

Keeping New England plugged in:
wholesale electricity in the information age



ISO New England | 2003 Annual Report

Table of Contents

Keeping New England Plugged In	1
Letter from the President and CEO	2
Markets Development	4
Market Operations	9
Market Monitoring and Mitigation	11
Power System Operations	12
Power System Planning	14
Governance	17
Four Pillars of a Competitive Energy Market	19
ISO New England Board of Directors	20
ISO New England Senior Management.....	21
Report of Independent Auditors	22
Statements of Financial Position	23
Statements of Activities	24
Statements of Cash Flows	25
Notes to Financial Statements	26

Electricity and information are inextricably linked. The advent of electricity quickly set into motion the development of communication and information technologies, such as the electric telegraph and early telephones. At the turn of the 20th century, the “electricity age” quickly evolved into the more widely heralded “information age,” which, one hundred years later, is paramount to modern life.



Laying the Atlantic Telegraph Cable from the steamship 'Great Eastern', from the Illustrated London News, September 2, 1865.

Today, electricity not only continues to drive our information-based society, but the wholesale electric power industry is information driven. In its transition from a vertically integrated industry with top down policymaking to a restructured, market-based industry, the role of information in the electricity business is critical.

The reliability of the bulk electric power grid and the effectiveness of the wholesale electricity markets depend on information. It is ISO New England's role to be the conduit for that information—to keep New England plugged in, not only to electricity but also to information about what's happening with the markets and the region's bulk power system.

ISO New England imparts information that is understandable, unambiguous, and uniformly available. It does this first by providing transparent data, procedures, and rules that guide participation in the markets and power system, including operational, trading, and investment decisions. Second, it ensures that access to this information is open and equal for all stakeholders. In so doing, ISO New England leads the region on the path toward achieving efficient and competitive markets and a reliable energy infrastructure for the ultimate benefit of New England's electricity consumers.



Since its creation more than six years ago, ISO New England has made significant strides in proving itself as an industry leader through the operation of the region's bulk power system, administration of the wholesale electricity markets, and management of a comprehensive regional power system planning process.

In carrying out these responsibilities, ISO New England plays another important but sometimes overlooked role—that of *information provider*. This function has become particularly significant over the past year with the introduction of Standard Market Design on March 1, 2003. To make this new and sophisticated market system successful, ISO New England must ensure that stakeholders have the information they need to act efficiently in the marketplace.

In the restructured wholesale electricity industry, markets are most effective when information is available to the market participants—those who generate, buy, sell, and transport power. The more information stakeholders have, the better they are able to make knowledgeable business decisions and hedge risks. State regulators and other public officials also rely on ISO New England for information that is accurate and impartial, easy to assimilate, and useful in guiding public policy decisions.

Whether it is market rules and procedures, day-ahead and real-time market data, real-time power system conditions, or the Regional Transmission Expansion Plan, the information ISO New England provides must be understandable, unambiguous, and uniformly available to all stakeholders.

Of course, information is worth little if it is biased. It is ISO New England's independence that allows us to effectively carry out the role of information provider. In 2003 alone, we showed time and again how our expertise, experience, and impartiality was critical in managing a reliable energy infrastructure with competitive markets for the prosperity and safety of the region's citizens.

In the first quarter of 2003, ISO New England successfully implemented Standard Market Design, which provided New England a set of markets with fair and understandable rules that promote greater economic efficiency, competition, and power system reliability.

2 During the summer, New England largely avoided the cascading effects of the August 14, 2003 blackout primarily due to a power system infrastructure that responded appropriately and to the quick response of system operators working according to well-defined procedures. The blackout



confirmed the importance of having established operating and communication procedures and a single operator in control of the region's power grid to maintain reliability and preserve the integrity of the bulk power system, not only on a daily basis but also in emergency situations.

After more than 60 stakeholder meetings over the course of the year, ISO New England filed to create a Regional Transmission Organization for New England in October 2003. This evolution will strengthen the independent and efficient management of the region's competitive wholesale electricity markets and bulk power system and will guarantee a decision-making process that meets both federal policy requirements and the needs of the New England region as a whole.

Over the past year, ISO New England significantly enhanced its information services and technology, including the quality and quantity of market data available to stakeholders as well as the online tools stakeholders use to access that data. We also began issuing a Wholesale Markets Plan to help provide certainty about the future of wholesale markets, thereby enhancing the ability of our market participants to make long-term investment decisions.

Again, a competitive marketplace is one in which its participants are able to make informed decisions. ISO New England has always been committed to soliciting input from stakeholders in developing its services, and we will continue to do so in order to meet the information needs of market participants and state regulators and the reliable electricity needs of New England.

Sincerely,

Gordon van Welie

Over the past year, ISO New England significantly enhanced its information services and technology.

A clear, consistent market design creates certainty within the wholesale electricity marketplace, making companies willing to participate, invest, innovate, and compete. A sound market design has positive economic consequences and ultimately affects the ability of power systems to meet ever-increasing demand efficiently.

ISO New England is a pioneer in the development of such a market structure. In March 2003, ISO New England successfully implemented Standard Market Design (SMD) ahead of the federal initiative for standardized markets. This major redesign of the interim markets in place in New England since 1999 was an incredible feat of planning, engineering, and execution. More than 22 months of dedication and hard work by ISO New England employees, market participants, and regulators resulted in a smooth transition to the new system.

The purpose of implementing SMD in New England is to harness the power of competition to ensure efficient energy markets and foster a reliable power system. SMD provides the industry with a sound market structure that is fair and transparent, more accurately prices wholesale electricity, and sends the right signals for conservation and investment.

SMD's First Year

Early results have shown that SMD was implemented successfully, without any significant operational or reliability problems, and that the markets have been operated well by ISO New England. In its first year, SMD worked exactly as was intended: it substantially improved the management of power system congestion and the efficient setting of energy prices in New England, which has influenced economic market behavior and reduced opportunities and incentives to manipulate the market.

In its first year, SMD substantially improved management of power system congestion and the efficient setting of energy prices in New England.



Karen Kochonies, Vice President of Commodities at Morgan Stanley, works at the real-time trading desk where she buys and sells electricity. This activity is important because it makes the marketplace more liquid and competitive. Traders use a wide variety of supply and demand data to analyze price movements and are more active in areas like New England where market information is more transparent and accessible.

SMD's most prominent feature, Locational Marginal Pricing, reflects the true cost of delivering and supplying electricity at every location on the grid. Under SMD, consumers in less congested areas no longer pay for transmission congestion costs they do not incur.

The Financial Transmission Rights (FTR) market, which provides participants a tool to hedge against higher wholesale prices caused by congestion, improved greatly over the course of 2003, with the amount bid in and the amount cleared increasing every month. Because the value market participants have been placing on bids into the FTR auctions has been growing, the amount of Auction Revenue Rights has also increased. This means that the market is becoming more liquid and therefore more competitive. In less than six months after the market's implementation, ISO New England began offering long-term FTR auctions in addition to its monthly FTR auction, which enable market participants to secure long-term transmission hedges to back up the long-term energy hedges they secure through bilateral contracts.

The day-ahead market under SMD also helps participants hedge against volatility and uncertainty of real-time prices. In 2003, more than 90 percent of demand cleared in the day-ahead market each month on average. Such hedging mechanisms provide certainty to participants making financial decisions in the markets.

What's more, in its first year, SMD began to provide market signals to promote investment in critical resources necessary for power system reliability. Proposals identified through ISO New England's regional system planning process are on the table for some of New England's areas of greatest concern.

To enhance SMD's ability to provide economic incentives for investment in quick-start generation that supplies energy in a short period of time, ISO New England created the nation's first-ever Forward Reserve Market in December 2003. Quick-start generators provide operating reserves that help maintain system reliability and reduce the need for more expensive measures to ensure sufficient capacity will be available in real-time.

SMD sets the foundation for a competitive marketplace in New England and represents a significant milestone in the evolution of the region's wholesale electricity markets. SMD not only adheres to federal policy requirements, but also provides transparency on wholesale market pricing at a state level, while providing economic and reliability benefits for the overall region.



Kristen Patneau is Project Manager of Operations at the Deer Island Wastewater Treatment Plant that services Metropolitan Boston. The plant participates in ISO New England's Real Time Price Response Program and voluntarily reduces electricity use when real-time wholesale prices in the Boston area exceed 10 cents per kilowatt hour. The plant operates on-site generation when notified by ISO New England that price response is in effect, which lowers the plant's energy costs, while helping lower the wholesale price of electricity for all customers in the Boston area and ensure power grid reliability.

Demand Response Programs

New England's peak electricity consumption has increased by 20 percent over the past decade and is expected to continue to grow by 15 percent over the next ten years. Conservation plays a critical role in maintaining system reliability and stabilizing wholesale electricity prices in times of high system demand. ISO New England's Demand Response Programs have been designed specifically to work in tandem with the markets under SMD. SMD's day-ahead and real-time markets provide increased options for demand response initiatives, and SMD's efficient pricing mechanisms provide signals that create incentives for reduced electricity use.

After implementation of SMD in 2003, enrollment in ISO New England's Demand Response Programs grew to 400 megawatts, doubling the prior year's participation. Demand response resources are signing up where they are most needed, in Connecticut and Boston, and where demand response resources are available, primarily among industrial consumers in Maine.



ISO New England works closely with electricity customers to help them understand how they can benefit from demand response and provides hands-on information on how to participate. To promote enrollment each year, ISO New England holds a conference that is open to all New England commercial and industrial electricity customers, including hotels, manufacturing facilities, supermarkets, and office complexes that are interested in learning about the Demand Response Programs.

In 2003, ISO New England also implemented a new Internet-based communication software system that allows demand response providers and ISO New England to freely exchange necessary data. Through this software, ISO New England notifies providers of demand response events and receives data on the amount of energy reduction achieved. This two-way information flow helps facilitate the calculation of compensation for program participants.

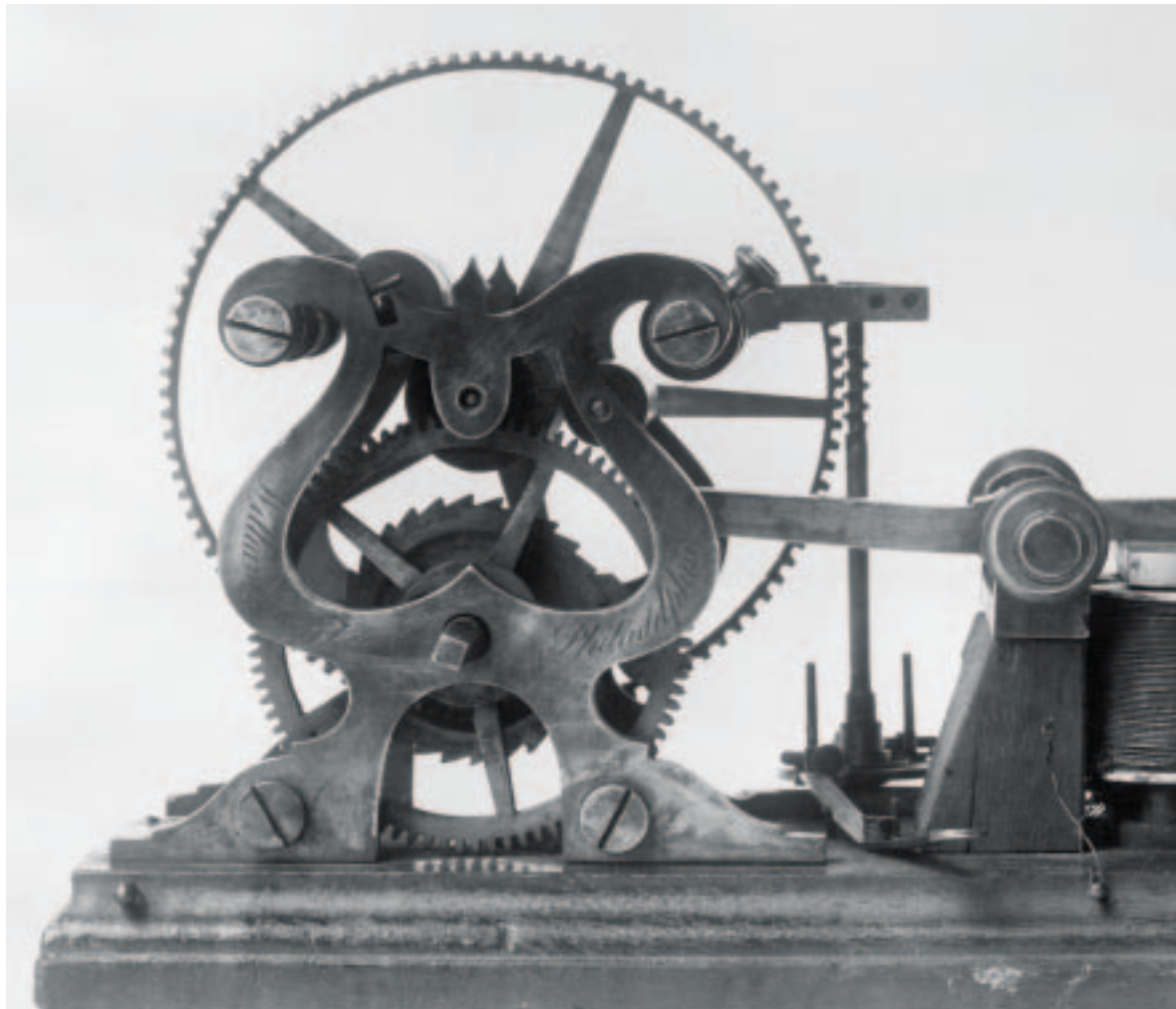
SMD's efficient pricing mechanisms provide signals that create incentives for reduced electricity use.

Wholesale Markets Plan

While New England has a sturdy foundation in SMD, the markets must continue to evolve to maximize the benefits of wholesale electricity restructuring. To plan for change in a practical way, ISO New England developed the Wholesale Markets Plan in 2003. The first of its kind in the nation, the plan identifies the timing and scope of potential market enhancements over the coming years and in so doing lays out a roadmap for the evolution of the wholesale electricity markets.

The plan benefits market participants and state regulators by allowing them to make decisions and long-range plans that reflect market changes. Given that enhancements to the wholesale electricity markets require significant resources and long lead times, the plan benefits ISO New England by allowing implementation of market changes to be organized in a cost effective manner, promoting efficient use of limited staff and budget dollars. Regional markets also benefit from the plan, which incorporates resolution of seams issues.

The Wholesale Markets Plan is updated annually as part of ISO New England's budget and business planning cycle. ISO New England incorporates input from the Federal Energy Regulatory Commission (FERC), state regulators and market participants in order to highlight specific issues and help determine regional priorities. The plan is subject to approval by ISO New England's Board of Directors and updated every fall.



To ensure fair oversight of the wholesale electricity markets, ISO New England provides essential and accurate market information that is available 24 hours a day, 365 days a year. The markets under SMD produce vast amounts of data, most notably the hundreds of day-ahead and real-time locational marginal prices available by hub, zone, node, and external interface every five minutes and every hour.

Market participants use this information to effectively participate in the markets. ISO New England also provides analytical data, historical data, periodic reports, and special studies that help guide market participation. Both the publishing of the data and the buying and selling of power are done through online interfaces. In 2003, ISO New England implemented state-of-the-art bidding, scheduling, and settlement software systems and enhanced its Web site, thereby improving stakeholder access to market information generated under SMD.

The information provided by ISO New England levels the playing field for market participants so that larger participants with bigger staffs and budgets do not have an advantage over smaller participants without similar resources.

Market Administration

As the market administrator, ISO New England not only calculates, analyzes, and provides the data, but also clears hourly, daily, monthly, and yearly the various markets that make up the wholesale electricity marketplace. ISO New England provides a monthly (weekly beginning second quarter 2004) financial settlement of the day-ahead and real-time energy markets; regulation, Financial Transmission Rights, Installed Capacity, operating reserves, and emergency energy markets; Demand Response Program, ISO Tariff, and NEPOOL Open Access Transmission Tariff.



Market Analysis and Reporting

In an effort to provide stakeholders “bigger picture” analysis and to meet federal reporting guidelines, ISO New England issues weekly, monthly, quarterly, and annual markets reports that describe the performance and development of New England’s wholesale markets.

Each year, ISO New England invites participants and government regulators to its Annual Markets Forum to review results of the year’s progress and to solicit feedback. The August 21, 2003, forum reviewed the performance of New England’s wholesale electricity market for the period from May 1, 2002 through December 31, 2002. Overall, results found the New England markets continued to yield results consistent with workably competitive markets and market reforms over the previous two years successfully advanced the goal of more efficient energy pricing during peak periods.

ISO New England provides stakeholders “bigger picture” analysis throughout the year in the form of markets reports.

Customer Services

Of course, strong technical support is essential to making a sophisticated market structure such as SMD work. In 2003, ISO New England aligned its customer services department with its market operations department to facilitate participants’ ability to do business in the marketplace ISO New England oversees. Each year, ISO New England publishes newsletters, issues hundreds of Web-based special notices, and responds to over 10,000 inquiries. ISO New England also offers extensive training on its markets. Since the Web is the primary channel for the exchange of information, ISO New England began embarking on a complete Web site redesign in 2003. Scheduled for release in 2005, the new site will allow users to more easily access market data and information they need.

One of ISO New England's most important roles in overseeing the region's markets is monitoring market behavior and performance to ensure participants' compliance with the market rules and operating manuals. Market participants' offers are mitigated as necessary, particularly in areas with congestion, to ensure that the markets are fair and competitive.

ISO New England also monitors the market design to uncover any flaws that may pose an impediment to efficiency or competition. Where design flaws are present, ISO New England works with market participants, state regulators, the FERC, and other jurisdictional agencies to correct those imperfections in a timely manner. Market monitoring is conducted continuously and openly.



ISO New England also seeks input regularly from an independent market adviser, David Patton, Ph.D. of Potomac Economics, Ltd., to provide an additional, independent review of significant market developments. In July 2003, his Competitive Assessment of the Energy Market in New England confirmed that the New England wholesale electricity markets performed competitively in 2002 as the markets were not subject to systematic economic withholding by participants, or the exercise of market power by withholding resources.

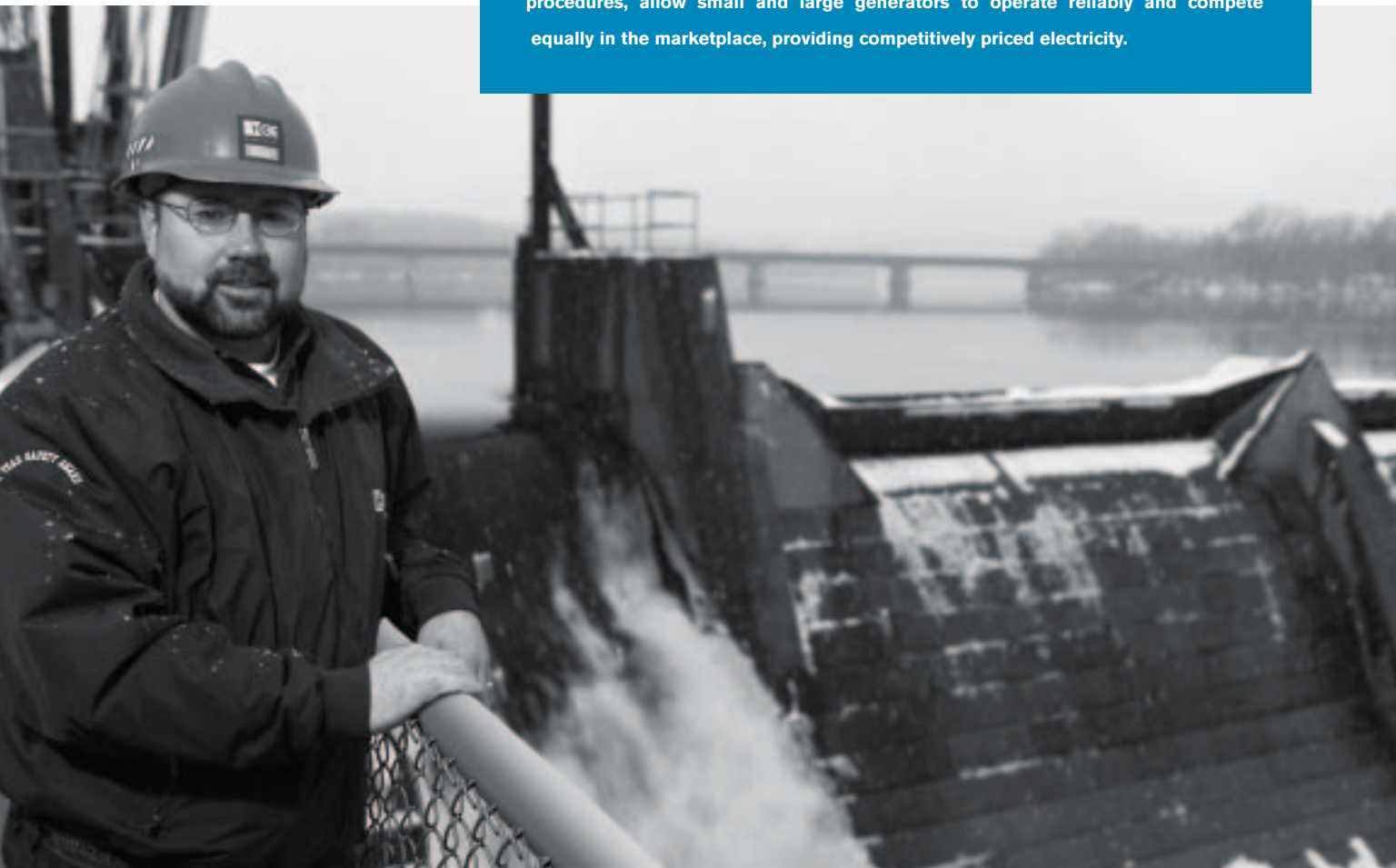
Donald W. Downes is the Chairman of the Connecticut Department of Public Utility Control. State regulators and other public officials rely on ISO New England for impartial and accurate market and power system information that is useful in guiding public policy decisions. Government stakeholders in turn help ISO New England determine regional priorities and ways to provide value to the marketplace that meet both federal requirements and state-level needs.

Just as ISO New England manages the markets around the clock, ISO New England system operators manage real-time generation and the flow of electricity across the region's interstate high voltage transmission system 24 hours a day, 365 days a year.

To balance supply and demand, ISO New England uses electronic communications to provide centrally dispatched, real-time direction every five seconds to each of its 350-plus generating resources. ISO New England also analyzes the power system every three to nine minutes to ensure the ability to react to power system events, while ISO New England forecasters provide updated load forecast and information about available generation every hour.

ISO New England maintains direct contact with four satellite control centers that backup its critical functions. ISO New England also coordinates its activities with neighboring bulk power system operators to protect the reliability of the interconnected systems. To ensure that adequate resources and reserves are available at all times for the reliability and safety of the grid, ISO New England coordinates the scheduling of maintenance activities of generators and the transmission lines.

Rich Murray is a hydroelectric engineer at the City of Holyoke Gas and Electric Department, a municipally owned utility that provides electricity to over 18,000 customers in Massachusetts. He stands in front of the Hadley Falls hydro-electric dam, which produces low cost, environmentally friendly power. Accurate and timely information provided by ISO New England, as well as formalized operating procedures, allow small and large generators to operate reliably and compete equally in the marketplace, providing competitively priced electricity.



Operating Procedures

ISO New England has defined operating procedures used by system operators to keep the lights on. These procedures, which include those for managing shortages in supply, load shedding, and system restoration, have been successful in maintaining reliability over the 34-year existence of the centrally dispatched bulk power grid.

2003 Northeast Blackout

ISO New England's procedures were tested during the summer of 2003 after New England largely avoided the cascading affects of the August 14 blackout that affected 50 million people in the Northeast. Using its formalized procedures, ISO New England operators worked with utilities and generators throughout New England to stabilize the system and restore power to affected areas within 12 hours of the initial disruption to New England's bulk power system.

Cascading outages like those of August 14 occur within seconds; there is no time for questions of overlapping responsibility, confusion of roles, or hesitance. The blackout underscored the importance of having established operating and communication procedures and a single operator in control of the region's power grid to effectively maintain reliability and preserve the integrity of the power system on a daily basis and in emergency situations.

The disruption affected areas of New England closest to New York, including Southwest Connecticut, parts of Western Massachusetts, and parts of Western Vermont. Recent investment in new power plants enabled New England to produce enough power within the region to be self-sufficient once it was cut off from the rest of the power grid.

Lessons Learned

The management of these events by ISO New England provides important operational experience that assists in improving procedures and coordination, thereby benefiting New England's electric customers. These events also demonstrated acutely that New England's power system is interconnected with the region's and the nation's systems. That requires regional solutions and national standards in order for the power system to operate reliably. ISO New England supports the creation of uniform, mandatory reliability standards, and operating procedures.

ISO New England system operators use well-defined procedures to keep the lights on.

New England has a history of successful coordinated power system planning in an environment of vertically integrated utilities. However, the need for planning is just as great, if not greater, in a restructured environment of dispersed generation and transmission ownership. As an independent system operator, ISO New England is in a position to coordinate and evaluate power system information in an objective manner and develop a plan focused on the needs of the overall region.

ISO New England has one of the nation's most sophisticated power system planning processes. Each year, ISO New England conducts an independent engineering assessment called the Regional Transmission Expansion Plan (RTEP). Through the RTEP, ISO New England informs regional stakeholders about the inadequacies of the bulk power system. The comprehensive and independent information provided in the plan gives the industry a roadmap to upgrade the region's power system, make it more efficient, and safeguard its reliability.

Identifying Market Solutions

The RTEP works in tandem with SMD, which provides price signals that identify areas on the system that are inadequate. By analyzing these needs, the RTEP reinforces SMD's market signals and facilitates market responses to address these needs, including investment in generation, transmission, distributed generation, and demand response. Where the market does not respond, ISO New England makes recommendations to address specific reliability problems. The study also provides information to the marketplace on resource adequacy, transmission congestion, air emissions, fuel diversity, and distributed resources.

ISO New England has one of the nation's most sophisticated power system planning processes.

Stakeholder Processes

ISO New England conducts and directs the studies that comprise the RTEP with the advice of a wide variety of regional stakeholders, including market participants, governmental representatives, state agencies, and the general public. ISO New England also coordinates the RTEP study results with interregional and local expansion plans. Information is exchanged with New England's neighbors, including New York, Quebec, the Maritimes, Ontario, and PJM. Accordingly, the RTEP addresses local, regional, and multi-regional considerations.



Rich Hinners, Manager of Transmission Planning for the Vermont Electric Power Company (VELCO), works with ISO New England to conduct transmission planning studies that seek to understand system problems, review the feasibility of alternatives, and identify the most effective solutions. Collaboration in these studies have led ISO New England to support VELCO's proposal filed with the state public service board to build a new 345-kilovolt line and other upgrades that will address critical reliability issues in Northwest Vermont.

RTEP03

The 2003 RTEP report, approved by ISO New England's Board of Directors in November, highlights approximately 250 regulated transmission projects planned or proposed throughout New England, including over 40 new projects identified in 2003 alone. All identified transmission upgrades, which are expected to cost from \$1.5 billion to \$3 billion, are needed over the next five to ten years to protect the reliability of the region's bulk power system.

The greatest need continues to be in Southwest Connecticut, the area of New England most affected by the August blackout. Other critical reliability needs include Northwest Vermont, Northeastern Massachusetts/Greater Boston, and an east-to-west 345 kilovolt transmission path from Southeast Massachusetts and Rhode Island to Connecticut. Reliability projects in these areas are well along the way in state siting processes.



The needs of the Northeastern Massachusetts/Greater Boston and Connecticut areas are driven by both an increase in demand growth and the potential retirements of generating units in those areas. In all cases, limited generation and insufficient connections to electricity sources in the rest of the region create risks of service interruptions, which could impact reliability in many other areas of New England.

Critical reliability areas include Southwest Connecticut, Northwest Vermont, and Northeastern Massachusetts/Greater Boston.

Just as information is worth little if it is biased, a truly competitive wholesale electricity market cannot be achieved if those with a financial interest in the marketplace manage its rules and procedures. Only a strictly independent entity can make impartial decisions concerning the region's power system and wholesale marketplace. ISO New England has proven itself as an industry leader in this area.

To ensure the continued independent and efficient management of the region's wholesale electricity needs, ISO New England has proposed the next step in the evolution of New England's electricity markets—the creation of a Regional Transmission Organization (RTO).

FERC Filing

On October 31, 2003, ISO New England filed its RTO proposal with the FERC. Becoming an RTO will strengthen the independence of ISO New England, giving it enhanced authority over the development and implementation of market rules, which currently resides with the market participants who are governed by those rules, and clear, operational control of the power system.

This change is of paramount importance to protecting the interests of New England consumers. Experience shows that a single point of responsibility is essential to effectively maintain reliability. The area of the country where the 2003 Northeast Blackout originated had multiple control centers and suffered from a lack of coordination and quick decision-making. Power disruptions come at a great cost to government, business, and residential consumers. An RTO will ensure that there is always one set of “hands on the wheel” operating the system.

Transmission Provider

The RTO will also make ISO New England the transmission provider for the region, giving it operational control over the day-to-day management of the region's transmission facilities and ability to require transmission owners to pursue needed transmission upgrades. This regional approach to transmission is important both for reliability and efficiency because power frequently flows on a regional basis that transcends state and local boundaries.

Certainty and Stability

An RTO for New England provides clarity of responsibilities, which will serve to reduce operational risk and prepare New England for future unknowns in the markets, the power system, and the industry. This will also provide the marketplace with greater certainty and stability, which is of vital importance to attracting capital to fund needed investment in infrastructure. What's more, reinforced independence ensures that market information, rules, and procedures are fair and transparent.

An RTO will continue the development of a reliable energy infrastructure.

As an RTO, ISO New England will continue its robust and well-tested stakeholder process to seek appropriate advice and input on market and power system issues, which is especially important in carrying out long-planned critical initiatives. ISO New England will also continue to develop SMD and expand its established regional planning process without weakening the integrity of the public and environmental review processes.

FERC Compliance

The RTO filing is the culmination of a three-year negotiation process. By forming an RTO, ISO New England complies with the FERC's Order No. 2000, which encouraged every transmission owner to put its facilities under the control of an RTO in order to promote efficiency in wholesale electricity markets.

Four Pillars

In the short time the region's restructured marketplace has existed, ISO New England has made enormous strides in strengthening each of the "Four Pillars of a Competitive Energy Market." An RTO will provide leadership tools necessary to further strengthen these pillars and continue the development of a reliable energy infrastructure for the benefit of New England's energy consumers.



Sound market structure

New England's Standard Market Design provides the region's wholesale electricity marketplace with a structure that has fair and transparent rules and procedures, provides more accurate pricing of wholesale electricity, and sends the right signals for conservation and investment in generation and transmission in congested areas, thereby enhancing overall power system reliability. SMD also aligns the New England market structure with the rest of the Northeast, helping to ease artificial barriers to the import of cheaper power from elsewhere. A strong market monitoring component ensures a level playing field for current and potential market participants.

Adequate power supply

Without enough power to meet demand, markets cannot provide the expected benefits. Genuinely competitive markets help prevent shortages, providing the incentives needed for investment in new generation. Market incentives introduced with competition have prompted an unprecedented investment in power generation. Already, new power plants have added more than 9,300 new megawatts of generating capacity to the region. By 2005, New England's power supply will have increased by 40 percent since 1999. Going forward, ISO New England is implementing enhancements to its marketplace to ensure adequate investment in generation resources in the right locations.

Incentives for conservation

Conservation plays a critical role in maintaining system reliability and stabilizing wholesale electricity prices in times of high system demand. Participation by electricity users in the marketplace enables wholesale prices to be set more efficiently, as proper interaction of supply and demand ensures that the right amount of power is produced and consumed at an economic price. ISO New England's Demand Response Programs provide financial incentives for large commercial users, such as factories or office complexes, to reduce power use during tight supply periods or when wholesale electricity prices are high. New incentives, such as greater price certainty and a wider range of program options under SMD, continue to be introduced to encourage larger participation in these conservation efforts.

Effective transmission system

Transmission is an area requiring urgent attention. Insufficient investment in upgrades and expansions in the face of growing demand and, in some cases, limited local generation or plant retirements, is causing the system to reach its limits. In 2003, ISO New England identified more than 200 transmission upgrades and additions necessary to reinforce the system and create stronger links between generation and demand. Because of long lead times for approval and construction, quick action is needed on these improvements.



William W. Berry
Chairman



Vincent M. O'Reilly
Vice Chairman



Gordon van Welie
*President and
Chief Executive Officer*



Alvin K. Klevatorick



Mary Sharpe Hayes



Alger "Duke" B.
Chapman



Donald L. Isaacs



V. Louise McCarren



John G. Kassakian



Kenneth R. Leibler



Stephen G. Whitley
*Senior Vice President and
Chief Operating Officer*



Kathleen A. Carrigan
*Senior Vice President,
General Counsel and Secretary*



Vamsi Chadalavada
*Senior Vice President,
Market and System Solutions*



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*



*Senior Management as of January 2004.

Financial Statements For the Years Ended
December 31, 2003 and 2002

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, 2003 and 2002, 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 our opinion.



PricewaterhouseCoopers LLP
March 3, 2004

Statements of Financial Position As of December 31, 2003 and 2002

	2003	2002
	<i>(In thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 45,329	\$ 62,519
Security deposits <i>(Note 1)</i>	137,482	143,631
Unbilled receivable, net <i>(Note 1)</i>	19,350	10,793
Prepaid expenses	142	72
Restricted cash on deposit <i>(Note 1)</i>	42,128	1,611
Noncurrent assets:		
Property and equipment, net <i>(Note 3)</i>	83,464	92,272
Deferred charges <i>(Note 1)</i>	834	3,601
Regulatory asset	<u>2,222</u>	<u>2,518</u>
Total assets	<u>\$ 330,951</u>	<u>\$ 317,017</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable <i>(Note 1)</i> :		
Settlement, net	\$ 493	\$ 611
Administration	8,405	10,491
Deposits payable	138,302	144,389
Revolving credit <i>(Note 4)</i>	-	5,000
Interest payable	292	129
Billing advance collections <i>(Note 1)</i>	20,643	53,176
Accrued expenses	6,713	5,710
Accrued pension and postretirement benefits <i>(Note 5)</i>	-	1,866
Minimum pension liability <i>(Note 5)</i>	1,988	2,518
Swap liability <i>(Note 4)</i>	234	-
Deferred income <i>(Note 1)</i>	9,854	516
Restricted cash on deposit <i>(Note 1)</i>	42,128	1,611
Term loan payable-current <i>(Note 4)</i>	35,421	13,859
Long-term liabilities:		
Term loan, net of current portion <i>(Note 4)</i>	<u>66,478</u>	<u>77,141</u>
Total liabilities	330,951	317,017
Unrestricted net assets	<u>-</u>	<u>-</u>
Total liabilities and net assets	<u>\$ 330,951</u>	<u>\$ 317,017</u>

Statements of Activities For Years Ended December 31, 2003 and 2002

	2003	2002
	<i>(In thousands)</i>	
Changes in unrestricted net assets:		
Revenues <i>(Note 1)</i> :		
ISO tariff revenues	\$ 100,942	\$ 62,568
Interest income	504	454
Fees and services	1,397	848
Other	<u>81</u>	<u>-</u>
Total unrestricted revenues	<u>102,924</u>	<u>63,870</u>
Expenses:		
General and administrative:		
Salaries and benefits	41,417	34,254
Professional and consultants	12,441	11,814
Rents and leases	2,850	3,593
Computer services	3,831	3,120
Depreciation and amortization expense	31,908	3,573
Communication expense	2,007	1,922
Interest expense	3,066	793
Other	<u>5,404</u>	<u>4,801</u>
Total expenses	<u>102,924</u>	<u>63,870</u>
Change in unrestricted net assets	-	-
Unrestricted net assets, beginning of year	<u>-</u>	<u>-</u>
Unrestricted net assets, end of year	<u>\$ -</u>	<u>\$ -</u>

Statements of Cash Flows

For the Years Ended December 31, 2003 and 2002

	2003	2002
	<i>(In thousands)</i>	
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	28,802	4,279
Loss on disposal of asset	51	-
(Increase)/decrease in accounts receivable	(8,557)	445
(Increase)/decrease in deferred charges	2,767	(330)
(Increase)/decrease in security deposits	6,149	(104,781)
(Increase)/decrease in prepaid expense	(70)	183
(Increase) in restricted cash on deposit	(40,517)	(1,611)
(Increase)/decrease in regulatory asset	296	(2,518)
Increase/(decrease) in accounts payable:		
Settlement	(118)	447
Administration	(2,086)	(457)
Increase/(decrease) in daily billing advance collections	(32,533)	38,880
Increase/(decrease) in accrued pension and postretirement benefits	(1,866)	497
Increase/(decrease) in minimum pension liability	(530)	2,518
Increase in swap liability	234	-
Increase/(decrease) in accrued expenses	1,003	(582)
Increase in restricted cash on deposit	40,517	1,611
Increase/(decrease) in deposits payable	(6,087)	105,063
Increase in interest payable	163	61
Increase/(decrease) in deferred revenue	<u>9,338</u>	<u>(2,063)</u>
Net cash provided/(used) by operating activities	<u>(3,044)</u>	<u>41,642</u>
Cash flows from investing activities:		
Capital expenditures	<u>(20,045)</u>	<u>(45,923)</u>
Net cash used in investing activities	<u>(20,045)</u>	<u>(45,923)</u>
Cash flows from financing activities:		
Proceeds from term loan	27,050	48,000
Repayment on term loan	(16,151)	-
Repayment on revolving credit, net	<u>(5,000)</u>	<u>(500)</u>
Net cash provided by financing activities	<u>5,899</u>	<u>47,500</u>
Net increase/(decrease) in cash and cash equivalents	(17,190)	43,219
Cash and cash equivalents, beginning of year	<u>62,519</u>	<u>19,300</u>
Cash and cash equivalents, end of year	<u>\$ 45,329</u>	<u>\$ 62,519</u>
Supplemental data:		
Cash paid during the year for interest:	<u>\$ 3,258</u>	<u>\$ 2,581</u>

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 New England control area. The Company administers NEPOOL’s open-access transmission tariff, administers a power exchange, and maintains the short-term reliability of the bulk power system. 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. On October 31, 2003, ISO and the New England transmission owners filed a joint proposal, with the FERC to create an RTO for New England. The RTO filing eliminates the need for continued extensions of the Interim ISO Agreement, addresses seams issues between control areas, continues ISO’s responsibility to manage the wholesale power markets, and to reliably operate the bulk power system. With this filing ISO will become the transmission provider for New England.

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, 2003 and 2002 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.

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 administrative expenses 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.

Restricted Cash on Deposit

The balance of \$42.1 million and \$1.6 million in 2003 and 2002, respectively, recorded as Restricted Cash on Deposit represents the Congestion Revenue Fund, NRG COS Escrow and Pre-petition funds, which are restricted by Market Rule 1, FERC Orders or Bankruptcy Law. The balance is offset by a liability on the Statement of Financial Position.

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.

The Company applies the provisions of Statement of Financial Accounting Standards No. 34, "Capitalization of Interest Costs" ("FAS 34"), which requires the Company to capitalize the interest and fees associated with the borrowings that the Company has entered into for the acquisition of assets related to a project that has a material effect on the Company's financial position.

In addition, the Company follows the provision of the Statement of Position 98-1, "Accounting for the Costs of Computer Service Software Development" ("SOP 98-1") in capitalizing internal software development costs.

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 – 3 to 5 years, software development costs – 3 to 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.

Derivative Policy

The Company follows the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FASB 133"), in establishing its derivative policy. The policy states that the Company's Management will make the determination with the approval of the Company's Audit and Finance Committee to enter into fixed interest rate swaps when the fixed interest rate offered at the time will outweigh the risk of leaving the term loan borrowings to the fluctuations of the market, taking into consideration the length of the term loan, the state of the economy and the direction the Management team believes the economy is moving.

Deferred Charges and Regulatory Assets

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 was recovered under the Tariff for Transmission Dispatch and Power Administration Services ("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 ISO Tariff filings. These cost totaled approximately \$324,000 in 2002. The cost of the post 9/11 security enhancements were not collected for in 2003, and will be recovered through the 2004 ISO Tariff rates and, in accordance with FAS 71, is now classified as Deferred Charges. Additionally, in 2003, ISO New England incurred pension cost of \$510,000 above the amount included in the 2003 ISO Tariff. As a result, these costs were deferred and will be collected in future ISO Tariff filings.

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, and is exempt under Section 501(a) of the Internal Revenue Code, and has no unrelated business tax.

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. The cash collateral deposits at December 31, 2003 and 2002 were approximately \$137,482,000 and \$143,631,000, 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

In 2002, the ISO, NEPOOL, and a certain Participant entered into a Weekly Billing Agreement, which has continued into 2003. The Weekly Billing Agreement requires the ISO to issue an invoice weekly to the affected Participant, who is required to pay the invoice on a weekly basis, which represents the amount of estimated charges they have incurred for the week. The amounts collected in advance are then trued-up at the end of each month through the normal settlement billing process.

Revenue Recognition

The Company recovers its operating and debt service costs pursuant to the ISO Tariff which provides for recovery of expenses through three schedules. Scheduling, System Control and Dispatch Service (Schedule 1) and Energy Administration Service (Schedule 2) recover related costs through a pre-approved rate applied to each month's activity. Reliability Administration Service (Schedule 3) recovered actual costs through June 30, 2001 through an allocation to Participants. Beginning July 1, 2001 and continuing into 2003, 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. Schedule 2 of the 2004 ISO Tariff has been redesigned to include an additional basis for recovery. The basis for this recovery will be a per transaction charge for increment offers and decrement bids submitted into the Day Ahead Market.

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 2003. The pre-funded fixed asset deferred income is being amortized to income over the life of the assets at the rate depreciation is recognized. In addition, the over/under collection amount of the ISO Tariff will be returned to the Participants through the mechanism provided for within the ISO Tariff.

Postretirement Benefit Plan

The Company recognizes that the Financial Accounting Standards Board ("FASB") issued FASB Staff Position 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP106-1"), and has elected to defer accounting for the effect of this Act as allowed for by the FASB.

In accordance with FSP 106-1, none of the measures of the accumulated postretirement benefit obligation and the net periodic postretirement benefit cost in the financial statements and the accompanying notes reflect the effects of FSP106-1 on the Company's plan. Additionally, specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require the Company to change previously reported information.

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.

Reclassification

Certain amounts on the financial statements of the prior year have been reclassified to conform with the current year's basis of presentation.

2. Commitments and Contingencies

Funding Arrangements

The Company has incurred major expenses on behalf of NEPOOL relating to the development of NEPOOL's interim wholesale electric market that was placed in service May 1, 1999 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, which includes members that originally funded the expenses if they are still active Participants, 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 May 1, 1999. 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, 2003 and 2002, the amount of these costs to be repaid by the current NEPOOL membership to the members that originally funded the expenses was approximately \$4,482,000 and \$15,240,000, respectively.

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 and 2003, to increase the ISO's limit on borrowing for capital needs to total \$127.5 million.

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 not held in escrow until the dispute is resolved. The billing disputes total approximately \$4,950,000 and \$1,540,000 at December 31, 2003 and 2002, respectively. Settlement of disputes that are deemed valid are paid by the Participants.

3. Property and Equipment

Property and equipment at December 31 consists of the following:

	2003	2002
Computer hardware, software and accessories	\$ 89,509,000	\$ 18,254,000
Software development costs	20,195,000	3,409,000
Furniture and fixtures	839,000	803,000
Leasehold improvements	3,537,000	3,127,000
Capitalized interest and fees	3,843,000	-
Vehicles	<u>75,000</u>	<u>75,000</u>
	117,998,000	25,668,000
Work in process	4,839,000	77,838,000
Less: accumulated depreciation and amortization	<u>(39,373,000)</u>	<u>(11,234,000)</u>
	<u>\$ 83,464,000</u>	<u>\$ 92,272,000</u>

On March 1, 2003 the Standard Market Design software system (“SMD”), which represents a new method for buying and selling wholesale power in the region, was implemented. The assets related to this project were categorized as work in process in 2002, including capitalized interest and fees of \$3,340,000, and are now reflected as depreciable assets in 2003.

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, 2003 and 2002 were \$0 and \$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, 2003 and 2002 was 2.37% and 2.84%, respectively.

The Company is currently in negotiation with various banking institutions to secure a new \$15 million revolving credit arrangement to replace the arrangement expiring in 2004.

Term Loan

The Company entered into a \$43.0 million term loan in 2001, a \$40.0 million term loan in 2002, and a \$24.5 million term loan in 2003. In addition, the Company entered into a \$20.0 million term loan in 2003. The total outstanding debt at December 31, 2003 and 2002 was \$101.9 million and \$91.0 million, respectively. Proceeds from the term loans were used to pay back NEPOOL participants for capital expenditures advanced to the Company and to fund capital

expenditures. Principal is payable monthly with the final repayments due between June 2006 – June 2007. Interest accrues on the \$20.0 million term loan at LIBOR of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a 1.375% spread.

The Company has entered into interest rate exchange agreements to mitigate the interest rate risks associated with its floating-rate term loans. On March 17, 2003, the Company entered into 3 interest rate exchange agreements whereby the Company pays at a fixed interest rate for predetermined notional amounts as scheduled at the time of execution of the agreements. The first interest rate exchange agreement for \$43.0 million is effective March 17, 2003 to June 1, 2006. The notional amount of this agreement at December 31, 2003 is \$35.8 million with a fixed rate of 3.375%. The second interest rate exchange agreement for \$40.0 million is effective March 17, 2003 to January 1, 2007. The notional amount of this agreement at December 31, 2003 is \$34.4 million with a fixed rate of 3.555%. The third interest rate exchange agreement for \$24.5 million is effective March 17, 2003 to June 30, 2006. The notional amount of this agreement at December 31, 2003 is \$21.1 million with a fixed rate of 3.455%. For the years ended December 31, 2003 and 2002, the weighted average floating interest rate is approximately 3.31% and 3.37%, respectively.

The fair market value of the out-of-market interest rate swaps as of December 31, 2003 is \$234,000, which is derived from proprietary models based upon well recognized financial principles provided to the Company from the Banking Institution at which the interest rate swaps are held. The offset is recorded as a liability on the Statement of Financial Position.

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

2004.....	\$	35,421,000
2005.....		37,179,000
2006.....		26,610,000
2007.....		2,689,000
		<hr/>
	\$	101,899,000

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, 2003 and 2002.

Interest incurred on the revolving credit and the term loans for the years ended December 31, 2003 and 2002 was approximately \$3,421,000 and \$2,642,000, respectively. Interest capitalized from the term loans for the years ended December 31, 2003 and 2002 was approximately \$355,000 and \$1,856,000, respectively.

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		Other Postretirement Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2003	2002	2003	2002
Change in benefit obligation:				
Benefit obligation at beginning of year	\$27,390,000	\$23,676,000	\$2,461,000	\$1,831,000
Service cost	2,102,000	1,717,000	380,000	326,000
Interest cost	1,851,000	1,614,000	153,000	131,000
Plan amendments	-	-	-	336,000
Benefits paid	(329,000)	(298,000)	(33,000)	(23,000)
Plan participants' contributions	-	-	5,000	-
Actuarial (gain) loss	<u>3,479,000</u>	<u>681,000</u>	<u>(180,000)</u>	<u>(140,000)</u>
Benefit obligation at end of year	<u>34,493,000</u>	<u>27,390,000</u>	<u>2,786,000</u>	<u>2,461,000</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	17,078,000	17,423,000	-	-
Actual return on plan assets	4,535,000	(2,128,000)	227,000	-
Employer contributions*	3,076,000	2,081,000	2,475,000	23,000
Plan participants' contributions	-	-	5,000	-
Benefits paid	<u>(329,000)</u>	<u>(298,000)</u>	<u>(33,000)</u>	<u>(23,000)</u>
Fair value of plan assets at end of year	<u>24,360,000</u>	<u>17,078,000</u>	<u>2,674,000</u>	<u>-</u>
Funded status	(10,133,000)	(10,313,000)	(112,000)	(2,461,000)
Unrecognized transition obligation	1,312,000	1,437,000	753,000	809,000
Unrecognized net actuarial (gain) loss	8,785,000	8,837,000	(876,000)	(500,000)
Unrecognized prior service cost	<u>36,000</u>	<u>39,000</u>	<u>235,000</u>	<u>286,000</u>
Prepaid (accrued) benefit cost	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(\$1,866,000)</u>

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

Amounts recognized in the statement of financial position consist of:

	Pension Benefits		Other Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2003	2002	2003	2002
(Accrued) benefit cost	(\$1,988,000)	(\$2,518,000)	\$ -	(\$1,866,000)
Regulatory assets	<u>1,988,000</u>	<u>2,518,000</u>	<u>-</u>	<u>-</u>
Net amount recognized	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(\$1,866,000)</u>

The accumulated benefit obligation for all defined benefit pension plans was \$25,906,000 and \$19,265,000 at December 31, 2003 and 2002, respectively.

	Years ended December 31,	
	2003	2002
Projected benefit obligation.....	\$34,493,000	\$27,390,000
Accumulated benefit obligation.....	25,906,000	19,265,000
Fair value of plan assets.....	24,360,000	17,078,000

The Company follows the provisions of Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions, and Financial Accounting Standards No. 132, Employers' Disclosures about Pensions and other Post Retirement Benefits, in determining the minimum liability requirements. A liability has been recorded on the Statements of Financial Position in the amount of \$1,988,000 and \$2,518,000 for the years ended December 31, 2003 and December 31, 2002, respectively, 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 assets at December 31, 2003 and December 31, 2002.

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2003	2002	2003	2002
Components of net periodic benefit cost:				
Service cost	\$ 2,102,000	\$ 1,717,000	\$ 379,000	\$ 326,000
Interest cost	1,851,000	1,614,000	153,000	131,000
Expected return on plan assets	(1,462,000)	(1,506,000)	-	-
Amortization of transition obligation	125,000	125,000	56,000	56,000
Amortization of net actuarial loss	458,000	129,000	-	-
Amortization of unrecognized Prior Service Cost	2,000	-	51,000	50,000
Amortization of unrecognized (gain)/loss	-	2,000	(30,000)	(43,000)
Net periodic benefit cost	<u>\$ 3,076,000</u>	<u>\$ 2,081,000</u>	<u>\$ 609,000</u>	<u>\$ 520,000</u>

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

Weighted-average assumptions used to determine net periodic benefit cost for the following years ended:

	Pension Benefits		Other Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2003	2002	2003	2002
Discount rate	6.50%	7.00%	6.50%	7.00%
Expected long-term rate of return on plan assets	8.00%	8.50%	N/A	N/A
Rate of compensation increase	4.00%	4.50%	4.00%	4.50%

Weighted-average assumptions used to determine benefit obligation for the following years ended:

	Pension Benefits		Other Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2003	2002	2003	2002
Discount rate	6.00%	6.50%	6.00%	6.50%
Rate of compensation increase	3.50%	4.00%	3.50%	4.00%

ISO's pension plan weighted-average asset allocations and expected returns by asset category are as follows:

Pension Plan Assets

	Target	Percentage of Plan Asset		Weighted Average
	Allocation	at December 31,		Expected Long-Term
	2004	2003	2002	Rate of Return - 2003
Equity Securities	60%	61%	68%	9.35%
Debt Securities	40%	39%	32%	4.85%
Total	100%	100%	100%	7.50%

ISO's postretirement benefit plan weighted-average asset allocations and expected returns by asset category are as follows:

Postretirement Plan Assets

	Target	Percentage of Plan Asset		Weighted Average
	Allocation	at December 31,		Expected Long-Term
	2004	2003	2002	Rate of Return - 2003
Equity Securities	60%	61%	0%	9.35%
Debt Securities	40%	39%	0%	4.85%
Total	100%	100%	100%	7.50%

The forward-looking estimates of total return are generated through combined assessment of current valuation measures, income, economic growth and inflation forecasts, and historical risk premiums. The long-term bond forecast is derived from the expected long-term return of a portfolio of corporate, government and high yield debt instruments. The equity forecasts are based on the long-term real returns of a portfolio of US large cap, US small cap, international developed markets and emerging markets equity securities.

The Plan's investment portfolio is to be invested to provide benefits for qualified employees of ISO New England. Investments are to be compatible with the liquidity requirements determined by the plan's actuary. An optimal target allocation of 60/40 between equities and fixed income investments is to be kept with an allowance of fifteen percent (15%) over/under deviation from the optimal allocation target.

The Company expects to contribute \$3,493,000 to its pension plan and \$401,000 to its postretirement benefit plan in 2004.

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 \$976,000 and \$870,000 for 2003 and 2002, respectively.

7. Leases

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

2004.....	\$ 2,192,000
2005.....	2,160,000
2006.....	2,119,000
2007.....	<u>1,125,000</u>
Total minimum lease payments	<u>\$ 7,596,000</u>

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 a separate location for a minimum annual payment. In April 2002, the Company secured additional space at the same facility.

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 2003 and 2002, actual rental payments for operating leases were \$2,191,000 and \$2,401,000, 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 \$818,000 and \$5,072,000 in assets in 2003 and 2002, respectively. The annual payments were approximately \$534,000 and \$1,080,000 for the years 2003 and 2002, 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, 2004.

New England Power System and Electricity Market Facts:

- > 6.5 million households and businesses; population 14 million
- > More than 350 generators
- > Over 8,000 miles of high voltage transmission lines
- > 12 interconnections to systems in New York and Canada
- > More than 32,000 megawatts of total supply
- > All-time peak demand of 25,348 megawatts (August 14, 2002)
- > More than 240 participants in the marketplace
- > \$7 billion total energy market value

About ISO New England

Created in 1997, ISO New England is a private, not-for-profit corporation responsible for the day-to-day reliable operation of New England's bulk power generation and transmission system; oversight and fair administration of the region's wholesale electricity markets, which first opened in 1999; and management of a comprehensive regional bulk power system planning process.

ISO New England is independent of any financial interest in the wholesale electricity marketplace. It is run by an independent board of directors comprised of energy and financial industry experts who have no ties to any company doing business in the region's power markets. ISO New England keeps the lights on from Eastport, Maine to Westport, Connecticut. Its 350 employees are "The People Behind New England's Power."



ISO New England Inc.
Holyoke, Massachusetts
413-535-4000
www.iso-ne.com