independent Auditors

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Financial Statements, Required Supplementary Information  
and Supplemental Schedules

Years Ended June 30, 2009 and 2008

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## Report of Independent Auditors

To the Governing Board of the  
Puerto Rico Electric Power Authority

We have audited the accompanying financial statements of the Puerto Rico Electric Power Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of PREPA Networks, Inc. (PREPA.Net) (a blended component unit), which financial statements reflect total assets constituting approximately .2%% and .2% of total assets as of June 30, 2009 and 2008, and revenues constituting .2% and .1% of total revenues for the years then ended. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for PREPA.Net, is based solely on the report of the other auditors.

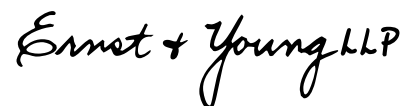
We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors, provide a reasonable basis for our opinion.

In our opinion, based on our audits, and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 30, 2009, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's Discussion and Analysis on pages 3 through 13 and the required supplementary information disclosed on page 67 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). 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.

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

A handwritten signature in cursive script that reads 'Ernst & Young LLP'.

December 30, 2009

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affixed to  
original of  
this report.



Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2009

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 years ended June 30, 2009, 2008 and 2007. As management of the Authority, we offer readers of the financial statements this narrative overview and analysis of the financial activities. We recommend readers to consider the information herein presented in conjunction with the financial statements that follow this section.

**Financial Highlights**

- Operating income for fiscal year ended June 30, 2009 was \$362.6 million representing an increase of 100 percent over the fiscal year ended June 30, 2008. For the fiscal years ended June 30, 2008 and 2007 was \$181.1 million and \$370.9 million respectively, representing a 51.1 percent decrease and an 8.0 percent decrease when compared to fiscal years ended June 30, 2008 and 2007 respectively.
- Operating expenses decreased by \$541.0 million or 12.9 percent for the fiscal year ended June 30, 2009; increased by \$871.7 million or 26.3 percent and decreased by \$3.6 million or 0.1 percent for the fiscal years ended June 30, 2008 and 2007, respectively, when compared to previous fiscal years.
- The Authority's Net Utility Plant for the fiscal year ended June 30, 2009 increased by \$236.2 million or 3.8 percent. For the fiscal year ended 2008 and 2007 the increase was \$419.4 million and \$316.9 million or 7.3 percent and 5.8 percent, respectively. Total assets decreased by \$450.0 million, increased by \$989.9 million and \$823.6 million or 4.9 percent decrease, 12.0 percent increase and 11.1 percent increase, respectively, for the fiscal years ended June 30, 2009, 2008 and 2007.
- For the fiscal year ended June 30, 2009, as compared to the fiscal year ended June 30, 2008, accounts receivable decreased from \$1,272.8 million to \$1,126.9 million, representing an 11.5 percent. The decrease was mainly due to a collection of \$136.7 million from insurance companies related to a claim filed as a result of two fires at the Palo Seco Steam Plant, and to a decline in the average fuel oil per barrel of 7.95 (9.4%) Accounts receivable from the governmental sector increased from \$357.3 million on June 30, 2008 to \$471.4 million on June 30, 2009, representing a 31.9 percent.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

- The Authority's net assets decreased by \$147.5 million (79.0 percent), \$284.7 million (60.4 percent) and \$39.8 million (7.8 percent) as a result of operations during fiscal years ended June 30, 2009, 2008 and 2007, respectively.
- Ratios of fuel and purchased power adjustment revenues to total operating revenues were 72.8 percent for 2008-2009, 73.8 percent for 2007-2008 and 67.6 percent for 2006-2007.
- Ratios of fuel oil and purchased power expenses to total operating expenses (excluding depreciation expense) were 77.7 percent for 2008-2009, 76.3 percent for 2007-2008 and 77.4 percent for 2006-2007.
- The decrease in the fuel adjustment revenues and fuel expense for fiscal year 2009 as compared to 2008 of \$311.6 million and \$383.2 million, respectively, was mainly due to a decrease in the average fuel oil price per barrel of \$7.95 (9.4%) and a decrease of 2.2 million (7.9%) in the consumption of fuel oil barrels for 2008-2009. The increase in the fuel adjustment revenues and fuel expense for fiscal year 2008 as compared to 2007 of \$695.0 million and \$586.1 million, respectively, was mainly due to an increase in fuel oil price per barrel of \$26.63 (46.3%). In addition, the decrease in the fuel adjustment revenues for fiscal year 2007 as compared to 2006 of \$90.3 million was mainly due to the excess of fuel expenses of \$123 million associated with alternate generation capacity as a result of the Palo Seco Steam Plant fires, which are being recovered from insurance companies. The increase in the fuel expenses for fiscal year 2007 as compared to 2006 of \$51.1 million was mainly due to an increase in fuel oil price per barrel of \$1.17 (2.1 percent).
- The increase in the purchased power adjustment revenue and expense of \$6.9 million and \$10.8 million, respectively, was due to an increase of 1.0 cent (9.9 percent) per kWh in average price of purchase power for fiscal 2009 when compared to fiscal 2008. The increase in the purchased power adjustment revenue and expense of \$36.8 million and \$36.4 million, respectively, was mainly due to an increase of 312,676 MWh (4.5 percent) in purchased power for fiscal 2008 when compared to 2007. The increase in the purchased power adjustment revenue and expense of \$34.5 million and \$21.5 million, respectively, was mainly due to an increase of 311,279 MWh (4.6 percent) purchase power for fiscal 2007 when compared to fiscal 2006.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

- For the fiscal year ended June 30, 2008, as compared to the fiscal year ended June 30, 2007, accounts receivable increased from \$994.6 million on June 30, 2007 to \$1,272.8 million on June 30, 2008, representing a 28.0 percent. The increase was mainly due to a claim to insurance companies related to the costs associated with alternate generation capacity in connection with two fires at the Palo Seco Steam Plant. The increase was also due to fuel oil prices that increased \$26.63 (46.3%) per barrel. Accounts receivable from the governmental sector increased from \$316.6 million on June 30, 2007 to \$357.3 million on June 30, 2008, representing a 12.8 percent.
- For the fiscal year ended June 30, 2007, as compared to the fiscal year ended June 30, 2006, accounts receivable increased from \$837.3 million on June 30, 2006 to \$994.6 million on June 30, 2007, representing an 18.8 percent. The increase was mainly due to a claim to insurance companies related to the costs associated with alternate generation capacity in connection with two fires mentioned above. Accounts receivable from the governmental sector increased from \$265.9 million on June 30, 2006 to \$316.6 million on June 30, 2007, representing a 19.1 percent increase.

### 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.

### Required Financial Statements

The financial statements report the financial position and operations of Puerto Rico Electric Power Authority and its blended component units, Puerto Rico Irrigation Systems and PREPA Networks Corp., which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, Statement of Cash Flows and the notes to financial statements.

PREPA Networks, Corp. issues a separate financial report that includes audited financial statements. That report may be obtained by writing to PREPA Networks, Corp. City View Plaza Suite 803, Guaynabo, Puerto Rico 00968.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

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 operating, non-capital and capital 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.

**Financial Analysis**

The Authority's net assets decreased by \$147.4 million, \$284.7 million and \$39.8 million for the fiscal years ended June 30, 2009, 2008 and 2007, respectively. Our analysis below focuses on the Authority's net assets and changes in net assets during the year.

**Authority's Net Assets**  
*(In thousands)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current, non-current and other assets	\$ 2,371,432	\$ 3,057,603	\$ 2,487,122
Capital assets	6,410,173	6,173,993	5,754,568
Total assets	<u>\$ 8,781,605</u>	<u>\$ 9,231,596</u>	<u>\$ 8,241,690</u>

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

**Authority's Net Assets**  
(In thousands)

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Long-term debt outstanding	\$ 6,843,137	\$ 7,113,832	\$ 6,127,770
Other liabilities	1,899,249	1,931,082	1,642,512
<b>Total liabilities</b>	<b>\$ 8,742,386</b>	<b>\$ 9,044,914</b>	<b>\$ 7,770,282</b>
Net assets:			
Invested in capital assets, net of related debt	\$ 19,433	\$ 55,101	\$ 168,307
Restricted	233,208	307,666	315,154
Unrestricted	(213,422)	(176,085)	(12,053)
<b>Total net assets</b>	<b>\$ 39,219</b>	<b>\$ 186,682</b>	<b>\$ 471,408</b>

A significant portion of the Authority's net assets 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 reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding.

Net assets invested in utility plant, net of related debt decreased from \$55.1 million in 2007-2008 to \$19.4 million in 2008-2009 (64.7 percent) mainly due to increases in the interim financing of construction expenditures to compensate a reduction in the availability of internal funds allocated to the construction activity.

Restricted for capital and debt service decreased by \$74.5 million (24.2%) from \$307.7 million as of June 30, 2008 to \$233.2 million as of June 30, 2009. The decrease was mainly due to a reduction in construction fund balances used to finance the annual capital improvement program. Also, as allowed by the 1974 Trust Agreement, cash reserves in excess of required balances were transferred to debt service accounts.

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

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (continued)

**Authority's Changes in Net Assets**  
*(In thousands)*

	<b>Year Ended June 30</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Operating revenues	<b>\$ 4,002,713</b>	\$ 4,362,209	\$ 3,680,390
Other income	<b>25,326</b>	25,874	20,942
Total revenues	<b>4,028,039</b>	4,388,083	3,701,332
Operating expenses	<b>3,640,109</b>	4,181,143	3,309,445
Interest expense, net	<b>326,165</b>	312,269	296,209
Total expenses	<b>3,966,274</b>	4,493,412	3,605,654
(Loss)/Income before contribution in lieu of taxes and other and contributed capital	<b>61,765</b>	(105,329)	95,678
Contribution in lieu of taxes and other	<b>(224,792)</b>	(218,379)	(192,591)
Loss before contributed capital	<b>(163,027)</b>	(323,708)	(96,913)
Contributed capital	<b>15,564</b>	38,982	57,137
Change in net assets	<b>(147,463)</b>	(284,726)	(39,776)
Net assets, beginning of year	<b>186,682</b>	471,408	511,184
Net assets, end of year	<b>\$ 39,219</b>	\$ 186,682	\$ 471,408

For fiscal year ended June 30, 2009, as compared to June 30, 2008, Net Assets decreased by \$147.5 million. The reduction in Net Assets was mainly due to a decrease of \$359 million in revenues caused principally by a decrease of 1,085.8 million of Kwh in the sales of energy, which represented \$59.6 million in basic rate revenues. In addition, revenues decreased due to a decline in the price per barrel of fuel of \$7.95 per barrel, which is billed to clients as a pass-through in their electric bills. Expenses decreased by \$541 million, mainly due to a reduction in the price of fuel, referred to above, and an adjustment to Other Pension Obligation Expenses resulting from the modification of health benefits to retired employees.

The Authority's management has taken the following expense control measures:

Puerto Rico Electric Power Authority  
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Management's Discussion and Analysis (continued)

On June 30, 2009, the Authority changed the retired employees' health plan from a defined benefit plan to a defined contribution plan. This amendment to the health plan resulted in a net decrease of \$55 million in the accrued actuarial obligation of the Authority for the year ended June 30, 2009. Furthermore, the OPEB unfunded accrued actuarial liability was reduced from \$3.4 billion to \$531 million due to the change. For 2010 the annual required contribution will be \$27 million.

As of June 30, 2009, the Authority reduced 457 positions through voluntary retirement, ended contracts to temporary employees and eliminated 30 percent of seniors' staff positions. In addition, in January 2009 the Authority implemented a hiring freeze for all new staff.

The Authority's management has also identified the following strategies to stabilize the cost of energy:

- Revenue diversification - Net income generated from two recently created subsidiaries will be used to fund a revenue stabilization fund to reduce fuel price volatility.
- Fuel diversification – The Authority is in the process of evaluating generating units that use fuel oil to convert them to burn coal and natural gas.

For the fiscal year ended June 30, 2008, as compared to June 30, 2007, operating revenues and expenses increased by \$681.8 million (or 18.5%) and \$871.7 million (or 26.3%), respectively, resulting in a decrease in net assets of \$284.7 million. The decrease in net assets was mainly due to the recognition of the Other Postemployment Benefit (OPEB) expense of \$189.5 million. The Authority implemented Statement No. 45 of the Governmental Accounting Standard Board (GASB), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. GASB 45 establishes standards for the measurement, recognition of Other Postemployment Benefits (OPEB), related liabilities and disclosures. In addition, other reasons for the decrease in net assets were the decrease in sales of energy by 1,070 MhW (5.2%), representing \$52.3 million on basic rate revenues, and the increases on the total interest charge, net, and reserve for uncollectible accounts of \$16.1 million and \$20.1 million, respectively.

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Management's Discussion and Analysis (continued)

For the fiscal year ended June 30, 2007, as compared to June 30, 2006, operating revenues and expenses decreased by \$35.7 million (or 1%) and \$35.7 million (or 1%), respectively, resulting in a decrease in net assets of \$39.8 million. The decrease in net assets was mainly due to an increase in the reserve for uncollectible accounts of \$29.4 million and \$19.4 million related to the portion of the loss the Authority observed in connection of the Palo Seco Steam Plant fire, net of other operating income. The Authority holds a 30-day waiting period as a deductible on each occurrence in the extra expenses clause of Business Interruption Insurance Policy. The Authority assumed the cost of such retention instead of recovering it from the clients through the fuel and purchased power adjustment clauses. In addition, there was an increase on the total interest charge, net, of \$9.4 million for 2006-2007.

### **Capital Assets and Debt Administration**

#### **Capital Assets**

The Authority's investment in capital assets as of June 30, 2009, 2008 and 2007, amounts to approximately \$6,410 million, \$6,174 million and \$5,755 million (net of accumulated depreciation), respectively. This investment in capital assets includes land, generation, transmission and distribution systems, buildings, fixed equipment, furniture, fixtures and equipment. The total increases in the Authority's investment in capital assets (net of accumulated depreciation) were 3.8 percent, 7.3 percent and 5.8 percent for 2008-2009, 2007-2008 and 2006-2007, respectively.

A substantial portion of the capital expenditures for production plant in fiscal year ended June 30, 2009, 2008 and 2007, was spent on the rehabilitation and life extension of generating plants in order to achieve and maintain higher levels of availability, reliability and efficiency.

Major capital assets projects during fiscal years 2008 and 2009 included the following:

- The Authority replaced the two 44 MW San Juan Units No. 5 and 6, removed from service in fiscal year 1997, with 464 MW of combined-cycle capacity. The plant is comprised of two combined-cycle units, each consisting of one combustion turbine rated at 165 MW with a heat recovery steam generator (HRSG) feeding a single 67 MW steam turbine-generator.



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Management's Discussion and Analysis (continued)

- The Authority replaced the four 21 MW combustion turbines at Mayagüez with new four 55 MW dual fuel aero-derivative combustion turbines, which represent a net increase in capacity of approximately 136 MW over the replaced combustion turbines and they will generate electricity more efficiently. The first two combustion turbines were installed in fiscal year 2008 and the remainders two were installed and in service on fiscal year 2009.
- The Authority modified the eight 50 MW combustion turbines of Aguirre Combined Cycle Plant to enable them to burn either natural gas or light distillate. This conversion to dual fuel capability was completed on fiscal year 2009. The Authority is evaluating various alternatives to supply natural gas to the plant.
- The Authority is 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 2012. 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.
- A second 230 kV line project is a new 38-mile long 230 kV transmission line connecting the South Coast Steam Plant and the Cambalache Plant at a cost of \$74 million. Currently, the line is scheduled for completion in fiscal year 2014.
- A program to improve the 38 kV sub-transmission systems is still in effect. This program includes the construction of underground 38 kV lines in Mayagüez, Carolina and San Juan. In addition, most 38 kV lines in the central part of the island are being replaced. These projects will improve the reliability of the sub-transmission system.
- The Authority constructed 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 is \$195 million. The Federal Emergency Management Agency provided \$75 million for the investment in construction for this project through grants to the Authority.
- Other projects in the San Juan metropolitan area are new gas-insulated switchgear (GIS) 115/38 kV transmission centers at San Juan and Palo Seco Steam Plants, for \$63 million and \$65 million, respectively.

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Management's Discussion and Analysis (continued)

- In addition, major expansions to 115/38 kV transmission centers in Isla Grande at San Juan, Isabela, Hato Tejas at Bayamón, Canóvanas, Juncos and Las Cruces at Cidra will increase the power transfer and improve the voltage regulation of the 38 kV system under emergency conditions.
- The Authority repaired steam turbines generators and replaced transformers and major electrical equipments of Palo Seco Steam Plant unit, which have an 85 MW capacity. In addition, the Authority replaced the control room for all Palo Seco Steam Plant units and switch gear for Palo Seco Steam Plant units two, three and four. The total cost of repairing the Palo Seco Steam Plant units is of approximately \$118 million.

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

Additional information on the Authority's capital assets can be found in Note 6 to the financial statements.

**Long-Term Debt**

At the end of the fiscal year 2009, 2008 and 2007, the Authority had total long-term debt outstanding of \$6,843.1 million, \$7,113.8 million and \$6,127.8 million, respectively, comprised of revenue bonds and other borrowings.

**Authority's Outstanding Debt**  
(In thousands)

	2009	2008	2007
Power revenue bonds, net	\$ 6,008,385	\$ 6,162,987	\$ 5,647,709
Notes payable	834,752	950,845	480,061
	<b>6,843,137</b>	7,113,832	6,127,770
Current portion	<b>(1,067,310)</b>	(598,296)	(363,358)
Long-term debt excluding current portion	<b>\$ 5,775,827</b>	\$ 6,515,536	\$ 5,764,412

Puerto Rico Electric Power Authority  
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Management's Discussion and Analysis (continued)

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

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

**Economic Factors and Next 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. In the second quarter of fiscal year 2009 U.S. Real GDP decreased at an annual rate of 1.0% after a 6.4% increase in the first quarter.

The preliminary estimate for the economy of Puerto Rico is expected to decrease in fiscal year 2010, at a rate of 5.5% in real terms, according to the latest forecast prepared by the Puerto Rico Planning Board (JP).

The Authority adopted the 2010 fiscal year budget on June 30, 2009. The total revenues for fiscal year 2009-2010 are projected to be approximately \$3,160.3 million. In addition, the Capital Improvement Program amounted to approximately \$350.0 million. The 2010 consolidated budget decreased by \$854.3 million (19.6 percent) when compared to the ammended consolidated budget approved on April 21, 2009 for fiscal year 2008-2009, due mainly to a decrease on projected fuel oil prices per barrel from \$73.75 for 2008-2009 to \$49.08 for 2009-2010, representing a 33.5 percent. In addition, the Capital Improvement Program decreased by \$96.0 million, representing a 21.5 percent.

**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 Authority's 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  
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Balance Sheets

	<b>June 30</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 76,194	\$ 40,920
Receivables, net	1,018,796	1,171,112
Fuel oil, at average cost	210,262	212,026
Materials and supplies, at average cost	200,084	192,554
Prepayments and other assets	2,177	2,510
Total current assets	1,507,513	1,619,122
Other non-current receivables	108,061	101,734
Restricted assets:		
Cash and cash equivalents held by trustee for payment of principal and interest on bonds	304,480	281,624
Investments held by trustee	329,625	338,918
Construction fund and other special funds	23,788	567,834
Total restricted assets	657,893	1,188,376
Utility plant:		
Plant in service	9,352,258	8,001,401
Accumulated depreciation	(4,639,335)	(4,383,884)
	4,712,923	3,617,517
Construction in progress	1,697,250	2,556,476
Total utility plant, net	6,410,173	6,173,993
Deferred expenses:		
Unamortized debt issue costs	64,476	68,461
Other	33,489	79,910
Total deferred expenses	97,965	148,371
Total assets	\$ 8,781,605	\$ 9,231,596

*(Continue)*

	<b>June 30</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Notes payable	\$ 595,374	\$ 395,547
Accounts payable and accrued liabilities	820,851	854,882
Customers' deposits	169,992	164,475
Total current liabilities	<b>1,586,217</b>	1,414,904
Current liabilities payable from restricted assets:		
Current portion of long-term debt and bond anticipation notes	853,040	584,203
Notes payable from restricted assets	11,622	-
Accrued interest	148,910	137,497
Other current liabilities payable from restricted assets	96,050	79,767
Total current liabilities payable from restricted assets	<b>1,109,622</b>	801,467
Noncurrent liabilities:		
Long-term debt, excluding current portion	5,775,827	6,515,536
Sick leave benefits to be liquidated after one year	136,544	123,515
Accrued unfunded other post-employment benefits liability	134,176	189,492
Total noncurrent liabilities	<b>6,046,547</b>	6,828,543
Total liabilities	<b>8,742,386</b>	9,044,914
Net assets:		
Invested in utility plant, net of related debt	19,433	55,101
Restricted for capital activity and debt service	233,208	307,666
Unrestricted	(213,422)	(176,085)
Total net assets	<b>39,219</b>	186,682
Total liabilities and net assets	<b>\$ 8,781,605</b>	<b>\$ 9,231,596</b>

*See accompanying notes.*

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

	<b>Year Ended June 30</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Operating revenues	\$ 4,002,713	\$ 4,362,209
Operating expenses:		
Operations:		
Fuel	1,919,789	2,303,036
Purchased power	671,849	661,097
Claim for extra fuel expense	-	(96,273)
Other production	64,409	58,035
Transmission and distribution	168,102	177,692
Customer accounting and collection	111,337	118,485
Administrative and general	171,864	415,185
Maintenance	226,642	248,569
Depreciation	306,117	295,317
Total operating expenses	<u>3,640,109</u>	<u>4,181,143</u>
Operating income	362,604	181,066
Interest income and other	25,326	25,874
Income before interest charges, contribution in lieu of taxes and contributed capital	<u>387,930</u>	<u>206,940</u>
Interest charges:		
Interest on bonds	299,173	271,016
Interest on notes payable and other long-term debt	28,798	44,291
Other interest	2,819	3,963
Amortization of debt discount, issuance costs and refunding loss	13,905	14,124
Allowance for funds used during construction	(18,530)	(21,125)
Total interest charges, net	<u>326,165</u>	<u>312,269</u>
Income/(Loss) before contribution in lieu of taxes and contributed capital	61,765	(105,329)
Contribution in lieu of taxes and other	(224,792)	(218,379)
Loss before contributed capital	<u>(163,027)</u>	<u>(323,708)</u>
Contributed capital	15,564	38,982
Change in net assets	<u>(147,463)</u>	<u>(284,726)</u>
Net assets, beginning balance	186,682	471,408
Net assets, ending balance	<u>\$ 39,219</u>	<u>\$ 186,682</u>

*See accompanying notes.*

Puerto Rico Electric Power Authority  
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Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
<b>Cash flows from operating activities</b>		
Cash received from customers	\$ 3,955,522	\$ 4,095,297
Cash paid to suppliers and employees	<b>(3,382,771)</b>	<b>(3,981,056)</b>
Net cash flows provided by operating activities	<b>572,751</b>	114,241
<b>Cash flows from noncapital financing activities</b>		
Proceeds from notes payable	<b>195,000</b>	226,450
Principal paid on notes payable	<b>(247,821)</b>	(62,277)
Interest paid on notes payable	<b>(12,716)</b>	(18,754)
Principal paid on fuel line of credit	–	100,000
Proceeds from fuel line of credit	<b>50,000</b>	(50,000)
Interest paid on fuel line of credit	<b>(11,064)</b>	(9,452)
Net cash flows (used) provided for noncapital financing activities	<b>(26,601)</b>	185,967
<b>Cash flows from capital and related financing activities</b>		
Construction expenditures	<b>(527,161)</b>	(673,207)
Proceeds received from contributed capital	<b>12,661</b>	17,379
Allowance for funds used during construction	<b>18,530</b>	21,125
Power revenue bonds:		
Proceeds from issuance of bonds, net of original discount	–	706,199
Principal paid on revenue bonds maturities	<b>(164,511)</b>	(197,583)
Interest paid on revenue bonds	<b>(285,353)</b>	(242,765)
Proceeds from bond anticipation notes	<b>98,000</b>	215,229
Payment of bond anticipation notes	<b>(200,000)</b>	–
Interest paid on notes payable	<b>(18,820)</b>	(23,189)
Net cash flows used in capital and related financing activities	<b>(1,066,654)</b>	(176,812)
<b>Cash flows from investing activities</b>		
Purchases of investment securities	<b>(1,512,316)</b>	(1,180,735)
Proceeds from sale and maturities of investment securities	<b>1,539,206</b>	1,385,132
Interest on investments	<b>25,295</b>	35,856
Transfer from restricted funds to general fund	<b>29,523</b>	25,438
Transfer from general fund to restricted funds	<b>(15,000)</b>	(5,000)
Net cash flows provided by investing activities	<b>66,708</b>	260,691
Net (decrease) increase in cash and cash equivalents	<b>(453,796)</b>	384,087
Cash and cash equivalents at beginning of year	<b>851,764</b>	467,677
Cash and cash equivalents at end of year	<b>\$ 397,968</b>	<b>\$ 851,764</b>

*(Continue)*

Puerto Rico Electric Power Authority  
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Statements of Cash Flows (continued)

	<b>Year Ended June 30</b>	
	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
<b>Cash and cash equivalents</b>		
Unrestricted	\$ 76,194	\$ 40,920
Restricted:		
Cash and cash equivalents held by trustee for payment of principal and interest on bonds	304,480	281,624
Cash and cash equivalents within construction and other special funds	17,294	529,220
	<b>\$ 397,968</b>	<b>\$ 851,764</b>
 <b>Reconciliation of net operating revenues to net cash provided by operating activities</b>		
Operating income	\$ 362,604	\$ 181,066
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	306,117	295,317
Amortization of asbestos removal	-	2,634
Provision for uncollectible accounts and other	20,637	30,021
Changes in assets and liabilities:		
Receivables	(118,391)	(582,615)
Fuel oil	12,828	(55,442)
Materials and supplies	(7,517)	(30,350)
Prepayments and other assets	333	3,667
Other deferred debits	50,659	(21,242)
Noncurrent liabilities, excluding revenue bonds and notes payable	(42,287)	184,293
Accounts payable and accrued liabilities	(17,749)	101,521
Customer's deposits	5,517	5,371
Total adjustments	<b>210,147</b>	<b>(66,825)</b>
Net cash flows provided by operating activities	<b>\$ 572,751</b>	<b>\$ 114,241</b>

*See accompanying notes.*



Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements

June 30, 2009

**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.

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, for profit or non-profit entities.

**Basis of Presentation – Blended Component Units**

The financial statements of the Authority include the financial position and operations of the Puerto Rico Irrigation Systems (Irrigation Systems) and PREPA Networks Corp. (PREPA.Net). 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.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

The Irrigations Systems and PREPA.Net conform to the requirements of Governmental Accounting Standards Board (GASB) No. 39, *Determining Whether Certain Organizations are Component Units*, on its stand-alone financial statements. GASB No. 39 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, 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.

Condensed financial information as of June 30, 2009 and 2008 and for the years then ended for the Irrigation Systems is as follows:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Balance sheets:		
Assets:		
Receivables, net	<b>\$ 18,796</b>	\$ 16,725
Prepayments and other assets	<b>2,186</b>	2,185
Utility Plant, net of depreciation	<b>20,211</b>	19,376
Total assets	<b>\$ 41,193</b>	\$ 38,286
Liabilities:		
Accounts payable, net	<b>\$ 1,020</b>	\$ 997
Statements of revenues, expenditures and changes in net assets:		
Operating revenues	<b>\$ 7,619</b>	\$ 5,985
Operating expenses	<b>(4,735)</b>	(3,949)
	<b>2,884</b>	2,036
Net assets, beginning balance	<b>37,289</b>	35,253
Net assets, ending balance	<b>\$ 40,173</b>	\$ 37,289

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

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

PREPA.Net is a subsidiary of the Authority created to develop strategies for commercializing the surplus capacity of the installed Optical Fiber Network (OFN), adding flexibility and diversification to its operations. PREPA.Net was created on April, 2004 and started commercial operations during fiscal year 2005-2006.

PREPA.Net provides Optical Infrastructure to carriers, ISPs and enhanced services providers – with a highly reliable island wide fiber optic network.

PREPA.Net entered into a long-term lease with PREPA for the Indefeasible Right of Use (IRU) of all PREPA’s Optical Infrastructure. PREPA.Net’s network features state of the art optical technology that is being used by service providers to reach undersea cable landing stations, wireless network towers, and island wide locations.

In February 2008, PREPA.Net acquired Telecomunicaciones Ultramarinas de Puerto Rico (Ultracom). Ultracom is one of the three submarine cable station administrators in Puerto Rico. This acquisition provides PREPA.Net with International fiber optic capacity and satellite teleport facilities.

Condensed financial information as of June 30, 2009 and 2008 and for the years then ended for PREPA.Net is as follows:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Balance sheets:		
Assets:		
Cash and cash equivalents	\$ 10,421	\$ 8,737
Receivables, net	1,369	1,116
Prepayments and other assets	163	130
Utility plant, net of depreciation	8,163	8,660
Total assets	<b>\$ 20,116</b>	<b>\$ 18,643</b>
Liabilities:		
Accounts payable, net	<b>\$ 16,856</b>	<b>\$ 18,059</b>

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

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

	2009	2008
	<i>(In thousands)</i>	
Statements of revenues, expenditures and changes in net assets:		
Operating revenues	\$ 9,075	\$ 5,678
Operating expenses	(6,399)	(4,227)
	2,676	1,451
Net assets, beginning balance	584	(867)
Net assets, ending balance	\$ 3,260	\$ 584

**Reclassifications**

Certain prior year's amounts have been reclassified to conform to the current year's presentation.

**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 to 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 basis of accounting in conformity with U.S. generally accepted accounting principles. 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  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited 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.

**GASB Statement No. 45**

During fiscal year 2008, the Authority adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*. This Statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. Effects on the financial statements of the adoption of Statement No. 45 are disclosed in Note 12.

**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.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Receivables**

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

**Materials, Supplies and Fuel Oil**

Materials, supplies and fuel oil 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.

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.

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

**2. Summary of Significant Accounting Policies (continued)**

**Investments (continued)**

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, 2009 and 2008 amounted to \$18.5 million and \$21.1 million, respectively. These amounts are net of interest income earned on investments amounting to \$4.1 million and \$375,117, respectively.

Capital expenditures of \$1,200 or more are capitalized at cost at the date of acquisition. 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.

**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 2009 and 2008.

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

**2. Summary of Significant Accounting Policies (continued)**

**Unamortized Debt Issuance Expense**

Debt issuance 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 debt 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.

**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.

**Other Postemployment Benefits**

Other Postemployment Benefits (OPEB) cost for healthcare provided to employees is measured and disclosed using the accrual basis of accounting (see Note 12).

**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 sheets date.

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



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

**2. Summary of Significant Accounting Policies (continued)**

**Revenue Recognition, Fuel Costs and Purchase Power**

Clients are billed monthly, except for rural clients who are billed bi-monthly. 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.

**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 11% to the Commonwealth and the Municipalities of gross electric sales as follows:

The Authority is required under the Act to make a contribution in lieu of taxes to municipalities of the greater of:

- a) Twenty percent of the Authority's Adjusted Net Revenues (Net Revenues, as defined in the 1974 Agreement, less the cost of the Commonwealth rate subsidies);
- b) The cost collectively of the actual electric power consumption of the municipalities;  
or
- c) The prior five-year moving average of the contributions in lieu of taxes paid to the municipalities collectively.

If the Authority does not have sufficient funds available in any year to pay the contribution in lieu of taxes, the difference is accrued and carried forward for a maximum of three years. The contribution in lieu of taxes to Municipalities can be used to offset accounts receivable balance owed by the Municipalities to the Authority as permitted by law.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Contributions in Lieu of Taxes and Governmental Subsidies (continued)**

*Commonwealth of Puerto Rico*

To the extent net revenues are available, the Authority is also required under the Act to set aside the remainder of contribution in lieu of taxes of gross electric sales for the purpose of (i) financing capital 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. 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 by third parties during recent years and local and federal agencies.

**Interest-Rate Swap Agreements**

The interest-rate swaps are used in the area of debt management to take advantage of favorable market interest rates and to limit interest rate risk associated with variable rate debt exposure. Under the interest-rate swap programs, the Authority pays fixed and variable rate of interest based on various indices for the term of the variable interest rate Power Revenue Bonds and receives a variable rate of interest, which is also based on various indices. These indices are affected by changes in the market. The net amount received or paid under the swap agreements are recorded as an adjustment to interest expense on the statements of income.

**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.

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

**3. Cash and Cash Equivalents (continued)**

At June 30, 2009 and 2008, 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):

	2009		2008	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Unrestricted	\$ 76,194	\$ 76,578	\$ 40,920	\$ 47,464
Restricted:				
Held by the Trustee	304,480	304,480	281,624	281,624
Held by the Authority	17,294	17,294	529,220	529,220
	<b>\$ 397,968</b>	<b>\$ 398,352</b>	<b>\$ 851,764</b>	<b>\$ 858,308</b>

**Custodial Credit Risk - Deposits**

Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned. The Authority's policy is to deposit funds with either institutions which provide insurance or securities as collateral. Such collateral is held by the Department of the Treasury of the Commonwealth, or with GDB, another component unit of the Commonwealth, which are uninsured and uncollateralized.

All moneys deposited with the Trustee or any other Depository hereunder in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other federal agency are continuously secured by lodging with a bank or trust company approved by the Authority and by the Trustee as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit, as collateral security, Government Obligations or other marketable securities.

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

**4. Accounts Receivable**

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

	<b>2009</b>	<b>2008</b>
Electric and related services:		
Government agencies and municipalities	\$ 471,400	\$ 357,257
Residential, industrial, and commercial	545,150	611,773
Recoveries under fuel adjustment clause under billed	25,189	5,487
Unbilled services	150,742	230,578
Commonwealth subsidy (fuel adjustment clause) for certain residential clients	18,980	18,980
Miscellaneous accounts and others	25,938	22,021
	1,237,399	1,246,096
Allowance for uncollectible accounts	(163,556)	(143,756)
	1,073,843	1,102,340
Recovery from insurance companies and other	50,229	167,733
Accrued interest on investments	2,785	2,773
Less other non-current receivables, mostly related to the Commonwealth	(108,061)	(101,734)
	<b>\$ 1,018,796</b>	<b>\$ 1,171,112</b>

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 was paying that amount over a fifteen-year period in installments of approximately \$6.3 million per year, without interest. As of June 30, 2004, the outstanding fuel adjustment subsidy receivable amounted to approximately \$31.6 million. In June 2004, the Legislature of the Commonwealth of Puerto Rico superseded the 1991 agreement with a revised agreement containing an eight-year payment schedule that totals \$55.7 million. The amount owed to the Authority under the 2004 agreement includes an allocation for past due government account receivables in addition to the unpaid balance of the fuel adjustment subsidy. As of June 30, 2009 and 2008, the outstanding receivable amounted to approximately \$18.9 million. This amount is included in other non-current receivables in the accompanying balance sheet.

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

**4. Accounts Receivable (continued)**

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 11% of gross electric sales, after the contribution in lieu of taxes to municipalities, 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, 2009 and 2008, 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. During fiscal year 2008-2009, as allowed by the Trust Agreement, the Authority withdrew \$29.5 million, which were accumulated in excess of the amount required.

*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. During fiscal year 2007-2008, the Authority withdrew \$29.5 million from 1974 Self-Insurance Fund to cover uninsured losses associated with the Palo Seco Steam Plant fires. In addition, the Authority deposited \$10 million and \$5 million to 1974 Self-Insurance Fund for fiscal years 2008-2009 and 2007-2008, respectively.

*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, 2009 and 2008, cash and cash equivalents in this account amounted to \$304.5 million and \$281.6 million, respectively.

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

**5. Restricted Assets (continued)**

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

	2009	2008
1974 Reserve Account	\$ 267,001	\$ 287,832
1974 Self-Insurance Fund	62,624	51,086
	\$ 329,625	\$ 338,918

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. The Authority withdrew \$67.7 million from 1974 Reserve Maintenance Fund to finance the recovery of the Palo Seco Steam Plant, which \$58.3 million was withdrawn during fiscal year 2007-2008. Such amount should be replenished following recommendations of the Consulting Engineers. During fiscal years 2008-2009 and 2007-2008 the Authority deposited \$5.0 million and \$9.7 million, respectively, to 1974 Reserve Maintenance Fund.

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

**5. Restricted Assets (continued)**

At June 30, the 1974 Construction Fund and Reserve Maintenance Fund consist of (in thousands):

	2009		2008	
	Cash and Cash Equivalents	Investments	Cash and Cash Equivalents	Investments
1974 Construction Fund	\$ 14,884	\$ 921	\$ 529,220	\$ 38,045
Reserve Maintenance Fund	-	5,573	-	569
Other Restricted Funds	2,410	-	-	-
	<b>\$ 17,294</b>	<b>\$ 6,494</b>	\$ 529,220	\$ 38,614

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

	2009	2008
U.S. Government obligations	\$ 921	\$ 924
Certificate of deposit	5,573	37,690
	<b>\$ 6,494</b>	<b>\$ 38,614</b>

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

**5. Restricted Assets (continued)**

**Investments**

The following table provides a summary of the Authority's investments by type at June 30, 2009 (in thousands):

June 30, 2009					
	Coupon Rate	Maturity Dates	Face Value	Fair Value	% of Total Portfolio
<b>1974 Reserve Maintenance Fund</b>					
Certificate of Deposits	0.18 to 0.21%	Jul-09	\$ 5,573	\$ 5,573	100.0%
			<b>Total Portfolio</b>	<u>5,573</u>	
<b>1974 Self Insurance Reserve Fund</b>					
Federal Home Loan Mortgage Corp.	2.0 to 5.05%	03/2012 to 06/2012	42,282	42,472	67.8%
Federal Home Loan Bank	2.00%	Jun-12	10,165	10,146	16.2%
Certificates of Deposit	0.18 to 0.19%	Jul-09	10,006	10,006	16.0%
			<b>Total Portfolio</b>	<u>62,624</u>	
<b>1974 Reserve Account</b>					
Federal Home Loan Mortgage Corporation	2.00%	Oct-09	40,550	40,474	15.2%
Federal Home Loan Bank	2.35 to 3.38%	12/2011 to 12/2014	105,625	105,773	3 9.6%
Federal National Mortgage Association	3.25%	Feb-09	20,500	20,535	7.7%
Federal Farm Credit Bank	2.60 to 4.90%	01/2013 to 05/2014	99,433	99,559	37.3%
Certificates of Deposit	0.08 to 0.18%	Jul-09	660	660	.2%
			<b>Total Portfolio</b>	<u>267,001</u>	
<b>1974 Construction Fund</b>					
Other – Rural Electrification Administration (REA) Investment			921	921	100.0%
			<b>Total Portfolio</b>	<u>921</u>	
				<u><u>\$336,119</u></u>	



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

**5. Restricted Assets (continued)**

**Investments (continued)**

The following table provides a summary of the Authority's investments by type at June 30, 2008 (in thousands):

June 30, 2008					
	Coupon Rate	Maturity Dates	Face Value	Fair Value	% of Total Portfolio
<b>1974 Reserve Maintenance Fund</b>					
Certificate of Deposits	1.35%	07/2008	\$ 569	\$ 569	100.0%
			<b>Total Portfolio</b>	<b>569</b>	
<b>1974 Self Insurance Reserve Fund</b>					
Federal Home Loan Mortgage Corp.	3.60 to 5.05%	08/2010 to 02/2011	20,000	20,359	39.9%
Federal Home Loan Bank	3.13 to 3.38%	06/2010 to 05/2011	30,000	30,068	58.8%
Certificates of Deposit	2.050%	07/2008	659	659	1.3%
			<b>Total Portfolio</b>	<b>51,086</b>	
<b>1974 Reserve Account</b>					
Federal Home Loan Mortgage Corporation	3.50 to 4.75%	11/2011 to 01/2013	60,000	60,116	20.9%
Federal Home Loan Bank	3.375 to 4.40%	07/2008 to 02/2012	51,410	51,683	18.0%
Federal National Mortgage Association	3.125 to 5.085%	06/2010 to 03/2013	100,000	100,903	35.1%
Federal Farm Credit Bank	3.80 to 3.90%	03/2012 to 02/2013	40,000	40,170	13.9%
Certificates of Deposit	2.05 to 2.30%	07/2008	34,960	34,960	12.1%
			<b>Total Portfolio</b>	<b>287,832</b>	
<b>1974 Construction Fund</b>					
Other – Rural Electrification Administration (REA) Investment			924	924	2.4%
Certificate of Deposit	3.00%	12/2008	37,121	37,121	97.6%
			<b>Total Portfolio</b>	<b>38,045</b>	
				<b>\$377,532</b>	

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

**5. Restricted Assets (continued)**

**Credit Risk**

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The 1974 Trust Agreement limits investments in:

- Government obligations, which are direct obligations of, or obligations whose principal and interest is guaranteed by the U.S. Government, or obligation of certain of its agencies or instrumentalities.
- Investment obligation of any of the states or territories of the United States or political subdivisions therefore (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 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.

As of June 30, 2009, the Authority's investments in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Bank and Freddie Mac were rated AAA by Standard & Poor's and Aaa by Moody's Investors Service.

**Concentration Credit Risk**

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer by five percent or more of total investment. The Authority's investment policy does not contain a limitation to invest in the securities of single issuer. As June 30, 2009, more than 5% of the Authority's total investments are in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Certificate of Deposits.

**Puerto Rico Electric Power Authority**  
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Audited Financial Statements (continued)

**5. Restricted Assets (continued)**

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. In accordance with the 1974 Trust Agreement, the Authority manages its exposure to declines in fair values by limiting the maturity of its investment portfolio up to 5 years. Information about the sensitivity of the fair values of the Authority's investment to market interest fluctuations is provided by the following tables that show the distribution of the investments by maturity as of June 30, 2009 and 2008 (in thousands):

<b>June 30, 2009</b>				
<b>Investment Type</b>	<b>Fair Value</b>	<b>Investment Maturities</b>		<b>Total</b>
		<b>Less than 1 year</b>	<b>1-5 years</b>	
Federal Home Loan Mortgage	\$ 82,946	\$ –	\$ 82,946	\$ 82,946
Federal Home Loan Bank	115,919	–	115,919	115,919
Federal National Mortgage	20,535	–	20,535	20,535
Federal Farm Credit Bank	99,559	–	99,559	99,559
Certificate of Deposits	16,239	16,239	–	16,239
Other – REA Investment	921	–	921	921
Total Investments				<u>\$ 336,119</u>

<b>June 30, 2008</b>				
<b>Investment Type</b>	<b>Fair Value</b>	<b>Investment Maturities</b>		<b>Total</b>
		<b>Less than 1 year</b>	<b>1-5 years</b>	
Federal Home Loan Mortgage	\$ 80,475	\$ –	\$ 80,475	\$ 80,475
Federal Home Loan Bank	81,751	11,627	70,124	81,751
Federal National Mortgage	100,903	–	100,903	100,903
Federal Farm Credit Bank	40,170	–	40,170	40,170
Certificate of Deposits	73,309	73,309	–	73,309
Other – REA Investment	924	–	924	924
				<u>\$ 377,532</u>

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

**6. Utility Plant**

As of June 30, utility plant consists of:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Distribution	<b>\$ 2,603,970</b>	\$ 2,491,417
Transmission	<b>1,387,017</b>	1,305,372
Production	<b>2,295,224</b>	1,799,070
Other production	<b>1,173,550</b>	691,083
Hydroelectric	<b>124,547</b>	107,593
General	<b>1,726,617</b>	1,558,640
Irrigation systems	<b>33,170</b>	31,898
Fiber Network	<b>8,163</b>	16,328
	<b>9,352,258</b>	8,001,401
Less accumulated depreciation	<b>(4,639,335)</b>	(4,383,884)
	<b>4,712,923</b>	3,617,517
Construction in progress	<b>1,697,250</b>	2,556,476
	<b>\$ 6,410,173</b>	\$ 6,173,993

Utility plant activity for the years ended June 30, 2009 and 2008 was as follows (in thousands):

	<b>2008</b>				<b>2009</b>
	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Transfers</b>	<b>Ending Balance</b>
Utility plant	\$ 8,001,401	\$ –	\$ (50,667)	\$ 1,401,524	<b>\$ 9,352,258</b>
Construction work in progress	2,556,476	542,298	–	(1,401,524)	<b>1,697,250</b>
Total utility plant	10,557,877	542,298	(50,667)	–	<b>11,049,508</b>
Less:					
Accumulated depreciation	(4,383,884)	(306,118)	50,667	–	<b>(4,639,335)</b>
Total utility plant, net	\$ 6,173,993	\$ 236,180	\$ –	\$ –	<b>\$ 6,410,173</b>

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

**6. Utility Plant (continued)**

	<b>2007</b>				<b>2008</b>
	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Transfers</b>	<b>Ending Balance</b>
Utility plant	\$ 7,570,186	\$ –	\$ (39,662)	\$ 470,877	\$ 8,001,401
Construction work in progress	2,312,611	714,742	–	(470,877)	2,556,476
Total utility plant	9,882,797	714,742	(39,662)	–	10,557,877
Less:					
Accumulated depreciation	(4,128,229)	(295,317)	39,662	–	(4,383,884)
Total utility plant, net	\$ 5,754,568	\$ 419,425	\$ –	\$ –	\$ 6,173,993

Construction work-in-progress at June 30, 2009 and 2008 consists principally of expansions and upgrades to the electric generation, distribution and transmission systems.

**7. Defeasance of Debt**

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, 2009, \$3,159 million of Power Revenue Bonds which remain outstanding are considered defeased.

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

**8. Notes Payable**

The following is a summary of notes payable as of June 30, 2009:

	<b>June 30, 2009</b>				
	<b>Maturity Date</b>	<b>Effective Interest Rate</b>	<b>Current Liabilities</b>	<b>Long- Term Debt</b>	<b>Total</b>
Notes payable, unrestricted:					
Revolving line of credit or \$275 million to finance fuel purchases	<b>Jun-2010</b>	<b>4.11%<sup>(V)</sup></b>	<b>\$ 275,000</b>	<b>\$ –</b>	<b>\$ 275,000</b>
Line of credit of \$25 million to finance improvements of Isabela Irrigation System	<b>Jun-2010</b>	<b>4.60%<sup>(V)</sup></b>	<b>6,104</b>	<b>–</b>	<b>6,104</b>
Line of credit of \$100 million to be used in the recovery of Palo Seco Steam Plant (PSSP)	<b>Dec-2009</b>	<b>3.81%<sup>(V)</sup></b>	<b>50,000</b>	<b>–</b>	<b>50,000</b>
Line of credit of \$100 million to be used in the recovery of PSSP	<b>Jun-2010</b>	<b>3.63%</b>	<b>50,000</b>	<b>–</b>	<b>50,000</b>
Revolving line of credit of \$200 million for operational purposes	<b>Jun-2010</b>	<b>3.12%<sup>(V)</sup></b>	<b>199,892</b>	<b>–</b>	<b>199,892</b>
Line of credit of \$64.2 million to fund payments required under a settlement agreement with municipalities	<b>Jun-2014</b>	<b>3.40%<sup>(V)</sup></b>	<b>9,000</b>	<b>39,058</b>	<b>48,058</b>
Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy	<b>Nov-2013</b>	<b>4.30%<sup>(V)</sup></b>	<b>5,378</b>	<b>16,363</b>	<b>21,741</b>
Prepa.Net entered an agreement for a loan to be used on the acquisition of subsidiary, Ultramarinas de P.R. (ULTRACOM)	<b>Feb-2023</b>	<b>3.36%<sup>(V)</sup></b>	<b>–</b>	<b>10,100</b>	<b>10,100</b>
			<b>595,374</b>	<b>65,521</b>	<b>660,895</b>
Notes payable, restricted:					
Current portion of bond anticipation notes					
Revolving line of credit of \$400 million to finance various capital projects under Capital Improvement Program (CIP)	<b>Sep-2009</b>	<b>2.45%<sup>(V)</sup></b>	<b>250,000</b>	<b>–</b>	<b>250,000</b>
Bridge loan of \$200 million to finance CIP	<b>Dec-2009</b>	<b>3.80%<sup>(V)</sup></b>	<b>200,000</b>	<b>–</b>	<b>200,000</b>
Line of credit of \$96 million to finance CIP	<b>Jun-2011</b>	<b>4.75%<sup>(V)</sup></b>	<b>–</b>	<b>48,000</b>	<b>48,000</b>
Line of credit of \$57 million to finance infrastructure in the municipalities	<b>Jun-2010</b>	<b>3.62%<sup>(V)</sup></b>	<b>56,961</b>	<b>–</b>	<b>56,961</b>
			<b>506,961</b>	<b>48,000</b>	<b>554,961</b>
Other notes payable, restricted:					
Revolving line of credit of \$150 million to cover the cash collateral required by the Basis Swap Agreement	<b>Dec-2009</b>	<b>3.01%<sup>(V)</sup></b>	<b>11,622</b>	<b>–</b>	<b>11,622</b>
			<b>11,622</b>	<b>–</b>	<b>11,622</b>
<b>Total notes payable</b>			<b>\$ 1,113,957</b>	<b>\$ 113,521</b>	<b>\$1,227,478</b>

(V) – variable interest rate

(F) – fixed interest rate

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

**8. Notes Payable (continued)**

The following is a summary of notes payable as of June 30, 2008:

	<b>June 30, 2008</b>				
	<b>Maturity Date</b>	<b>Effective Interest Rate</b>	<b>Current Liabilities</b>	<b>Long-Term Debt</b>	<b>Total</b>
Notes payable unrestricted:					
Revolving line of credit or \$225 million to finance fuel purchases	Jun-2009	4.83% <sup>(V)</sup>	\$ 225,000	\$ –	\$ 225,000
Line of credit of \$25.3 million to finance the improvements of Isabela Irrigation System	Jun-2009	4.35% <sup>(V)</sup>	6,104	–	6,104
Line of credit of \$100 million to be used in the recovery of Palo Seco Steam Plant (PSSP)	Dec-2008	4.03% <sup>(V)</sup>	100,000	–	100,000
Line of credit of \$100 million to be used in the recovery of PSSP	Jun-2009	3.70% <sup>(V)</sup>	50,000	–	50,000
Revolving line of credit of \$200 million for operational purposes	Dec-2009	4.93% <sup>(V)</sup>	–	199,892	199,892
Line of credit of \$64.2 million to fund payments required under a settlement agreement with the municipalities	Jun-2014	5.22% <sup>(V)</sup>	8,900	48,058	56,958
Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy	Nov-2013	4.20% <sup>(V)</sup>	5,193	21,741	26,934
Revolving line of credit of \$2 million for working capital purposes by PREPA.Net			350	–	350
Prepa.Net entered an agreement for a loan to be used on the acquisition of subsidiary, Ultramarinas de P.R. (ULTRACOM)	Feb-2023	3.36 % <sup>(V)</sup>	–	10,100	10,100
			<u>395,547</u>	<u>279,791</u>	<u>675,338</u>
Notes payable, restricted:					
Current portion of Bond anticipation notes					
Revolving line of credit of \$400 million to finance various capital projects under Capital Improvement Program (CIP)	Sep-2009	4.00% <sup>(V)</sup>	–	400,000	400,000
Bridge loan of \$200 million to finance CIP	Jun-2009	5.16% <sup>(V)</sup>	200,000	–	200,000
Line of credit of \$57 million to finance the infrastructure in the municipalities	Jun-2009	5.57% <sup>(V)</sup>	56,961	–	56,961
			<u>256,961</u>	<u>400,000</u>	<u>656,961</u>
<b>Total notes payable</b>			<u>\$ 652,508</u>	<u>\$ 679,791</u>	<u>\$1,332,299</u>

(V) – variable interest rate  
(F) – fixed interest rate

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

**8. Notes Payable (continued)**

Short-term debt activity for the years ended June 30, 2009 and 2008 was as follows:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Balance at beginning of year	\$ 652,508	\$ 436,766
Proceeds and transfers from long-term debt	709,270	329,672
Payment of short-term debt	(247,821)	(113,930)
Balance at end of year	<b>\$ 1,113,957</b>	<b>\$ 652,508</b>
Notes payable – short-term:		
Unrestricted	\$ 595,374	\$ 395,547
Restricted	518,583	256,961
Total of notes payable	<b>\$ 1,113,957</b>	<b>\$ 652,508</b>

**9. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities for the years ended June 30, 2009 and 2008 was as follows:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Accounts payable, accruals, and withholdings in process of payment	\$ 537,200	\$ 630,960
Additional accruals and withholdings:		
Injuries and damages and other	23,210	22,373
Accrued vacation and payroll benefits	57,374	57,396
Accrued sick leave and payroll benefits - exclusive of benefits to be liquidated after one year of approximately \$136.5 million in 2009 and \$123.5 in 2008	25,749	32,111
Accrued compensation	27,294	24,240
Accrued pension plan contribution and withholding from employees:		
Employees' Retirement System	15,154	13,432
Employees health plan	21,803	20,125
Contribution in lieu of taxes	100,462	40,613
Other accrued liabilities	12,605	13,632
	<b>\$ 820,851</b>	<b>\$ 854,882</b>



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

**10. Other Current Liabilities Payable from Restricted Assets**

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Contract retainage	\$ 20,794	\$ 26,642
Other liabilities	<b>75,256</b>	53,125
	<b>\$ 96,050</b>	\$ 79,767
	<b>\$ 96,050</b>	\$ 79,767

**11. Long-Term Debt**

At June 30, long-term debt consists of:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Power Revenue Bonds payable:		
Publicly offered at various dates from 1992 to 2005, interest rates ranging from 3.2% to 6.25%, maturing to 2038	<b>\$ 6,004,060</b>	\$ 6,167,780
Rural Utility Services (RUS) issues - interest rate of 5%, maturing through 2028	<b>26,631</b>	27,422
	<b>6,030,691</b>	6,195,202
Less unamortized discount and debt reacquisition costs	<b>(22,306)</b>	(32,215)
Revenue bonds payable, net	<b>6,008,385</b>	6,162,987
Notes payable and bond anticipation notes	<b>834,752</b>	950,845
	<b>6,843,137</b>	\$ 7,113,832
Less current portion of long-term debt:		
Notes payable from unrestricted assets	<b>214,270</b>	14,093
Notes payable and bond anticipation notes from restricted assets	<b>506,961</b>	256,961
Power revenue bonds	<b>346,079</b>	327,242
Current portion of long term debt from restricted assets	<b>853,040</b>	584,203
Total current portion of long-term debt	<b>1,067,310</b>	\$ 598,296
	<b>\$ 5,775,827</b>	\$ 6,515,536

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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

Long-term debt activity for the years ended June 30, 2009 and 2008 was as follows:

	<b>2009</b>	<b>2008</b>
	<i>(In thousands)</i>	
Long-term debt excluding current portion	<b>\$ 7,113,832</b>	\$ 6,369,502
New issues:		
Power revenue bonds	–	697,345
Debt discount on new bond issues – net	–	4,905
Notes payable	<b>98,000</b>	241,329
	<b>7,211,832</b>	7,313,081
Payments:		
Power revenue bond – July 1	<b>(164,111)</b>	(197,202)
Power revenue bond – January 1	<b>(400)</b>	(381)
Notes payable	<b>(214,093)</b>	(12,277)
Total payments	<b>(378,604)</b>	(209,860)
Amortization of debt discount and excess reacquisition costs	<b>9,909</b>	10,611
Balance at end of year	<b>\$ 6,843,137</b>	\$ 7,113,832
Total current portion of long-term debt	<b>\$ 1,067,310</b>	\$ 598,296

**Power Revenue Bonds Payable**

During fiscal year 2008, the Authority issued its Power Revenue Bonds, Series WW for the purpose of paying a portion of the cost of its Capital Improvements Program (CIP).

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

Principal amount of the Bonds	\$ 697,345,000
Plus:	
Net original issue premium	8,853,673
Proceeds	<b>\$ 706,198,673</b>

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

**11. Long-Term Debt (continued)**

**Power Revenue Bonds Payable (continued)**

Application of net proceeds:	
Deposit to 1974 Construction Fund	\$ 650,004,640
Capitalized interest on Bonds through July 1, 2009	37,120,672
Underwriting discount and estimated legal, printing and other financing expenses	<u>19,073,361</u>
Application of proceeds	<u><u>\$ 706,198,673</u></u>

Maturities of the Power Revenue Refunding Bonds Series WW issued during fiscal year 2008 range from July 1, 2010 to July 1, 2038. The Series WW Bonds bear fixed interest rates ranging from 5% to 5.5%. Interest on the Series WW Bonds is payable on each January 1 and July 1.

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.

**Bond Anticipation Notes**

Bond anticipation notes (BANs) are used primarily to provide interim construction financing and usually are retired with the proceeds of long-term debt.

**Interest-Rate Swap Agreements**

To protect against the potential of rising interest rates, the Authority entered into quarterly separate pay-fixed, receive-variable interest-rate swaps at a cost anticipated to be less than what the Authority would have paid to issue fixed-rate debt.

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

**11. Long-Term Debt (continued)**

**Interest-Rate Swap Agreements (continued)**

The terms, fair values and credit ratings of the outstanding swaps as of June 30, 2009, were as follows:

Associated Power Revenue Bonds	Notional Amount	Effective Date	Maturity Date	Fixed Rate	Fair Value
LIBOR Bonds, Series UU	\$ 169,531,850	May 3, 2007	July 2, 2029	4.080%	\$ (19,008,841)
LIBOR Bonds, Series UU	123,762,250	May 3, 2007	July 1, 2025	4.232%	(12,401,403)
LIBOR Bonds, Series UU	225,597,150	May 3, 2007	July 1, 2031	4.286%	(27,326,155)
LIBOR Bonds, Series UU	61,107,750	May 3, 2007	July 1, 2025	4.232%	(6,579,534)
LIBOR Bonds, Series UU	83,343,150	May 3, 2007	July 2, 2029	4.080%	(9,996,186)
LIBOR Bonds, Series UU	111,092,850	May 3, 2007	July 1, 2031	4.286%	(14,295,628)
Muni-BMS Bonds, Series UU	25,525,000	May 3, 2007	July 3, 2017	4.014%	(404,845)
Muni-BMS Bonds, Series UU	17,000,000	May 3, 2007	July 2, 2018	4.054%	(266,327)
Muni-BMS Bonds, Series UU	29,055,000	May 3, 2007	July 1, 2020	4.124%	(448,647)
Total	<u>\$ 846,015,000</u>				<u>\$ (90,727,566)</u>

The notional amounts of the swaps match the principal amounts of the associated Power Revenue Bonds.

During fiscal years 2008-2009, and 2007-2008 the payments of fixed rate interest from the Authority exceeded the amount received as variable interest rate from swap counter parties by \$16.6 million and \$4.8 million, respectively.

Using rates as of June 30, 2009, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. These debt service requirements are included in the scheduled maturities of long-term debt disclosed further on this note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

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

**11. Long-Term Debt (continued)**

**Interest-Rate Swap Agreements (continued)**

Fiscal Year Ending June 30	Principal	Interest	Interest Rate Swap, Net	Total
2010	\$ —	\$ 12,650,917	\$ 22,832,597	\$ 35,483,514
2011	—	12,650,917	22,832,597	35,483,514
2012	—	12,650,917	22,832,597	35,483,514
2013	—	12,650,917	22,832,597	35,483,514
2014	—	12,650,917	22,832,597	35,483,514
2015-2031	846,015,000	173,554,557	325,604,509	499,159,066
Total	<u>\$ 846,015,000</u>	<u>\$ 236,809,142</u>	<u>\$ 439,767,494</u>	<u>\$ 676,576,636</u>

As of June 30, 2009, the swaps had a negative fair value of approximately \$90.7 million. The negative fair value of the swaps may be countered by reduction in future net interest payments required on the variable-rate Power Revenue Bonds, creating higher synthetic rates.

As of June 30, 2009, the Authority was not exposed to credit risk because the swaps had a negative fair value in the amount of the swaps' fair value. However, should interest rates change and the fair value of the swap become positive, the Authority would be exposed to credit risk in the amount of the derivative's fair value. The swaps counterparties were rated Aa1 and Aa3 as issued by Moody's Investor Services (Moody's), AA- and A+ by Standard & Poors (S&P), and AA- and A+ by Fitch Ratings.

The derivative contract uses the International Swaps and Derivatives Association, Inc. master agreement, which includes standard termination events, such as failure to pay bankruptcy. The Authority or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contracts. Also, the swaps may be terminated by the Authority if the counterparties' credit quality rating falls below Baa1 as issued by Moody's or BBB+ as determined by S&P. If at the time of termination the swap has a negative fair value, the Authority would be liable to the counterparty for a payment equal to the swap's fair value.

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**Notes to Audited Financial Statements (continued)**

**11. Long-Term Debt (continued)**

**Forward Swap Agreements**

On September 5, 2007, the Authority entered into two forward floating-to-fixed interest-rate swap transaction relating to the bonds (Forward Swap Agreement) with UBS AG and Goldman Sachs Capital Markets for two thirds and one third, respectively, of a notional amount of \$600 million in Power Revenue Bonds to be issued by the Authority. The transaction was set to expire on September 1, 2008 or the date before the bonds would be issued, if earlier than September 1, 2008. The transactions fixed rate was established a 3.652 percent per annum.

On June 26, 2008, the Authority paid to the aggregate amount of \$13.5 million to the counterparties to terminate the Forward Swap Agreement with the proceeds of Power Revenue Bonds, Series WW.

**Basis Swap Agreement**

In March 2008 (with effective date of July 1, 2008), the Authority entered into a basis swap agreement in the notional amount of \$1,375 million with an amortization schedule matching certain maturities of the Authority's outstanding power revenue and revenue refunding bonds issued in various years from 2027 to 2037 (the 2008 basis swap). Under the terms of a master swap agreement, the Authority receives from its counterparty (Goldman Sachs Capital Markets, L.P., an affiliate of Goldman, Sachs & Co.) quarterly, commencing on October 1, 2008, a floating amount applied to said notional amount at a rate equal to 62% of the taxable London Inter-Bank Offering Rate ("LIBOR") index reset each week plus 29 basis points (hundredths of a percent) and a fixed rate payment of 0.4669% per annum (the "basis annuity"), quarterly for the term of swap in return for quarterly payments by the Authority, commencing also on October 1, 2008, on such notional amount at a rate based on the Securities Industry and Financial Markets Association ("SIFMA") municipal swap index.

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Authority exposes itself to credit risk, market-access risk and basis risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Authority, which creates a credit risk for the Authority. When the fair value of the derivative contract is negative, the Authority owes to the counterparty and, therefore, does not pose credit risk to the Authority. The Authority minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the investment policies of the Authority and of Government Development Bank for Puerto Rico ("GDB"), its fiscal agent.

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

**11. Long-Term Debt (continued)**

**Basis Swap Agreement (continued)**

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with an interest rate swap contract is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Authority assesses market risk by continually identifying and monitoring changes in interest rate exposures that may adversely affect expected interest rate swap contract cash flows and evaluating other hedging opportunities. The Authority and GDB maintain risk management control systems to monitor interest rate cash flow risk attributable to both the Authority's outstanding or forecasted debt obligations as well as the Authority's offsetting hedge positions.

Basis risk arises when different indices are used in connection with a derivative instrument such as an interest rate swap contract. The 2008 basis swap exposes the Authority to basis risk should the relationship between LIBOR and the SIFMA municipal swap index converge. If a change occurs that results in the relationship moving to convergence, the expected financial benefits may not be realized. The Authority assesses basis risk by following the aforementioned market risks control system.

During the fiscal year 2008-2009, the Authority received from its counterparty \$7.9 million. The following table shows the cash flow benefit of the basis annuity in exchange for the Authority taking tax and other basis risks tied to the change in the relationship between LIBOR and the SIFMA municipal swap index.

	<u>2008-2009</u>
Basis annuity received	\$ 6,419,875
LIBOR index amounts received	20,662,060
SIFMA index amounts paid	<u>(19,178,536)</u>
Net amount received	<u>\$ 7,903,399</u>

As of June 30, 2009, the 2008 basis swap had a negative fair value to the Authority of approximately \$61.3 million. The negative fair value of the basis swap may be view as a reduction in future benefits to be received from the counterparty.

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

**11. Long-Term Debt (continued)**

**Basis Swap Agreement (continued)**

According to the Credit Support Annex of the Master Swap Agreement, if the fair value of the 2008 basis swap is negative and exceeds the threshold amount, the Authority shall post eligible collateral on the next business day upon notification from its counterparty. During fiscal year 2008-2009 the threshold amount for the Authority was \$50.0 million. The Authority and GDB entered into an agreement for a \$150 million revolving line of credit to meet collateral posting requirements from the 2008 basis swap. As of June 30, 2009, \$11.6 million of this line of credit was outstanding.

**Scheduled Maturities of Long-Term Debt**

The scheduled maturities of long-term debt with interest thereon at June 30, 2009, are as follows:

<b>Fiscal Year Ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
		<i>(In thousands)</i>	
2010	\$ 1,075,595	\$ 443,533	\$ 1,519,128
2011	241,740	284,592	526,332
2012	207,016	273,107	480,123
2013	230,071	263,058	493,129
2014	236,329	251,922	488,251
2015-2019	1,155,091	1,083,399	2,241,575
2020-2024	1,336,076	780,630	2,113,621
2025-2029	1,197,530	466,799	1,664,329
2030-2034	838,585	207,937	1,046,522
2035-2038	347,410	39,826	387,236
Total	6,865,443	4,094,803	10,960,246
Less:			
Unamortized discount and premium	186,225	—	186,225
Excess reacquisition costs	(208,531)	—	(208,531)
Interest	—	(4,094,803)	(4,094,803)
Total long-term debt	6,843,137		6,843,137
Current portion of notes payable	(214,270)	—	(214,270)
Current portion, net of discount and excess reacquisition costs of bonds	(346,079)	—	(346,079)
Current portion of notes payable from restricted assets	(506,961)	—	(506,961)
Current portion of long-term debt from restricted assets	(853,040)	—	(853,040)
Total current portion	(1,067,310)	—	(1,067,310)
Long-term debt, excluding current portion	\$ 5,775,827	\$ —	\$ 5,775,827



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

## 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.

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, 2007 and projected to June 30, 2009, based on current year demographic data.

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Notes to Audited Financial Statements (continued)

**12. Employees' Retirement Benefits (continued)**

**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.

The Authority's annual pension cost for the year ended June 30, 2009 and related information for the Plan and supplemental benefits follows:

	<u>Pension Plan</u>
Contribution rates:	
Authority	21.08%
Plan members	10.10%
Annual pension cost (thousands)	\$78,844
Contributions made and accruals (thousands)	\$78,555
Actuarial valuation date	6/30/2007
Actuarial cost method	Entry age
Amortization method	Level percentage of pay, closed (4% payroll increases per year)

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Notes to Audited 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)

	<b>Pension Plan</b>
Remaining amortization period	29 years
Asset valuation method	3-year smoothed market
Actuarial assumptions:	
Investment rate of return (net of administrative expenses)*	8.5%
Projected salary increases*	5%
*Includes inflation at	3.0%
Cost-of-living adjustments	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  
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Notes to Audited 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)

<b>Trend Information</b>			
<i>(In millions)</i>			
<b>Fiscal Year Ending</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Net Pension Obligation</b>
Pension Plan:			
06/30/01	35	100%	0.0
06/30/02	43	100%	0.0
06/30/03	50.6	100%	0.0
06/30/04	65	81%	12.3
06/30/05	69.9	100%	12.6
06/30/06	74.8	100%	12.9
06/30/07	74.6	100%	13.2
06/30/08	76.3	100%	13.5
06/30/09	78.8	100%	13.8

The annual required contribution amounted to \$78.6 million in 2009 and \$76.0 million in 2008. The net pension obligation is included in accounts payable and accrued liabilities on the balance sheet.

**Other Post-Employment Benefits (OPEB)**

Postemployment Health Plan

*Plan Description* – PREPA Retired Employees Healthcare Plan (Health Plan) is a single-employer defined contribution benefit healthcare plan administered by the Authority. During the fiscal year 2008-2009, the Authority adopted a resolution to change the Health Plan. The Health Plan for all retirees will be capped at \$300 per member per month for retirees and spouses under age 65 and \$200 per member per month for retirees and spouses age 65 and over.

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

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

*Membership* – During the fiscal year 2008-2009, the Health Plan changed to require all new retired employees on or after September 1, 2009 to have 30 year of services to receive health benefits. Certain retired employees on or after September 1, 2009, all retired employees before September 1, 2009, their legal spouses, and certain disabled dependents are eligible to participate in the Postretirement Health Plan. To remain eligible for participation, Medicare eligible retired participants and their spouses must enroll in Medicare Part B at age 65, or whenever eligible, at their own expenses. The benefit provisions to retired employees are established and may be amended by the Authority.

*Funding Policy and Annual OPEB Cost* – The required contribution is based on projected pay-as-you-go financing requirements. The contribution requirements of plan members and the Authority are established and may be amended by the Authority.

The Annual OPEB Cost is calculated based on the Annual Required Contribution of the employer (ARC), an amount actuarially determined in accordance with the provisions of GASB Statement No. 45. The ARC represents a level of funding that, if paid on ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The following table shows the components of the Authority's annual OPEB cost for the fiscal year 2008-2009 and 2007-2008. (in thousands):

Annual OPEB cost (or ARC)	\$ 24,363	\$ 259,266
Actuarial Accrued Liability (AAL)	\$ 531,054	\$ 3,375,046
Unfunded AAL	\$ 531,054	\$ 3,375,046
Funded Ratio	0%	0%
Annual Covered Payroll	\$ 348,929	\$ 349,183

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Notes to Audited Financial Statements (continued)

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

The net OPEB obligation change is as follows (in thousands):

Change in net OPEB obligation:	
Net OPEB obligation, June 30, 2008	\$ 189,492
Total annual required contribution (ARC), July 1, 2008 – June 30, 2009	25,626
Actual benefit payments, July 1, 2008 – June 30, 2009	(80,942)
Net OPEB obligation, June 30, 2009	<u>\$ 134,176</u>

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheet as of June 30, 2009 and 2008.

For the fiscal year ended June 30, 2009, the Authority's annual OPEB expense was (\$55.3) million, which reduced the accrued unfunded OPEB liability. This was due to changes in the Postemployment Health Plan benefits to retirees effective June 30, 2009. This is included in Administrative and General Expenses.

Major changes to the Health Plan during 2008-2009 were as follows:

1. All future retirees on or after September 1, 2009 to have 30 years of service to received health benefits.
2. Health benefits for all current and future retirees will be applied at \$300 per member per month per retirees and spouses under age 65 and \$200 per member per month for retirees and spouses over age 65 and over.

The OPEB expense is not equal to the Annual Required Contribution, which is \$25.6 million. The OPEB expense is considered in operating expenses in the Authority's Statement of Revenues, Expenses and Changes in Net assets. The actual payment to the health plan for retirees and their beneficiaries, which totaled \$80.9 million, is included in Administrative and General Expenses.

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

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

For the fiscal year ended June 30, 2008, the Authority's annual OPEB expense of \$189.5 million was not equal to the Annual Required Contribution, which was \$259.3 million. The payment to the health plan for retirees and their beneficiaries, which totaled \$69.8 million for fiscal year 2008, is included in Administrative and General Expenses.

*OPEB Actuarial Valuation* – The Authority's other Post-Employment Benefits Program actuarial valuation was conducted by Buck Consultants, LLC and Cavanaugh Macdonald Consulting, LLC for fiscal year 2008 and 2009, respectively. Both are, members of the American Academy of Actuaries. The valuation was performed in accordance with GASB Statement No. 45 requirements.

Actuarial Methods and Assumptions:

Actuarial Valuation Date	June 30, 2007	June 30, 2006
Actuarial Cost Method	Projected Unit Credit	Projected Unit Credit
Amortization method	Level Dollar Amortization over 30 years	Level Dollar Amortization over 30 years
Remaining Amortization Period	28 years	29 years
Actuarial Assets Valuation Method	Not applicable	Not applicable
Investment Rate of Return	4% (includes inflation rate)	4% (unfunded rate)
Inflation Rate:	3%	
Medical	Not applicable	Start at 9% decreasing by 1% to an ultimate rate of 5%
Prescription drug	Not applicable	Start at 10% decreasing by 1% to an ultimate rate of 5%
Dental	Not applicable	Fixed 4%
Projected Salary Increases	4%	4%

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

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

The required schedule of funding progress, included supplementary information (Schedule I) that presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

**13. Revenues from Major Clients and Related Parties**

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

	<u>2009</u>	<u>2008</u>
	<i>(In thousands)</i>	
Governmental sector, principally instrumentalities, agencies and corporations of the Commonwealth of Puerto Rico	<b>\$ 497,951</b>	\$ 505,991
Municipalities of the Commonwealth of Puerto Rico	<b>187,686</b>	187,365
	<b><u>\$ 685,637</u></b>	<b><u>\$ 693,356</u></b>

**14. Net Assets**

Restricted assets at June 30, 2009 and 2008 include \$233.2 million and \$307.7 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).



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

**15. Claim for Extra Fuel Expense**

The Authority expects insurance companies to cover higher fuel price and other costs associated with alternate generation capacity in connection with two fires on the Authority's generating units. In years preceding and up to June 30, 2009, there were \$334 million in claims to insurance companies due to these fires. \$283 million has been collected up to June 30, 2009 and \$51 million was outstanding as of June 30, 2009. Subsequent to June 30, 2009, the Authority has received \$17 million of the outstanding amount. During the year ended June 30, 2009 there were no additional claims related to extra fuel expense.

**16. Contribution in Lieu of Taxes**

	2009	2008
	<i>(In thousands)</i>	
Municipalities	\$ 187,686	\$ 187,365
Commonwealth:		
Hotels	6,508	6,689
Fuel adjustment subsidy	30,579	24,299
Other subsidies (offset against outstanding accounts receivable and reimbursable costs)	19	26
	\$ 224,792	\$ 218,379

**17. 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, Oil Pollution Act (OPA), Resource Conservation Recovery Act (RCRA), Comprehensive Environmental, Response, Compensation and Liability Act (CERCLA) and Underground Storage Tanks, among others. 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.

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

**17. Commitments and Contingencies (continued)**

**Environmental Matters (continued)**

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 environmental supplemental 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 improves and implements compliance programs and operations in order to assure compliance with environmental laws and regulations.

Since the Consent Decree became effective, several Notices of Dispute Resolution were filed 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, EPA's determination that the Costa Sur power plant was a repetitious violator of the visible emission requirements of the Consent Decree, and several other notices of violation issued by EPA regarding the applicable method to determine visible emission.

The parties reached an agreement to settle such Notices and lodged a Consent Decree Modification at the United States District Court for the District of Puerto Rico on June 24, 2004. A major program within the agreement was 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. Currently, the requirements under this program have been fulfilled. The Authority believes that the agreement enables the Authority to take additional measures that will enhance its ability to comply with the Consent Decree.

In general, the Authority is consistently achieving a level of compliance with in-stack opacity requirements and the Clean Water Act regulations equal or greater of 99%. Also, as of today the Authority had finished with the requirements of the Spill Prevention, Control and Countermeasures regulation under the Consent Decree.

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

**17. Commitments and Contingencies (continued)**

**Environmental Matters (continued)**

Efforts are on-going to complete pending cooling seawater thermal discharge under the Clean Water Act “National Pollutant Discharge Elimination System” operating permits program, for the four Thermoelectric Power Plants. Specifically for South Coast Power Plant, extensive negotiations led to a cooperative effort as to which alternative should be developed under a Detail Evaluation Engineer Review (DEER). Meetings have been conducted at different stages of the work plan to address and keep informed the Guayanilla Community Group. Conversations are still in progress to determine the specific route through the two corridors identified for an Offshore Submerged Discharge. Draft National Pollutant Discharge Elimination System (NPDES) permit for South Coast Power Plant was issued by EPA in September 30, 2009. As expected, it included a work plan for the alternative development and its permitting process. Conversations with the Army Corps of Engineer as part of the permitting process required are in its initial stages.

The fieldwork of the Aguirre 316 Demonstration Study finished in May 2004 and the Final Report was submitted by May 2005.

The Authority submitted to EPA the reports and waiver requests, pursuant to the Clean Water Act-Section 316(a) Thermal Waiver, for the San Juan and Palo Seco power plants on July 11, 1997 and November 18, 1997, respectively. EPA issued a new NPDES Permit for the San Juan Power Plant in April 2007, including the approval of the 316(a) Waiver

**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.

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

**17. Commitments and Contingencies (continued)**

**Commitments to Purchase Power (continued)**

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.

**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 \$750 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million, \$2 million for all other covered risks and \$10 million for Boiler and Machinery. 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.

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.

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

**17. Commitments and Contingencies (continued)**

**Risk Management (continued)**

Changes in the balances of the health insurance program (self-insurance risk) incurred but not recorded (IBNR) during fiscal years 2009 and 2008 were as follows:

	<b>Liability Beginning Balance</b>	<b>Expenses</b>	<b>Payments</b>	<b>Liability Ending Balance</b>
	<i>(In thousands)</i>			
<b>2008</b>	\$ 11,273	\$ 132,358	\$ 136,477	\$ 7,154
<b>2009</b>	\$ 7,154	\$ 136,348	\$ 137,950	\$ 5,552

**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 there will be a material difference in the quality of service provided by the Authority.

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

**17. Commitments and Contingencies (continued)**

**Contingencies (continued)**

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico (the “Comptroller”) 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. 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 rates 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.

**Construction and Other Commitments**

As of June 30, 2009, the Authority has commitments of approximately \$127.4 million on active construction, maintenance and engineering services contracts.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures*, which more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits.

**18. Significant New Accounting Pronouncement**

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, to provide guidance regarding how to identify, account for, and report intangible assets.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

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

**18. Significant New Accounting Pronouncement (continued)**

Statement No. 51 requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets.

Statement No. 51 provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable
- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)
- Providing guidance on recognizing internally generated computer software
- Establishing specific guidance for the amortization of intangible assets.

The requirements Statement 51 are effective for financial statements for periods beginning after June 15, 2009. The GASB made significant changes to the transition provisions, based on constituent response to the proposed version of the standards, to make it easier for governments to implement.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 is intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

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

**19. Subsequent Events**

On October 23, 2009, a fire at Caribbean Petroleum Refining LC (“CPR”) facilities, which are rented by the Authority to allow a supplier to store fuel, had an immediate effect on the price of fuel as the Authority contracted supplier declared force majeure on its contract due to the loss of the blending operations that took place at the facility. Price increase has been limited to approximately \$3.00 per barrel equivalent to around 4 percent at current fuel oil prices. Availability of fuel has not been an issue. The Authority’s Governing Board authorized the purchase of fuel on an emergency basis to secure Palo Seco and San Juan steam plants operations.

On January 10, 2008, the Authority and Skanska Energy Services, LLC (“Skanska”) entered into an Engineer Procure Construct Finance Contract for the construction of the Gasoducto del Sur Project (the “Project”) for an original Contract Price of \$74,324,259. On December 2, 2008, the Superior Court of Ponce issued an injunction stopping all construction. On July 23, 2009, PREPA’s Governing Board authorized the termination and settlement of the Contract. The Authority obtained title to all equipment and material procured and 100% of engineering documents and all pending disputes were settled for a lump-sum payment of \$59,000,000 due to the Contractor. The Termination and Settlement Agreement was executed on August 7, 2009. Pursuant to an Asset Purchase Agreement dated August 17, 2009, PREPA sold the assets of the Gasoducto del Sur Project to The Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA by its Spanish acronym) for approximately \$36 million. In addition, PREPA entered into a Subordinated Loan Agreement with the Government Development Bank (GDB) for \$35,000,000 evidenced by a 24-month subordinated note until such time that Puerto Rico Aqueduct and Sewer Authority (PRASA) shall purchase from AFICA the Project.

On December 16, 2009, the Authority and a financial institution entered into an agreement for a line of credit of \$150 million to finance a portion of the cost of various projects under its capital improvement program. This line of credit will be paid with proceeds from a bond issuance expected to occur during the third quarter of the fiscal year ending June 30, 2010.

The Authority is expected to issue Power Revenue Bonds to finance a portion of the cost of various projects under its capital improvement program and to pay certain bond anticipation notes. Upon market conditions the Authority is expected to issue Power Revenue Refunding Bonds. The refunding will enable the Authority to realize savings on its debt service requirements on bonds outstanding under the 1974 Agreement. This bond issuance is expected to occur during the third quarter of the fiscal year ending June 30, 2010.



## Required Supplementary Information

## Schedule I

### Puerto Rico Electric Power Authority (A Component Unit of the Commonwealth of Puerto Rico)

#### Supplementary Schedule of Funding Progress

June 30, 2009

*(In millions)*

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)
<u>Pension Plan</u>						
6/30/97	\$1,084	\$1,333	\$ 249	51%	\$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%
6/30/03	1,337	2,137	799	63%	306	262%
6/30/04	1,294	2,139	846	60%	335	252%
6/30/05	1,338	2,203	866	61%	349	248%
6/30/06	1,403	2,280	877	62%	349	251%
6/30/07	1,488	2,313	826	64%	349	237%
6/30/08	1,571	2,337	766	67%	363	211%
<u>Postemployment Health Plan</u>						
6/30/07	-	3,375	3,375	0%	349	967%
6/30/08	-	531	531	0%	349	152%

**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 6/30/98 valuation.*

\*\* *Estimated valuation, projected from actual 6/30/99 valuation. Does not reflect benefit improvements effective January 1, 2000.*

## Supplemental Schedules

Puerto Rico Electric Power Authority  
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Note to Schedules II-VII - Information Required by the 1974 Agreement

As of June 30, 2009 and 2008, and for 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.

Puerto Rico Electric Power Authority  
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Supplemental Schedule of Sources and Disposition of Net Revenues  
under the Provisions of the 1974 Agreement

Statements of Income (GAAP) and Reconciliation of Net Income

For the Years Ended June 30, 2009 and 2008  
(In thousands)

	2009			2008		
	1974 Trust Agreement	Statement of Income (GAAP)	Reconciliation of Net Income	1974 Trust Agreement	Statement of Income (GAAP)	Reconciliation of Net Income
Reconciliation of components of net income:						
Revenues:						
Operating revenues	\$ 3,986,180	\$ 4,002,713		\$ 4,350,515	\$ 4,362,209	
Revenues from Commonwealth for rural electrification	19	19		26	26	
Other operating revenues	14,641	14,641		22,210	22,210	
Other	6,428	6,590		(3,254)	(3,283)	
1974 agreement construction fund investment income and gain on sale of other properties	—	19,640		—	45,903	
Total revenues	<u>4,007,268</u>	<u>4,043,603</u>	36,335	<u>4,369,497</u>	<u>4,427,065</u>	57,568
Current expenses:						
As shown	3,377,772	3,389,307		3,688,070	3,696,334	
Other interest	—	2,819		—	3,963	
Total as defined	<u>3,377,772</u>	<u>3,392,126</u>	(14,354)	<u>3,688,070</u>	<u>3,700,297</u>	(12,227)
Net revenues, as defined	<u>\$ 629,496</u>			<u>\$ 681,427</u>		
Depreciation	\$ —	306,118	(306,118)	\$ —	295,317	(295,317)
Other post-employment benefit (OPEB)	—	(55,316)	55,316	—	189,492	(189,492)
Disposition of revenues: (not classified in order of payment)						
Interest on debt	261,486	299,173		255,593	271,016	
Interest on general obligation notes	28,434	28,798		44,290	44,291	
Amortization of debt discount, financing expenses	—	(7,197)		—	(7,478)	
Amortization of bond defeasance	—	21,102		—	21,602	
Allowance for funds used during construction	—	(18,530)		—	(21,125)	
Net interest on long-term debt	<u>289,920</u>	<u>323,346</u>	(33,426)	<u>299,883</u>	<u>308,306</u>	(8,423)
Power revenue bonds:						
Principal	173,040	—	173,040	164,492	—	164,492
Reserve Account	(29,523)	—	(29,523)	—	—	—
Internal Funds	4,695	—	4,695	11,400	—	11,400
Appropriation Self Insurance Fund	10,000	—	10,000	(20,438)	—	(20,438)
Contribution in lieu of taxes	<u>181,364</u>	<u>224,792</u>	<u>(43,428)</u>	<u>226,090</u>	<u>218,379</u>	<u>7,711</u>
Total expenses (GAAP)		<u>4,191,066</u>			<u>4,711,791</u>	
Net revenues, as defined	<u>\$ 629,496</u>			<u>\$ 681,427</u>		
Net income		<u>\$ (147,463)</u>	<u>\$ (147,463)</u>		<u>\$ (284,726)</u>	<u>\$ (284,726)</u>

**Schedule III**

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Supplemental Schedule of Sources and Disposition  
of Net Revenues under the Provisions of the 1974 Agreement

For the Years Ended June 30, 2009 and 2008  
(In thousands)

	2009	2008
Sources of net revenues:		
Revenues:		
Electric revenues	\$ 3,986,180	\$ 4,350,515
Revenues from the Commonwealth for rural electrification	19	26
Other operating revenues	14,641	22,210
Other (principally interest)	6,428	(3,254)
	4,007,268	4,369,497
Current expenses:		
Operations:		
Fuel	1,919,789	2,303,036
Purchased power	671,849	661,097
Fuel extra expense claimed	-	(96,273)
Other production	62,271	57,507
Transmission and distribution	162,334	171,585
Customer accounting and collection	111,126	118,196
Administrative and general	222,477	220,553
Maintenance	225,107	248,406
Other Interest	2,819	3,963
	3,377,772	3,688,070
Net revenues, as defined	\$ 629,496	\$ 681,427
Disposition of net revenues:		
Revenue fund:		
Power revenue bonds - sinking fund requirements:		
Interest	\$ 261,486	\$ 255,593
Principal	173,040	164,492
Reserve Account	(29,523)	-
Self Insurance Fund	10,000	(20,438)
Balance available for capital improvements	4,695	11,400
	419,698	411,047
General obligation notes:		
Interest	28,434	44,290
Contribution in lieu of taxes and other	181,364	226,090
Net revenues, as defined	\$ 629,496	\$ 681,427

*See accompanying notes.*

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Supplemental Schedule of Funds under the Provisions of the  
1974 Agreement

Years Ended June 30, 2009 and 2008  
(In thousands)

	2009				2008			
	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
<b>By Account</b>								
1974 Agreement (restricted)								
Sinking Fund - principal and interest	\$ 304,480	\$ -	\$ 304,480	\$ -	\$ 281,624	\$ -	\$ 281,624	\$ -
Reserve account	267,001	-	-	267,001	287,832	-	-	287,832
Self insurance fund	62,624	-	-	62,624	51,086	-	-	51,086
Reserve maintenance fund	5,573	5,573	-	-	569	569	-	-
Other restricted fund	2,410	2,410	-	-	-	-	-	-
Construction Fund:								
Rural Utilities Services (RUS)	1,911	1,911	-	-	1,896	1,896	-	-
Other	13,894	13,894	-	-	565,369	565,369	-	-
General purpose (unrestricted):								
General	64,725	64,725	-	-	30,406	30,406	-	-
Working funds	1,048	1,048	-	-	1,777	1,777	-	-
Total	<u>\$ 723,666</u>	<u>\$ 89,561</u>	<u>\$ 304,480</u>	<u>\$ 329,625</u>	<u>\$ 1,220,559</u>	<u>\$ 600,017</u>	<u>\$ 281,624</u>	<u>\$ 338,918</u>
<b>By Type of Assets Held</b>								
Working funds	\$ 1,048	\$ 1,048	\$ -	\$ -	\$ 1,777	\$ 1,777	\$ -	\$ -
Cash in bank and time deposits (by depository institutions):								
Government Development Bank for Puerto Rico	1,047	1,047	-	-	517,304	517,304	-	-
Banco Popular de Puerto Rico	40,334	40,334	-	-	13,144	13,144	-	-
Citibank, N. A.	34,305	34,305	-	-	16,157	16,157	-	-
US Bank	304,480	-	304,480	-	281,624	-	281,624	-
Banco Bilbao Vizcaya	12	12	-	-	1,848	1,848	-	-
Banco Bilbao Vizcaya, Mayagüez, Puerto Rico	46	46	-	-	(163)	(163)	-	-
First Bank, San Juan, Puerto Rico	350	350	-	-	551	551	-	-
Banco Santander, Santurce, Puerto Rico	3,865	3,865	-	-	9,108	9,108	-	-
RG Premier Bank	118	118	-	-	(20)	(20)	-	-
Western Bank, Mayagüez, Puerto Rico	752	752	-	-	725	725	-	-
JP Morgan	200	200	-	-	-	-	-	-
Other institutions	990	990	-	-	972	972	-	-
	<u>387,547</u>	<u>83,067</u>	<u>304,480</u>	<u>-</u>	<u>843,027</u>	<u>561,403</u>	<u>281,624</u>	<u>-</u>
Investment securities	336,119	6,494	-	329,625	377,532	38,614	-	338,918
Total	<u>\$ 723,666</u>	<u>\$ 89,561</u>	<u>\$ 304,480</u>	<u>\$ 329,625</u>	<u>\$ 1,220,559</u>	<u>\$ 600,017</u>	<u>\$ 281,624</u>	<u>\$ 338,918</u>

See accompanying notes.

## Schedule V

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

## Supplemental Schedule of Changes in Cash and Investments by Funds

Year Ended June 30, 2009  
(In thousands)

	General Purposes Funds				
	Total	General Fund	Revenue Fund	Working Fund	Interest 1974 Agreement
<b>2008 - 2009 Activity</b>					
<b>Balances at June 30, 2008</b>	\$ 1,220,559	\$ 110,876	\$ 10	\$ 1,777	\$ 117,510
Operations:					
Net revenues	-	(629,496)	181,364	-	261,486
Funds provided from internal operations	450,714	450,714	-	-	-
1974 Agreement investment income Acct 4191	-	(4,076)	-	-	-
Investment income and other	26,926	7,903	-	-	1,523
Unrealized gain (or loss) on market value of investment	(1,401)	-	-	-	-
Offset of current year's contribution in lieu of taxes against certain government accounts receivable	-	139,294	(139,294)	-	-
Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to general obligations	-	42,070	(42,070)	-	-
Funds used for construction	(478,719)	-	-	-	-
Reclassified constructions costs for deferred debits	(40,695)	(40,695)	-	-	-
Financing:					
Proceeds from new bond issues-net of original discounts	-	-	-	-	-
Proceeds from contributed capital	12,661	-	-	-	-
Sinking Funds and account transfers	-	(5,000)	-	-	37,171
Notes issued for construction	98,000	-	-	-	-
Notes issued for municipalities settlement agreement	-	-	-	-	-
Notes issued to working capital	195,000	195,000	-	-	-
Note issued to finance the acquisition on fuel oil	50,000	50,000	-	-	-
Notes issued to finance the recovery of Palo Seco Steam Plant that are payable from proceeds from insurance companies	-	-	-	-	-
Payment of notes	(447,471)	(247,471)	-	-	-
Payment of interest	(313,397)	(11,064)	-	-	(270,797)
Payment to counterparties - Interest Rate Swap	(14,556)	(14,556)	-	-	-
Payment of current maturities of long-term debt	(164,511)	-	-	-	-
Payment to municipalities settlement agreement	-	-	-	-	-
Changes in assets and liabilities:					
Working funds	-	729	-	(729)	-
Accounts receivable (includes non-current)	128,259	128,259	-	-	-
Fuel oil	12,828	12,828	-	-	-
Materials and supplies	(7,517)	(7,517)	-	-	-
Prepayments and other	300	300	-	-	-
Deferred debits	50,659	50,659	-	-	-
Accounts payable and accrued liabilities (includes non-current)	(59,490)	(75,773)	-	-	-
Customer deposits	5,517	5,517	-	-	-
Interfund transfers, etc.	-	7,697	6	-	(9,308)
Total before interfund accounts	723,666	166,198	16	1,048	137,585
Add (deduct) Interfund accounts	-	(101,489)	-	-	-
<b>Balances at June 30, 2009</b>	<b>\$ 723,666</b>	<b>\$ 64,709</b>	<b>\$ 16</b>	<b>\$ 1,048</b>	<b>\$ 137,585</b>



Sinking Fund			Other Funds			
Principal 1974 Agreement	Reserve 1974 Agreement	Self Insurance Fund	Construction 1974 Agreement	Reserve Maintenance Fund	Subordinated Obligation Fund	Other Restricted Fund
\$ 164,114	\$ 287,832	\$ 51,086	\$ 486,785	\$ 569	\$ -	\$ -
173,040	(29,523)	10,000	4,695	-	28,434	-
-	-	-	-	-	-	-
-	-	-	4,076	-	-	-
1,697	9,816	1,818	4,165	4	-	-
-	(1,120)	(281)	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	(478,719)	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	12,661	-	-	-
-	-	-	(37,171)	5,000	-	-
-	-	-	98,000	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	(200,000)	-	-	-
-	-	-	-	-	(31,536)	-
(164,511)	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	16,283	-	-	-
-	-	-	-	-	-	-
(7,445)	(4)	1	3,541	-	3,102	2,410
166,895	267,001	62,624	(85,684)	5,573	-	2,410
-	-	-	101,489	-	-	-
<b>\$ 166,895</b>	<b>\$ 267,001</b>	<b>\$ 62,624</b>	<b>\$ 15,805</b>	<b>\$ 5,573</b>	<b>\$ -</b>	<b>\$ 2,410</b>

## Schedule V

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

## Supplemental Schedule of Changes in Cash and Investments by Funds

Year Ended June 30, 2008  
(In thousands)

	Total	General Purposes Funds			Interest 1974 Agreement
		General Fund	Revenue Fund	Working Fund	
<b>2007 - 2008 Activity</b>					
<b>Balances at June 30, 2007, before interfund account</b>	\$ 1,049,128	\$ 104,509	\$ 16	\$ 1,576	\$ 90,704
Operations:					
Net revenues	—	(681,427)	226,090	—	255,593
Funds provided from internal operations	318,054	318,054	—	—	—
1974 Agreement investment income Acct 4191	—	(6,922)	—	—	—
Investment income and other	22,733	—	—	—	2,009
Unrealized gain (or loss) on market value of investment	2,430	—	—	—	—
Offset of current year's contribution in lieu of taxes against certain government accounts receivable	—	188,313	(188,313)	—	—
Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to general obligations	—	37,777	(37,777)	—	—
Funds used for construction	(639,263)	—	—	—	—
Financing:					
Proceeds from new bond issues-net of original discounts	687,125	—	—	—	—
Proceeds from contributed capital	17,379	—	—	—	—
Sinking Funds and account transfers	—	71,782	—	—	21,319
Notes issued for construction	200,000	—	—	—	—
Notes issued for municipalities settlement agreement	15,229	—	—	—	—
Notes issued to working capital	16,000	16,000	—	—	—
Note issued to finance the acquisition on fuel oil	100,000	100,000	—	—	—
Notes issued to finance the recovery of Palo Seco Steam Plant that are payable from proceeds from insurance companies	200,000	200,000	—	—	—
Payment of notes	(112,277)	(112,277)	—	—	—
Payment of interest	(293,019)	—	—	—	(241,624)
Payment to counterparties - Interest Rate Swap	(1,141)	(1,141)	—	—	—
Payment of current maturities of long-term debt	(197,583)	—	—	—	—
Payment to municipalities settlement agreement	(15,229)	—	—	—	—
Changes in assets and liabilities:					
Working funds	—	(201)	—	201	—
Accounts receivable (includes non-current)	(333,947)	(333,947)	—	—	—
Fuel oil	(55,442)	(55,442)	—	—	—
Materials and supplies	(30,350)	(30,350)	—	—	—
Prepayments and other	3,537	3,537	—	—	—
Deferred debits	(21,242)	(21,242)	—	—	—
Accounts payable and accrued liabilities (includes non-current)	283,066	283,066	—	—	—
Customer deposits	5,371	5,371	—	—	—
Interfund transfers, etc.	—	25,416	(6)	—	(10,491)
Total before interfund accounts	1,220,559	110,876	10	1,777	117,510
Add (deduct) Interfund accounts	—	(80,480)	—	—	—
<b>Balances at June 30, 2008</b>	<b>\$ 1,220,559</b>	<b>\$ 30,396</b>	<b>\$ 10</b>	<b>\$ 1,777</b>	<b>\$ 117,510</b>

Sinking Fund			Other Funds		
Principal 1974 Agreement	Reserve 1974 Agreement	Self Insurance Fund	Construction 1974 Agreement	Reserve Maintenance Fund	Subordinated Obligation Fund
\$ 202,313	\$ 273,108	\$ 68,922	\$ 259,740	\$ 48,240	\$ -
164,492	-	(20,438)	11,400	-	44,290
-	-	-	-	-	-
-	-	-	6,922	-	-
3,496	11,943	2,352	1,507	1,426	-
-	2,677	254	-	(501)	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	(639,263)	-	-
-	-	-	-	-	-
-	-	-	687,125	-	-
-	-	-	17,379	-	-
-	-	-	(44,508)	(48,593)	-
-	-	-	200,000	-	-
-	-	-	15,229	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	(51,395)
(197,583)	-	-	-	-	-
-	-	-	(15,229)	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
(8,604)	104	(4)	(13,517)	(3)	7,105
164,114	287,832	51,086	486,785	569	-
-	-	-	80,480	-	-
<b>\$ 164,114</b>	<b>\$ 287,832</b>	<b>\$ 51,086</b>	<b>\$ 567,265</b>	<b>\$ 569</b>	<b>\$ -</b>

**Schedule VI**

Puerto Rico Electric Power Authority  
(A Component Unit of the Commonwealth of Puerto Rico)

Supplemental Schedule of Changes in Long-Term Debt  
and Current Portion of Long-Term Debt

Years Ended June 30, 2009 and 2008  
(In thousands)

	2009	2008
<b>Long-term debt excluding current portion</b>		
Balance at the beginning of year	\$ 6,515,536	\$ 6,006,144
Transfers to current liabilities:		
Power revenue bonds	(637,709)	(434,187)
Payment of general obligation notes:		
Note payable	(200,000)	—
Remainder	5,677,827	5,571,957
 New issues:		
Power revenue bonds	—	697,345
Power revenue refunding bonds	—	—
Debt discount on new bond issues - net	—	4,905
Defeasance of bonds	—	—
Debt discount and excess reacquisition costs on cancelled bonds - net	—	—
Notes payable	98,000	241,329
Balance at the end of year	\$ 5,775,827	\$ 6,515,536
 <b>Current portion of long-term debt</b>		
Balance at beginning of year	\$ 598,296	\$ 363,358
Transfer from long-term debt	637,709	434,187
Payments to bondholders:		
Power revenue- July 1	(164,111)	(197,202)
Power revenue- January 1	(400)	(381)
General obligation notes	(14,093)	(12,277)
Total payments	(178,604)	(209,860)
Amortization of debt discount and excess reacquisition costs	9,909	10,611
Balance at end of year	\$ 1,067,310	\$ 598,296

*See accompanying notes.*

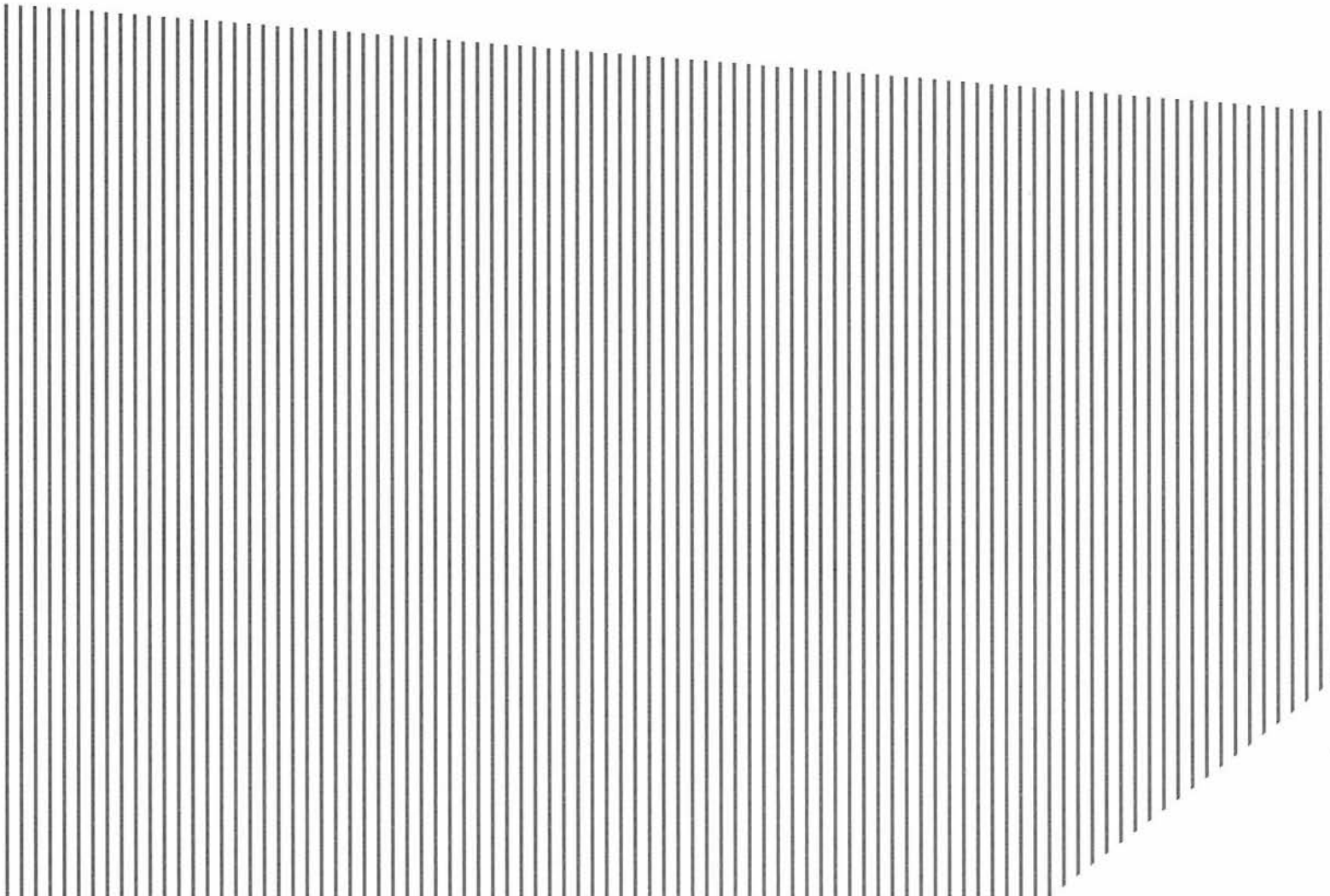
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December 24, 2010

Puerto Rico Electric Power Authority  
San Juan, Puerto Rico

Dear Sirs:

URS Corporation (“URS”) 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, in accordance with the Agreement the report includes 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 annual report provided to the Authority and the Trustee was dated as of June 2009.

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, URS 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. URS 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 URS without it having conducted an independent investigation thereof. In addition, URS 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 operable generating units;
3. that the Authority’s forecast of costs and availability of fuels are reasonable;



4. that financing will be available to the Authority at reasonable rates, in adequate amounts and at appropriate times;

5. that the Authority will not be adversely affected by labor disputes and will have adequate levels of labor productivity;

6. that the Authority will reasonably comply with the projected budgets of Current Expenses, excluding fuel and purchased power, included in the Official Statement to which this letter is appended;

7. that there will be no material changes in the requirements of regulatory authorities and the Commonwealth and Legislature of Puerto Rico will not enact any regulation or legislation that will materially affect the Authority adversely, including the Economic Incentives Act regarding wheeling and certain industrial client tax credits to be paid by the Authority as described in the Official Statement to which this letter is appended;

8. that there will be no unforeseen technological developments;

9. that the demographic, statistical, economic and other information regarding Puerto Rico obtained by URS from publicly available sources is reliable;

10. that the Authority will not be unduly affected by natural disasters; and

11. 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 revenue and generation 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;

2. 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;

3. the Authority's generating capacity expansion plan referred to in the Official Statement, to which this letter is appended, under the caption "Adequacy of Capacity" is adequate and should allow the Authority to meet targeted electric reliability criteria;





4. the Authority's production, transmission and distribution plant is in good repair and sound operating condition;

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 meet the Trust Agreement obligations for deposits into certain Funds from 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 System 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.

Sincerely,

URS CORPORATION

A handwritten signature in black ink, appearing to read 'George W. Romano, Jr.', with a long, sweeping flourish extending to the right.

George W. Romano, Jr.  
Consulting Group Manager

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437 Madison Avenue  
New York, New York 10022  
(212) 940-3000  
Fax: (212) 940-3111

December 29, 2010

Puerto Rico Electric Power Authority  
San Juan, Puerto Rico

Re: \$355,730,000 Puerto Rico Electric Power Authority Power Revenue Bonds, Series EEE  
(Issuer Subsidy Build America Bonds)

Ladies and 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 \$355,730,000 aggregate principal amount of Power Revenue Bonds, Series EEE (Issuer Subsidy Build America 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 or provided for 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 and supplemented (the "Trust Agreement"), by and between the Authority and U.S. Bank National Association, as successor trustee; Resolution No. 3783, duly adopted by the Authority on December 21, 2010 ("Resolution No. 3783"), a Certificate of Determination executed by the Acting Executive Director, dated December 24, 2010 (the "Certificate of Determination," and together with Resolution No. 3783, 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 or the Resolution, as applicable. We understand the Authority has received an opinion of O'Neill & Borges, San Juan, Puerto Rico as Special Puerto Rico Tax Counsel; we have not independently verified the accuracy of that opinion.

We have also examined one of said 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 Bonds have been duly authorized and issued to provide funds to pay all or a portion of the cost of certain Improvements (as defined in the Trust Agreement) included in the Authority's capital improvement program.
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. Interest on the Bonds is not excluded from gross income for Federal income tax purposes under Section 103 of the Internal Revenue Code and so will be fully subject to Federal income taxation; this opinion is not intended or provided by Bond Counsel to be used and cannot be used by an owner of the Bonds for the purpose of avoiding penalties that may be imposed on the owner of such Bonds. The opinion set forth in this paragraph is provided to support the promotion or marketing of the Bonds. Each owner of the Bonds should seek advice based on its particular circumstances from an independent tax advisor.

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

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material to our opinion, we have relied on representations of the Authority furnished to us, without undertaking to verify such representations by independent investigation.

Except as stated in paragraph 8, we express no opinion as to any other Federal, state, Commonwealth, local or foreign tax consequences with respect to the Bonds.

We express no opinion as to the accuracy or sufficiency of any financial or other information which has been or will be supplied to purchasers of the Bonds.

The opinions set forth above are subject to the effect of, and restrictions and limitations imposed by or resulting from, bankruptcy, insolvency, debt adjustment, moratorium, reorganization or other similar 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,

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