ISO NEW ENGLAND

Milestones

2002 ANNUAL REPORT

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TIMELINE OF SUCCESS

The year 2002 begins, ends and is filled with goals set and achievements made by "The People Behind New England's Power."

Milestones connote success, they mark completion of important objectives, and they provide direction for future aspirations. Each milestone on the timeline below and along the following pages fits with the rest to build a legacy in New England—a legacy of a competitive, efficient and fair wholesale electricity marketplace and the highest standards of bulk power system reliability seen in the industry today.

JAN 29 New England and New York ISOs agree to jointly develop common electricity markets and evaluate a NE-NY Regional Transmission Organization (RTO). FEB 14 James Bushnell and Celeste Saravia study on market competitiveness released. Finds New England's wholesale electicity market compares favorably with other U.S. markets. FEB 15 Gas Study Phase II Report released: Steady-State and Transient Analysis of New England's Interstate Pipeline Delivery Capability 2001-2005. Provides technical assessment of region's interstate natural gas infrastructure. MAR 03 Forty new hires; five new departments created. APR 02 Request for Proposals issued to solicit approximately 80 megawatts of resources for Southwest Connecticut for the summer of 2002. Emergency Capability Supplement program designed to improve system reliability within Southwest Connecticut as an enhancement to the 2002 Demand Response Program. APR 10 Upgrade to North American Electric Reliability Council (NERC) Electronic Transaction Information System (E-Tag) successfully implemented as part of nationwide effort. Improves performance, reliability and security of the original platform. MAY 01 Enhanced market reforms implemented. MAY 20 Revised NEPOOL Financial Assurance Policy implemented. MAY 31 Report by Independent

ABOUT ISO NEW ENGLAND

Created in 1997, ISO New England Inc. is responsible for operating the six-state region's bulk electric power system and for administering the region's wholesale electricity marketplace. It is the independent system operator (ISO) of New England's electricity supply.

Its mission is to plan for and ensure a reliable bulk power system for New England's 6.5 million electricity customers, guarantee equal access to the electric transmission system and operate a fair, efficient wholesale electricity market.

ISO New England's direction comes from an independent board of directors comprised of energy and financial industry experts without ties to any company doing business in the region's electricity markets. ISO New England keeps the lights on from Eastport, Maine to Westport, Connecticut.

ISO New England's 350 employees are truly *"The People Behind New England's Power."*

NEW ENGLAND POWER SYSTEM AND WHOLESALE ELECTRICITY MARKET FACTS

> 6.5 million households and businesses; population 14 million

> More than 350 generators and power plants

> Over 8,000 miles of high voltage transmission lines

> 12 interconnections to systems in New York and Canada

> More than 31,000 megawatts of total supply

> All-time peak demand of 25,348 megawatts (August 14, 2002)

> More than 200 participants in marketplace

> $4.5 billion total market value; $1.5 billion cleared in spot market

LETTER FROM THE PRESIDENT AND CEO

In the United States, reliable electricity is the foundation of our prosperity and quality of life. Without it, our world literally grinds to a halt—businesses cannot plan and operate productively, hospitals and schools cannot provide their essential services, and residents cannot depend on the electricity they need just to live their daily lives. Without reliable electricity, the monetary and societal costs would be enormous.

New England is no less dependent on reliable electricity supplies. During the past three decades, electricity use in New England has more than doubled. This trend is likely to continue: New England's maximum consumption is expected to grow from 22,000 megawatts in 2000 to more than 27,800 megawatts in 2010. Despite this tremendous growth, our region's power system—one of the most divested in the nation—has kept up with demand, adding generating capacity at unprecedented speed over the past four years.

Why? In a word, *competition.* When suppliers of any commodity compete, they introduce efficiencies, invest in improvements and reduce their costs in an effort to attract consumers. Between the introduction of competitive markets in 1999 and 2004, generators will increase the region's power supply by 40 percent—not because of government mandates, but because the markets make it possible for them to sell the power they produce.

New England businesses and consumers benefit from the reliable power promised by competitive markets, and ISO New England's number one priority is continued development of the region's wholesale electricity market. Although deregulated markets provide a framework for competition, they can succeed in the long term only if four ingredients are present: a good market structure that sends the right signals for efficient

Market Design Notice of Proposed Rulemaking is issued. JUN 27 ISO New England and New York ISO increase regional

market operations and that is kept in check by diligent market monitoring; an adequate supply of power to provide reliable, competitive options; a transmission system that moves power to where it is needed; and aggressive conservation with incentives for reduced use.

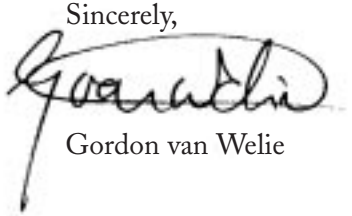
Much has been accomplished already in New England to develop these four pillars of a competitive market, as the determined efforts of market participants and the foresight of state regulators have successfully managed New England's deregulation efforts to date. And through close coordination with the New England Power Pool (NEPOOL), the New England Conference of Public Utilities Commissioners (NECPUC) and other regional regulators and legislators, ISO New England continued throughout 2002 to work on one of our most significant market enhancement projects thus far, Standard Market Design (SMD).

I am particularly proud of the advancements made this year toward implementing SMD, an improved market framework that better promotes reliable and efficient electricity for all of New England. Not only has New England's SMD furthered the Federal Energy Regulatory Commission's (FERC) national agenda for standardizing markets across the United States, it has reinforced a healthy and productive relationship among the region's industry stakeholders.

Nevertheless, we continue to face challenges that—if left unmet—could prevent the marketplace from working with maximum efficiency and competitiveness. Many of these solutions involve difficult choices and decisions that affect all of us. In the years to come, *The People Behind New England's Power* will continue to focus on the four pillars of a competitive energy market and will remain committed to collaborating with all electric industry stakeholders to enhance the system for the benefit of the entire region.

"I am particularly proud of the advancements made toward implementing Standard Market Design."

Sincerely,



Gordon van Welie

coordination and efficiency through shared regulation service to reduce regulation requirements while promoting

FOUR PILLARS OF A COMPETITIVE ENERGY MARKET

MARKET STRUCTURE

Sending the right market signals for efficient market operations.

ISO New England and market participants spent much of 2002 preparing for the March 1, 2003 implementation of an improved wholesale electricity market design in the region. Standard Market Design, or "SMD," provides incentives to market participants to build necessary infrastructure in areas with heavy demand to relieve the congestion that is adding millions of dollars a year to the cost of electricity. SMD also sends commercial and industrial consumers clear price signals that promote conservation, and it aligns the region's market rules with those of other Northeastern markets to reduce trade barriers that also inflate the cost of energy brought into New England.

Diligent market monitoring ensures that the market structure works as well as possible and that, in the long run, the marketplace adapts and evolves to support continued reliability, competitiveness and efficiency. Through monitoring, impediments to efficiency and competition are quickly defined, allowing ISO New England to implement changes in a timely manner.

compliance with applicable industry standards for reliability. JUN 27 Demand Response Summit held. JUL 01 Audit of Market

SUPPLY

Adequate supply of power.

In 2002, almost 3,000 megawatts were added to the region, with over 3,000 more expected in 2003. In the coming years, SMD will provide incentives for generating facilities to locate in areas with heavy demand and will align New England's market structure with neighboring markets in the Northeast to ease trade barriers. This will promote the free flow of energy between regions, increase supply and improve the system's ability to meet power demand. ISO New England is also working with regulators, legislators and other stakeholders to address one of the region's greatest challenges: ensuring that essential new power plants and transmission lines are built in a timely fashion while reasonably satisfying local siting concerns.

Monitoring and Mitigation Market Rule (MRP 17) complete. Ensures procedures for monitoring and mitigating participants'

TRANSMISSION

A delivery system that moves power to where it is needed.

One of the greatest challenges the electricity industry faces is delivering its product to where it is needed most. Although the transmission system has worked well for generations, insufficient investment in upgrades and expansions—in the face of growing demand and significant power grid changes—is causing the system to reach its limits. Over the past year, upgrades have reduced congestion in the Boston area, and proposals are on the table for major upgrades in Southwest Connecticut and Vermont, two other critically congested areas. ISO New England's 2002 Regional Transmission Expansion Plan (RTEP) identified nearly $900 million in needed transmission projects in the region. Because of long lead times for approval and construction, quick action is needed on these improvements.

CONSERVATION

Incentives for reduced use.

Demand response programs promote conservation during periods of peak electricity use when prices are highest. ISO New England's demand response efforts are designed to increase system reliability, mitigate extreme price volatility in the wholesale electricity market and increase the market's response to price signals. In 2002, ISO New England's Demand Response Program was improved to provide participants in the most constrained areas with increased incentives, greater price certainty and simplified program participation. The program has had measurable success, due in large part to close coordination with regional stakeholders and state regulators. Demand response will continue to play a critical role under SMD with a wider range of options for participation in both the day-ahead and real-time markets.

for filing at FERC after NEPOOL Participants Committee approve rule by a majority vote. MR1 is overarching rule governing

2002: A MILESTONE YEAR

Market structure, supply, transmission and conservation. These four pillars of a competitive energy market guide the work of ISO New England employees, and every milestone reached in 2002 reflects one or more of these components.

But it's the integrity and ingenuity of "The People Behind New England's Power" that make these pillars strong. Whether designing market rules, operating the power grid on a day-to-day basis, developing and recruiting a motivated workforce, working with market participants or implementing financial policies, each employee helps achieve a milestone, and each milestone contributes to the success of ISO New England.

Among the many significant events of 2002, ISO New England celebrated one of its most momentous accomplishments on July 1—the company's fifth anniversary as the independent system operator for New England. Through experience and achievement ISO New England is indeed building a legacy for the region, a legacy sustained by a winning energy strategy and realized through an unparalleled stakeholder process that is robust, open and inclusive.

operation of the New England wholesale electricity market under SMD. JUL 15 First of its kind in the nation, NEPOOL

FEB 14

MARKET MONITORING ANALYSES

ISO New England monitors the region's wholesale electricity marketplace to ensure that the market is working fairly and efficiently and that market participants abide by the market rules and procedures approved by the FERC. In addition to its own daily monitoring efforts, in 2002, ISO New England commissioned two in-depth studies conducted by third-party experts to assess the competitive performance of the New England market. Both studies found that the market was functioning well, without undue volatility and with sufficient competition—critical factors that deter market power manipulation, keep the cost of electricity at appropriate levels and promote investment in the bulk power system.

In February, James Bushnell, Ph.D., and Celeste Saravia, researchers at the California Energy Institute, published *An Empirical Assessment of the Competitiveness of the New England Electricity Market,* which found that the New England electricity market compared favorably with other electricity markets and was competitive during typical system conditions. In May, *Competitive Assessment of the Energy Market in New England,* by David Patton, Ph.D., of Potomac Economics, Ltd., found New England's market system workably competitive under peak load conditions.

(From right) Director of Market Monitoring, Robert Ethier, Ph.D., and Market Assessment Analysts, Janine Dombrowski, Malcolm Ainspan and Lisa Szlosek, continually evaluate market behavior and performance to ensure a fair and competitive marketplace.

Generation Information System launched. Certificate-based system documents and unbundles specific attributes of electric

MAR 3

NEW DEPARTMENTS NEW HIRES

During 2002, ISO New England created five new departments to help facilitate its efforts to foster a more competitive marketplace and, particularly, to administer the design and implementation of SMD. The first employee hired for the new Credit Department joined ISO New England on March 3. Soon after, the Market Design, Demand Response, Market Services and Market Administration groups were formed.

Over the course of the year, 40 new hires were brought on board, 34 promotions awarded and 19 internal positions filled. ISO New England currently employs over 350 men and women from around the world whose teamwork, integrity and innovation are the very definition of excellence.

Chris Campbell, Human Resource Coordinator (left), talks with veteran Jay Dwyer, Senior Analyst in the new Market Services group, and new employee Michael Taniwha, Manager of the recently formed Market Administration group. She also greets new hires Tongxin Zheng, Senior Analyst for the Systems Architecture and Technology group, and Kelly O'Donnell, Administrative Assistant in the Project Management Office.

MARKET RULE REFORMS

Analyses of New England's wholesale electricity marketplace, including assessments by Independent Market Adviser to ISO New England's Board of Directors, David Patton, Ph.D., found certain inefficiencies in the existing NEPOOL market rules that, once removed, would improve the energy pricing process and reduce any incentive for participants to exercise market power.

ISO New England committed to enhance the market rules and developed a set of reforms, which were approved by the FERC on April 26 and implemented on May 1. These amendments were designed to improve the pricing efficiency of the New England market for the summer of 2002, an interim fix until SMD could be introduced for 2003—the best long-term solution to ensuring the utmost competitive, efficient and fair wholesale electricity marketplace for the region.

Mark Karl (left), Manager of the new Markets Design group, works with Jim Milligan, Principal Engineer in Markets Development, to build the foundation of the electricity market, the market rules. In 2002, their work involved enhancing the interim rules and creating Market Rule 1, the overarching rule that governs the operation of New England's wholesale electricity market under Standard Market Design.

MAY 20

NEPOOL FINANCIAL ASSURANCE POLICY

On May 20, ISO New England and NEPOOL instituted a new Financial Assurance Policy, which altered the financial requirements and documentation necessary for participating within New England's market. The policy makes certain that market participants are in good financial health and will not cause undue risk to the wholesale marketplace.

Once approved by the FERC, ISO New England established a Credit Department, which worked closely with the Information Technology Department to develop software that would enable ISO New England to effectively administer the more robust policy. The Financial Assurance Policy is constantly under review, and changes are implemented as new risks are defined.

Steve Bonasoni, Enterprise Software Development Supervisor (left), helps Lin McDonough, Credit Analyst; Gary Faber, Credit Department Supervisor; Cheryl Arnold, Controller; and Tom Woodruff, Credit Analyst, develop software for the new Financial Assurance Policy that provides NEPOOL market participants with added security from other potentially defaulting participants.

Market Operators Coordinating Committee designated to address "seams" and market standardization issues. AUG 08 Nation's

Henry Yoshimura (right), Manager of ISO New England's innovative Demand Response Department, works alongside Robert Burke, Principal Analyst, to develop demand-side management programs that are a cohesive and integrated component of the region's wholesale electricity marketplace.

JUN 27

DEMAND RESPONSE PROGRAM SUMMITS

Energy conservation and demand response programs are critical components of New England's wholesale electricity marketplace. These demand-side management programs help to reduce demand when curtailment is needed most in order to ensure system reliability. In 2002, ISO New England furthered efforts to encourage conservation and promoted enrollment in its Demand Response Program through a series of summits held in Stamford, Connecticut on April 24; in Boston, Massachusetts on April 29; and in Burlington, Vermont on June 27.

Calling it an "investment in the future of responsible power markets," the FERC pledged to provide financial support to help New England design and launch demand response strategies that would eventually serve as a prototype for wholesale electricity market demand response programs across the nation. This initiative has led to an important partnership among the FERC, ISO New England, NECPUC and other regional stakeholders that will guide New England's demand response initiative well into the future.

first merchant transmission facility, Cross Sound Cable, interconnected into the New England transmission system.

AUG 14

MEETING RECORD DEMAND

ISO New England's control room operators and forecasters kept their cool this summer and maintained power system reliability during four extended heat waves that hit New England during 2002. The last, and one of the longest ever in the Northeast, brought the all-time record for electricity use to 25,348 megawatts on August 14.

An enhanced Demand Response Program, the public's overwhelming response to calls for voluntary electricity conservation and the region's increased supply of electricity enabled ISO New England to keep the lights on during those hot and humid days. In 2002, New England increased its electric supply by almost 3,000 megawatts—that's a total of 6,182 megawatts installed since the wholesale electricity market began in New England in 1999.

To manage the reliability of the bulk power system, the System Operations group, including (from left) Don Gates, Operations Manager, Michael Miodonka, Senior System Operator, and David Pease, Forecaster, analyzes weather, historical data and sociological data to anticipate system demand and monitors the "real-time" generation and flow of electricity across the region's high voltage transmission system 24 hours a day, 365 days a year.

AUG 14 Power system reliability maintained during four extended heat waves. All-time demand record set at 25,348 megawatts.

In his role as Market Assessment Analyst, Shiv Mani, along with his colleagues in the Markets Analysis and Reporting group, drafted the Annual Markets Report, which demonstrated that the region's wholesale market continues to be workably competitive. The report also recognized the importance of ISO New England's RTEP process and Demand Response Program to the health of the region's marketplace and reliability of the bulk power system.

More than 100 industry stakeholders attended ISO New England's third Annual Markets Forum to review findings from the 2002 Annual Markets Report released on September 12. The report describes the performance and development of New England's competitive wholesale electricity market during its third year of operation, from May 2001 through April 2002.

The forum, which included a keynote address by William F. Hederman, Jr., Director of the Office of Market Oversight and Investigation for the FERC, was a success. Allowing interested stakeholders the opportunity to ask questions and provide input, the forum reported results that demonstrate how ISO New England's continued efforts to refine the competitive wholesale electricity market have increased the operational efficiency of the market and produced reasonable wholesale costs in New England. The Annual Markets Report found that the enhanced market rules implemented on May 1 strengthened the market's competitive nature, resulting in wholesale energy prices that reflect more efficient bidding and dispatch, particularly during the summer. The study also supported the implementation of SMD as potentially the most significant enhancement to New England's market system.

SEP 12

ANNUAL MARKETS REPORT

AUG 19 Northwestern Vermont Reliability Study complete. Planning analysis associated with improving reliability of

OCT 8

SMD EXTERNAL MARKET TRIALS

Final preparations for implementing SMD defined 2002 for ISO New England. SMD is a complex undertaking of tremendous proportions, and ISO New England employees worked steadfastly to design the improved market rules and procedures and develop the new market's sophisticated computer technology. Market participants overwhelmingly approved the market rules in July, followed by final approval from the FERC in September. The software system passed extensive testing, received certification from an independent software auditor and succeeded through two rigorous internal market trials.

Most importantly, ISO New England held a series of three external market trials that allowed ISO New England and market participants to test the readiness of the SMD software, business processes and systems under simulated market conditions. Months of preparation culminated in a Financial Transmission Rights (FTR) auction on September 23 and real-time operation of the first trial on October 8-10. The trial provided the first signs that ISO New England was well on track for successful SMD implementation. Over the course of the year, ISO New England continued to work closely with the market participants to provide the necessary resources to ensure their readiness for a seamless transition to the more competitive and efficient market system.

Preparation for successful SMD implementation was realized through intense and often round-the-clock collaborative efforts of employees from across ISO New England. Meeting together, (from left to right) 2001 employee of the year, Wilson Kazibwe, Energy Management System Applications Support Supervisor; Michael Gilmore, Chief Integration Engineer; Shannon Hann, Market Settlements Manager; Joseph Mercer, Forecasting Supervisor; and Elham Mahdavy, Market System Software Development Supervisor review the results of the SMD market trials.

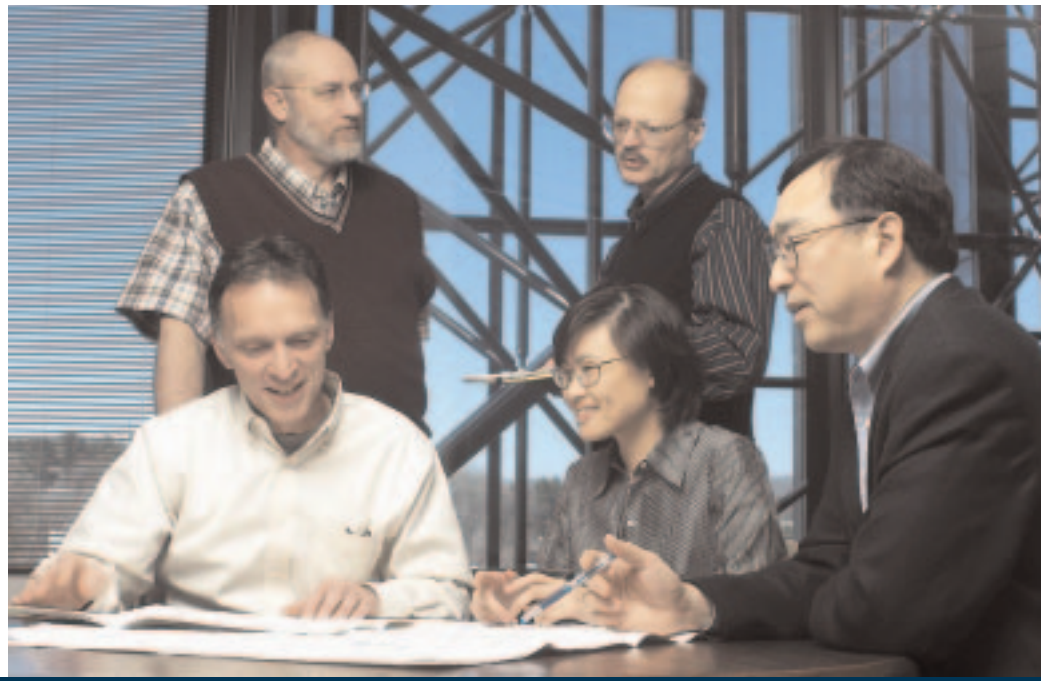
supply to Burlington load pocket supports another five years of expected load growth in state. AUG 30 ISO New England

REGIONAL TRANSMISSION EXPANSION PLAN

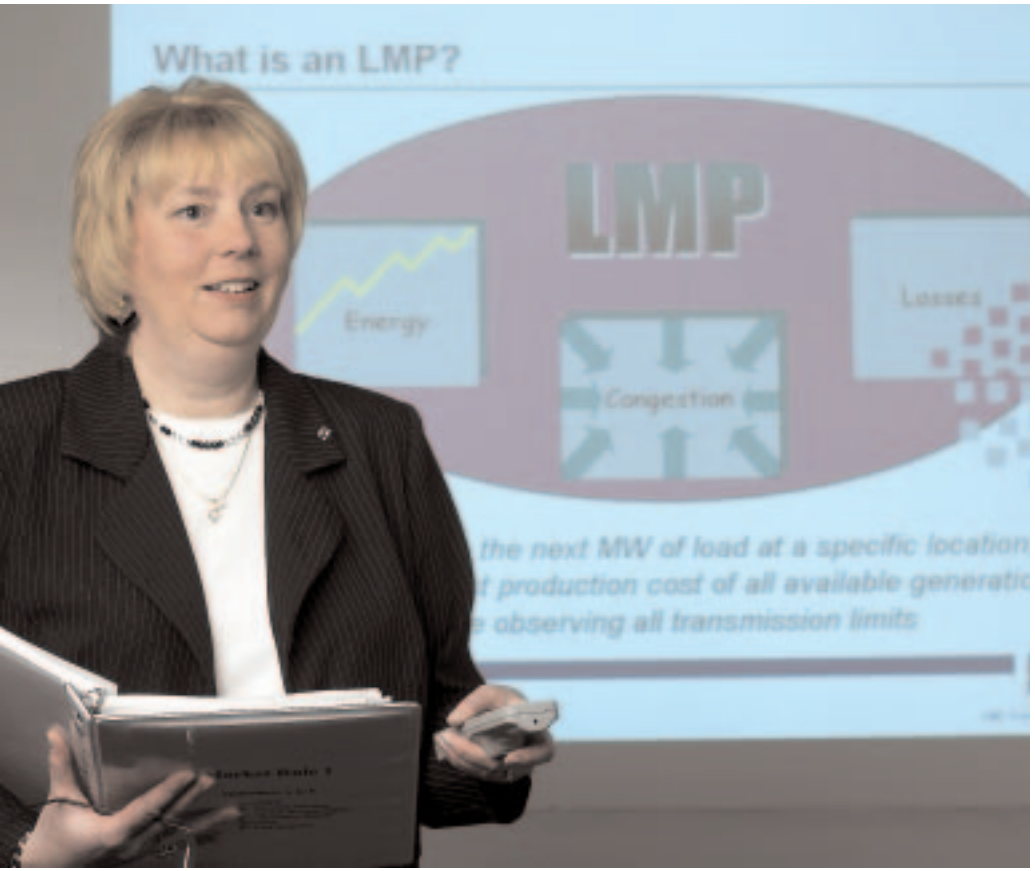
On November 7, ISO New England's Board of Directors approved the company's second annual Regional Transmission Expansion Plan (RTEP). The first of its kind in the country, RTEP is a comprehensive electrical engineering assessment that reviews and reports on the status of the region's bulk power system. The plan is developed through a series of public stakeholder meetings held throughout the year and across the region. It allows ISO New England to determine inadequacies in the bulk power system and make recommendations regarding necessary projects to address needs not met by the market. By producing this report, ISO New England helps to point market participants to areas in need of transmission upgrades, new generation or demand response.

The 2002 plan highlights more than 30 transmission projects planned or proposed by electric companies throughout New England. These transmission upgrades, which are expected to cost almost $900 million, are needed to maintain power system reliability and improve wholesale electricity market efficiency.

The System Planning group developed the RTEP process to objectively evaluate transmission and capacity needs. (Back left) Frank Mezzanotte, Lead Engineer; Rich Kowalski, Transmission Planning Manager; (front left) David Ehrlich, Principal Economic/Load Analyst; Hang Wang, Engineer; and Peter Wong, Power Supply and Reliability Manager, are committed to a coordinated, regional approach to planning.



evolves into process-oriented organization. Formal business processes complete for market-facing areas; methodologies for



Gail Hogan Lucia, Customer Services and Training (CST) Coordinator, led ISO New England's SMD training efforts in 2002, spearheading over 50 training programs. As a team, CST designed the intensive multimedia courses to ensure market participants' readiness for the new market.

DEC 31

SMD TRAINING

Close coordination with market participants and regional regulators was a significant element in the decision to move ahead with the implementation of SMD in New England. Throughout 2002, ISO New England developed and delivered training programs for SMD to thousands of stakeholders using its state-of-the-art computer lab and instructor-led training with ready access to subject matter experts from across the company. ISO New England also held regular Web-assisted teleconferences to provide the latest SMD information and to allow market participants frequent opportunities to discuss and resolve all issues and concerns to ensure their SMD readiness.

In addition to supporting SMD training and resources, ISO New England's Customer Services and Training team provided the day-to-day information needed to participate in the market through its call center and other customer communications, such as electronic newsletters and Web-based special notices.

on-going development and maintenance of business processes defined. SEP 01 Installed Capacity (ICAP) Forward Obligation

REPORT OF INDEPENDENT ACCOUNTANTS

FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

To the Board of Directors and Members of ISO New England Inc.:

In our opinion, the accompanying statements of financial position and the related statements of activities and of cash flows present fairly, in all material respects, the financial position of ISO New England Inc., at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

March 6, 2003

process implemented in accordance with FERC in anticipation of SMD. Designed to ensure system reliability by assigning

STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2002 AND 2001

	2002	2001
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,130	$ 19,300
Total cash and cash equivalents	64,130	19,300
Unbilled receivable, net *(Note 1)*	10,793	11,238
Prepaid expenses	72	255
Noncurrent assets:		
Property and equipment, net *(Note 3)*	92,272	50,628
Deferred charges *(Note 1)*	3,601	3,271
Security Deposits *(Note 1)*	143,631	38,850
Regulatory asset *(Note 5)*	2,815	-
Total assets	$317,314	$123,542

	2002	2001
	(In thousands)	
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable *(Note 1)*:		
Settlement, net	$ 611	$ 164
Administration	10,491	10,948
Deposits payable	144,389	39,326
Revolving credit *(Note 4)*	5,000	5,500
Interest payable	129	68
Billing advance collections *(Note 1)*	54,787	14,296
Accrued expenses	5,710	6,292
Accrued pension and postretirement benefits *(Note 5)*	1,866	1,369
Minimum pension liability *(Note 5)*	2,815	-
Deferred income *(Note 1)*	516	2,579
Term loan payable-current *(Note 4)*	13,859	-
Long-term liabilities:		
Term loan *(Note 4)*	77,141	43,000
Total liabilities	317,314	123,542
Unrestricted net assets	-	-
Total liabilities and net assets	$317,314	$123,542

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

	2002	2001
	(In thousands)	
Changes in unrestricted net assets:		
Revenues *(Note 1)*:		
ISO tariff revenues	$ 62,568	$ 61,392
Interest income	454	736
Fees and services	848	503
Total unrestricted revenues	63,870	62,631
Expenses:		
General and administrative:		
Salaries and benefits	34,254	31,176
Professional and consultants	11,814	15,089
Rents and leases	3,593	2,994
Computer services	3,120	3,361
Depreciation expense	3,573	2,833
Communication expense	1,922	1,395
Interest expense	793	1,037
Other	4,801	4,746
Total expenses	63,870	62,631
Change in unrestricted net assets	-	-
Unrestricted net assets, beginning of year	-	-
Unrestricted net assets, end of year	$ -	$ -

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

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	2002	2001
	(In thousands)	
Cash flows from operating activities		
Increase in unrestricted net assets	$ -	$ -
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:		
Depreciation and amortization	4,279	3,561
Decrease in accounts receivable	445	399
(Increase) in deferred charges	(330)	(3,271)
(Increase) in security deposits	(104,781)	(34,059)
(Increase)/decrease in prepaid expense	183	(249)
(Increase) in regulatory asset	(2,815)	-
Increase/(decrease) in accounts payable:		
Settlement	447	(8,278)
Administration	(457)	5,567
Increase in daily billing advance collections	40,491	14,296
Increase in accrued pension and postretirement benefits	497	311
Increase in minimum pension liability	2,815	-
Increase/(decrease) in accrued expenses	(582)	4,133
Increase in deposits payable	105,063	34,191
Increase in interest payable	61	68
Decrease in deferred revenue	(2,063)	(3,655)
Net cash provided by operating activities	43,253	13,014

	2002	2001
	(In thousands)	
Cash flows from investing activities:		
Capital expenditures	(45,923)	(34,598)
Net cash used in investing activities	(45,923)	(34,598)
Cash flows from financing activities:		
Decrease in working capital advance from NEPOOL Participants	-	(10,521)
Decrease in capital expenditure funding from NEPOOL Participants	-	(14,285)
Proceeds from term loan	48,000	43,000
Proceeds from/(repayment on) revolving credit, net	(500)	5,500
Net cash provided by financing activities	47,500	23,694
Net increase in cash and cash equivalents	44,830	2,110
Cash and cash equivalents, beginning of year	19,300	17,190
Cash and cash equivalents, end of year	$ 64,130	$ 19,300
Supplemental data:		
Cash paid during the year for interest:	$ 2,581	$ 2,087

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

wholesale electricity prices under SMD. Exemplifies customer responsiveness and dedication to development and support of

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

DESCRIPTION OF BUSINESS

ISO New England Inc. (the "Company" or "ISO") commenced operations on July 1, 1997 as the New England electric transmission independent system operator for the New England Power Pool ("NEPOOL") in compliance with the requirements of the Federal Energy Regulatory Commission ("FERC"). On May 1, 1999, the competitive marketplace opened in the NEPOOL control area. The Company administers a wholesale power exchange, and ensures the short-term reliability of the control area. The Company operates as an organization described in Section 501(c)(4) of the Internal Revenue Code and is exempt from tax pursuant to Section 501(a) of the Internal Revenue Code.

REGIONAL TRANSMISSION ORGANIZATION PROPOSAL

In January 2003, the Board of Directors of ISO voted to unanimously pursue the creation of a Regional Transmission Organization (RTO) for New England. ISO and the transmission owners expect to prepare a joint petition, with input from the market participants, regulators and other stakeholders for filing at the FERC. The RTO filing will address the seams issues between control areas and will ensure that New England's marketplace remains efficient and competitive, while maintaining the reliability of the bulk power system.

CASH EQUIVALENTS

The Company considers cash on hand and short-term marketable securities with original maturities of three months or less to be cash equivalents. The cash equivalents at December 31, 2002 and 2001 were held in overnight repurchase agreements and also in direct and indirect obligations of the United States.

ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

In the course of bulk power transactions administered by the Company on behalf of the NEPOOL Participants, amounts for energy purchased and sold among Participants become payable to and receivable from such Participants. The Company summarizes and prices the energy transactions each month and provides an invoice or remittance advice to each Participant that summarizes the amount either payable to or receivable from each Participant.

Included in the invoice or remittance advice is each Participant's share of Company expenses, which is netted into the payable or receivable amount for each Participant. Accounts payable on the balance sheet are segregated between the amounts owed for energy transactions and transmission, for which the ISO functions as paying agent, and for the amounts incurred by the Company in the course of operations.

The net unbilled receivables at the end of each month include those amounts that will be billed and included in the invoice or remittance advice to Participants in the subsequent month. The net payables and receivables for energy transactions are settled with the Participants in the subsequent month. Accounts receivable and accounts payable are reflected net of NEPOOL Settlement amounts, which were $0 at December 31, 2002 and 2001. A default payment liability of $266,000 and $164,000 was outstanding at December 31 2002 and 2001, respectively. At December 31, 2002, a liability of $250,000 was owed to a Participant under a special billing arrangement, and an additional liability at December 31, 2002 of $95,000 was owed to a number of Participants related to prior settlements.

PROPERTY AND EQUIPMENT

The Interim Independent System Operator Agreement between the Company and NEPOOL states that any fixed assets acquired or developed by the Company and funded by the NEPOOL Participants shall be the property of the NEPOOL Participants. All capital expenditures of the Company subsequent to January 1, 2000 have been funded by the Company, principally through bank borrowings, and the assets acquired or developed have been recorded in Property and Equipment. The Company has elected to capitalize additions in excess of $1,000 or whose useful life is greater than one year. Property and equipment is stated at cost, net of accumulated depreciation.

DEPRECIATION

Depreciation is generally computed using straight-line methods over an estimated useful life ranging from three years to ten years (computer hardware, software and accessories – 5 years, software development costs – 5 years, furniture and fixtures – 7 years, leasehold improvements – 10 years, vehicles – 3 years). No depreciation is recorded for assets classified in "Work in Process" (Note 3). Depreciation expense is offset by amortization of Deferred Income related to fixed assets the Company purchased and placed in service in 1997 through 1999 that were pre-funded by NEPOOL participants.

INCOME TAXES

Income taxes, for both Federal and State of Massachusetts, are not provided by the Company because it is operating as a corporation described in Section 501(c)(4) of the Internal Revenue Code, is exempt under Section 501(a) of the Internal Revenue Code, and has no unrelated business tax.

DEFERRED CHARGES

The Company applies the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (FAS 71), which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because they are expected to be collected or refunded through future customer billings. During 2001, the Company determined that certain Congestion Management System and Multi-Settlement System costs totaling approximately $3,300,000 that had been previously capitalized as part of work in process no longer had future value and were thus impaired, this impairment will be recovered under the ISO Tariff in 2003. In addition, in 2002, in response to a FERC Ruling, all post 9/11 security enhancement costs incurred above and beyond the amount filed in the ISO Tariff for 2002 are allowed to be capitalized and recovered in future Tariff filings. These cost totaled approximately $330,000 in 2002. The cost of the post 9/11 security enhancements were not expensed and will be recovered through future ISO Tariff rates and, in accordance with FAS 71, is now classified as Deferred Charges.

SECURITY DEPOSITS

The NEPOOL Participants are required to comply with the NEPOOL Financial Assurance Policy. In the case of non-investment grade rated Participants that meet certain criteria, the NEPOOL Financial Assurance Policy requires these Participants to put in place alternate forms of financial assurance. There are several options allowed under the NEPOOL Financial Assurance Policy for compliance, one of which is to post cash as collateral. Effective May 2002, a change in the Financial Assurance Policy required a significant increase in the levels of assurance for compliance with the Policy. At December 31, 2002 and 2001, the balance of these deposits was approximately $143,631,000 and $38,850,000, respectively.

Certain Participants that do not meet the credit ratings criteria of the Financial Assurance Policy and have not provided an alternate form of financial assurance, can prepay an estimate of their monthly bill on a weekly basis or will be subject to default procedures to remove them from NEPOOL.

BILLING ADVANCE COLLECTIONS

During 2001, the ISO, NEPOOL, and certain Participants entered into a Standstill Agreement, which has continued into 2002. The Standstill Agreement requires the ISO to issue an invoice daily to the affected Participants, who are required to pay the invoice on a daily basis, which represents the amount of estimated charges they have incurred for each day. The amounts collected in advance are then trued-up at the end of each month through the normal settlement billing process. In 2002, a weekly billing arrangement was entered into with a certain Participant.

REVENUE RECOGNITION

The Company recovers its operating costs pursuant to the Tariff for Transmission Dispatch and Power Administration Services (ISO Tariff). The tariff provides for recovery of expenses through three schedules. Scheduling, System Control and Dispatch Service (Schedule 1) and Energy Administration Service (Schedule 2) recover related operating costs through a pre-approved rate applied to each month's activity. Reliability Administration Service (Schedule 3) recovered actual operating costs through June 30, 2001 through an allocation to Participants. Beginning July 1, 2001 and continuing into 2002, these costs were recovered through a pre-approved rate applied to each month's activity. Schedules 1, 2, and 3 are subject to true-up through subsequent years' rates. The tariff may be redesigned for future years.

DEFERRED INCOME

Deferred income offsets the net fixed assets of the Company that were purchased and placed in service in 1997 and 1998, and the amount of the ISO Tariff for Schedules 1, 2, and 3 that was over/under collected from 1999 through 2002. The pre-funded fixed asset deferred income is being amortized to income over the life of the assets at the rate depreciation is recognized. The over/under collection amount of the ISO Tariff will be returned to the Participants through the mechanism provided for within the ISO Tariff.

FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the statement of financial position for current assets and liabilities approximate their fair values.

USE OF ESTIMATES

Generally accepted accounting principles require management to make estimates and assumptions that affect assets and liabilities, contingent assets and liabilities, and revenues and expenses. Actual results could differ from those estimates.

LIQUIDITY INFORMATION

In order to provide information about liquidity, assets have been sequenced according to their nearness to conversion to cash, and liabilities have been sequenced according to the nearness of their resulting use of cash.

2. Commitments and Contingencies

FUNDING ARRANGEMENTS

The Company has incurred major expenses on behalf of NEPOOL relating to the development of NEPOOL's wholesale electric market for New England and the formation of the Company (implementation costs). Additional costs were incurred by NEPOOL itself. The final project costs were $50,567,000, exclusive of interest.

In accordance with the fortieth amendment to the NEPOOL Agreement, the Company has begun administering repayment of these costs by the current NEPOOL membership to the members that originally funded the expenses. The repayment is to be made over a five-year period to the funding Participants at an interest rate of 8% per annum until August 18, 2001 and 10.78% per annum thereafter, beginning with May 1, 1999 (the start of the wholesale electric markets in New England). The source of repayment was a monthly charge to NEPOOL Participants based on their pro rata share of ISO Schedule 2 costs which expired January 1, 2001.

Beginning January 1, 2001, the source of repayment for the remaining amounts is based fifty percent on Participants' pro rata share of electrical load and generating shares and fifty percent on Participants' pro rata share of electrical load and generating share peaks as defined in the Restated NEPOOL Agreement. At December 31, 2002, the amount of these costs to be repaid by the current NEPOOL membership to the members that originally funded the expenses was approximately $15,240,000.

CAPITAL FUNDING TARIFF

The FERC accepted ISO's "capital funding tariff" ("CFT"), filing for 2001. This filing supported the ISO's loan arrangements with various banks for a line of credit to fund the capital and working capital requirements of the Company. The CFT was refiled and approved by the FERC in 2002, to increase the ISO's limit on borrowing.

LEGAL PROCEEDINGS

The Company is party to various legal actions incident to its business; however, management believes that no material awards against the Company will result from such proceedings.

In accordance with the revised NEPOOL Billing Policy, formal billing disputes of Participants are no longer held in escrow until the dispute is resolved. However, approximately $1,540,000 and $25,400,000 remained in dispute at December 31, 2002 and 2001, respectively.

3. Property and Equipment

Property and equipment at December 31 consists of the following:

	2002	2001
Computer hardware, software and accessories	$18,254,000	$14,215,000
Software development costs	3,409,000	3,234,000
Furniture and fixtures	803,000	540,000
Leasehold improvements	3,127,000	2,081,000
Vehicles	75,000	75,000
	25,668,000	20,145,000
Work in process (including $3,340,000 and $1,148,000 of capitalized interest & fees)	77,838,000	37,438,000
Less: accumulated depreciation and amortization	(11,234,000)	(6,955,000)
	$92,272,000	$50,628,000

Internal software development costs capitalized as work in process in 2002 and 2001 were $5,943,000 and $1,167,000, respectively. These costs will be amortized over three years.

4. Credit Facilities

REVOLVING CREDIT ARRANGEMENT

In June 2001, the Company entered into a $15 million revolving credit arrangement, of which the outstanding balances at December 31, 2002 and 2001 were $5.0 million and $5.5 million, respectively. Interest accrues on the revolving credit at a London Inter-bank Offering Rate ("LIBOR") of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a 1% spread. Interest is paid at the earlier of the selected LIBOR term or 90 days. The arrangement expires June 4, 2004 and any outstanding balance must be paid by this date. The Company is charged a fee of 0.25% on the entire line of credit. The weighted average interest rate for the years ended December 31, 2002 and 2001 was 2.84% and 4.02%, respectively.

TERM LOAN

The Company entered into a $43 million term loan in 2001 and a $40 million term loan in 2002, all of which is outstanding at December 31, 2002. In addition, the Company entered into a $24.5 million term in 2002, of which $8 million is outstanding at December 31, 2002. Proceeds from the term loans were used to pay back NEPOOL participants for capital expenditures advanced to the Company and to fund future capital expenditures. Interest accrues on the term loans at LIBOR of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a 1.375% spread. Principal is payable monthly with the final repayments are due between June 2006 – January 2007. Interest is paid at the earlier of the selected LIBOR term or 90 days. The weighted average interest rate for the years ended December 31, 2002 and 2001 approximately 3.37% and 4.98%, respectively.

Principal payments on the term loan are due annually as follows:

2003	$13,859,000
2004	28,163,000
2005	28,163,000
2006	19,885,000
2007	930,000
	$91,000,000

These credit agreements contain both affirmative and negative covenants, the most restrictive of which is the maintenance of a financial ratio related to revenue and expense plus debt service. The Company was in compliance with these ratios at December 31, 2002 and 2001.

Interest incurred on the revolving credit and the term loans for the years ended December 31, 2002 and 2001 was approximately $2,642,000 and $1,180,000, respectively. Interest capitalized from the term loans for the years ended December 31, 2002 and 2001 was approximately $1,856,000 and $686,000, respectively.

In February 2003, the Company entered into a commitment to borrow an additional $20 million to fund additional capital expenditures.

5. Pension and Other Employee Benefits

The Company sponsors defined benefit pension and postretirement plans, which cover substantially all union and nonunion employees and provide retirement income, medical, dental and life insurance benefits.

The Company sponsors two defined benefit pension plans, which are funded solely by Company contributions. Benefits are determined based on years of service and average compensation.

The Company sponsors two defined benefit postretirement plans which provide medical, dental and life insurance benefits for union and nonunion eligible employees and their beneficiaries. The medical benefits are contributory with participants' contributions adjusted annually and participants are responsible for deductible and coinsurance amounts. Dental benefits are non-contributory but participants are responsible for deductible and coinsurance amounts. The life insurance benefits are noncontributory. The Company's future liability for medical benefits is limited to 200% of 1993 costs and as a result the impact of a one-percentage-point change in assumed health care cost trend is immaterial.

	PENSION BENEFITS YEARS ENDED DECEMBER 31,		OTHER POSTRETIREMENT BENEFITS YEARS ENDED DECEMBER 31,	
	2002	2001	2002	2001
Change in benefit obligation:				
Benefit obligation at beginning of year	$23,676,000	$21,226,000	$ 1,831,000	$ 1,887,000
Service cost	1,717,000	1,483,000	326,000	187,000
Interest cost	1,614,000	1,438,000	131,000	106,000
Plan amendments	-	41,000	336,000	-
Benefits paid	(298,000)	(281,000)	(23,000)	(15,000)
Actuarial (gain) loss	681,000	(231,000)	(140,000)	(334,000)
Benefit obligation at end of year	27,390,000	23,676,000	2,461,000	1,831,000
Change in plan assets:				
Fair value of plan assets at beginning of year	17,423,000	16,887,000	-	-
Actual return on plan assets	(2,128,000)	(631,000)	-	-
Employer contributions	2,081,000	1,448,000	23,000	15,000 *
Benefits paid	(298,000)	(281,000)	(23,000)	(15,000)
Fair value of plan assets at end of year	17,078,000	17,423,000	-	-
Funded status	(10,313,000)	(6,253,000)	(2,461,000)	(1,831,000)
Unrecognized transition obligation	1,437,000	1,562,000	809,000	865,000
Unrecognized net actuarial (gain) loss	8,837,000	4,650,000	(500,000)	(403,000)
Unrecognized prior service cost	39,000	41,000	286,000	-
Prepaid (accrued) benefit cost	$ -	$ -	$(1,866,000)	$(1,369,000)

**Cash contributions made by employer to providers, insurers, trusts or participants for payment of claims.*

The primary economic assumptions used to value these liabilities are summarized in the following chart. These assumptions are selected at the measurement data based on prevailing economic conditions.

	PENSION BENEFITS YEARS ENDED DECEMBER 31,		OTHER POSTRETIREMENT BENEFITS YEARS ENDED DECEMBER 31,	
	2002	2001	2002	2001
Weighted-average assumptions:				
Discount rate	6.50%	7.00%	6.50%	7.00%
Expected return on plan assets	8.50%	8.50%	n/a	n/a
Rate of compensation increase	4.00%	4.50%	4.00%	4.50%

For measurement purposes, the assumed increase in per capita cost of dental benefits is 4.00% for 2001 and level thereafter. The medical trend rate no longer applies as the Company's commitment to cost sharing has reached caps.

	PENSION BENEFITS YEARS ENDED DECEMBER 31,		OTHER POSTRETIREMENT BENEFITS YEARS ENDED DECEMBER 31,	
	2002	2001	2002	2001
Components of net periodic benefit cost:				
Service cost	$1,717,000	$1,483,000	$ 326,000	$ 187,000
Interest cost	1,614,000	1,438,000	131,000	106,000
Expected return on plan assets	(1,506,000)	(1,575,000)	-	-
Amortization of transition obligation	125,000	125,000	56,000	56,000
Amortization of net actuarial loss	129,000	(16,000)	-	-
Amortization of unrecognized Prior Service Cost	-	-	50,000	-
Amortization of unrecognized (gain)/loss	2,000	-	(43,000)	(22,000)
Net periodic benefit cost	$2,081,000	$1,455,000	$ 520,000	$ 327,000

The Company follows the provisions of Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions, in determining the minimum liability requirements. A liability has been recorded on the balance sheet in the amount of $2,815,000 for the year ended December 31, 2002 as a result of the accumulated benefit obligation exceeding the fair value of plan assets. The Company has determined that this amount is probable of recovery through the ISO Tariff and has recorded a regulatory asset at December 31, 2002.

6. 401(k) Savings Plan:

The Company has a 401(k) Retirement and Savings Plan open to substantially all employees. This savings plan provides for employee contributions up to specified limits. The Company matches employee contributions up to 3% of eligible compensation and provides a 50% match on the next 2% of eligible compensation. The matching contributions for the Company were $870,000 and $746,000 for 2002 and 2001, respectively.

7. Leases

The following is a schedule by year of future minimum rental payments for all noncancelable-operating leases:

2003	$2,192,000
2004	2,189,000
2005	2,160,000
2006	2,119,000
2007	1,125,000
Total minimum lease payments	$9,785,000

The Company leases under a sublease from NEPOOL one of its buildings and various furniture and equipment with terms of up to 15 years and renewable options for additional periods. The sublease terminates on the earlier of the termination of the Interim ISO Agreement (see note 8), termination of the NEPOOL Agreement, or under the terms and conditions contained in the underlying master lease.

The Company currently houses its back-up facilities at Northeast Utilities for a minimum annual payment. In April 2002, the Company secured additional space at the same facility. The Company leases storage space at a nearby facility. The term of the lease commenced in April 2001 with a right to extend the lease by 1 year, which the Company has done.

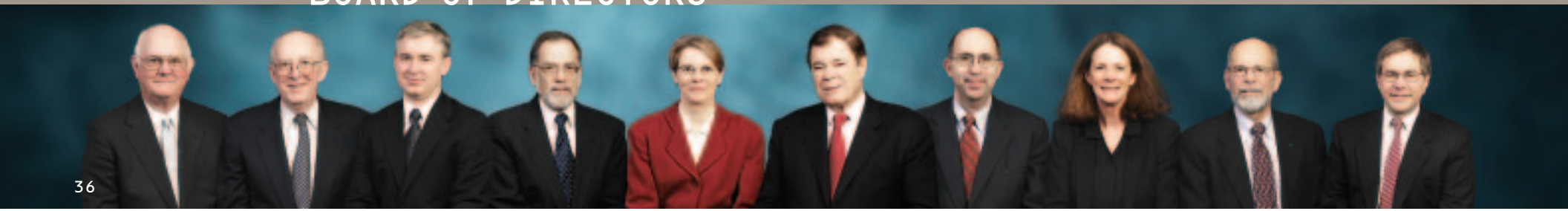
Additionally, the Company leases office space in one other building. The additional office space is leased with an initial term of six years with an automatic month-to-month renewal option. For fiscal years 2002 and 2001, actual rental payments for operating leases were $2,401,000 and $1,753,157, respectively.

As part of a separation agreement with NUSCO, the Company has agreed to reimburse NUSCO for all charges related to providing service to NEPOOL. This includes charges for leased equipment used at the Control Center. These leases covered approximately $5,072,000 and $5,600,000 in assets in 2002 and 2001, respectively. The annual payments were approximately $1,080,000 and $1,188,000 for the years 2002 and 2001, respectively.

8. Expiration of ISO Interim Agreement

The Company operates under an Interim ISO Agreement with NEPOOL, which was scheduled to expire on June 30, 2002. The Company and NEPOOL agreed to extend this agreement through December 31, 2003.

ISO NEW ENGLAND BOARD OF DIRECTORS



From left to right: William W. Berry, *Chairman;* Vincent M. O'Reilly, *Vice Chairman;* Gordon van Welie, *President and CEO;* Alvin K. Klevorick; Mary Sharpe Hayes; Alger "Duke" B. Chapman; Donald L. Isaacs; V. Louise McCarren; John G. Kassakian; Kenneth R. Leibler

ISO NEW ENGLAND SENIOR MANAGEMENT

From left to right: Stephen G. Whitley, *Senior Vice President and Chief Operating Officer;* Kathleen A. Carrigan, *Senior Vice President, General Counsel and Secretary;* Robert C. Ludlow, *Vice President and Chief Financial Officer;* Kevin A. Kirby, *Vice President, Market Operations;* David LaPlante, *Vice President, Markets Development;* Jamshid A. Afnan, *Vice President and Chief Information Officer;* Linda J. Swanson, *Director, Human Resources*

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