

# **ISO New England Inc.**

**Financial Statements**

**For the Years Ended December 31, 2003 and 2002**

**ISO New England Inc.**  
**Financial Statements**  
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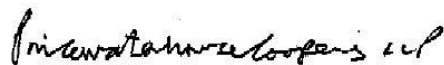
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**Report of Independent Auditors**

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.



March 3, 2004

**ISO New England Inc.**  
**Statements of Financial Position**  
**As of December 31, 2003 and 2002**

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

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

**ISO New England Inc.**  
**Statements of Activities**  
**For Years Ended December 31, 2003 and 2002**

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	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>	
Changes in unrestricted net assets:		
Revenues (Note 1):		
ISO tariff revenues	\$ 100,942	\$ 62,568
Interest income	504	454
Fees and services	1,397	848
Other	81	-
	<u>102,924</u>	<u>63,870</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	5,404	4,801
	<u>102,924</u>	<u>63,870</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>

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

**ISO New England Inc.**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2003 and 2002**

	2003	2002
	(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	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	9,338	(2,063)
	<u>(3,044)</u>	<u>41,642</u>
Net cash provided/(used) by operating activities		
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>

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

# ISO New England Inc.

## Notes to Financial Statements

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### 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 market place opened in the ISO 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, continue 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.

## **ISO New England Inc.**

### **Notes to Financial Statements**

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#### **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

## **ISO New England Inc.**

### **Notes to Financial Statements**

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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.

# ISO New England Inc.

## Notes to Financial Statements

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### **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.

**ISO New England Inc.**  
**Notes to Financial Statements**

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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:

	<b>2003</b>	<b>2002</b>
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	75,000	75,000
	<u>117,998,000</u>	<u>25,668,000</u>
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.

# ISO New England Inc.

## Notes to Financial Statements

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### 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
	<u>\$ 101,899,000</u>

## **ISO New England Inc.**

### **Notes to Financial Statements**

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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.

**ISO New England Inc.**  
**Notes to Financial Statements**

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.

	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>Years Ended December 31, 2003</b>	<b>2002</b>	<b>Years Ended December 31, 2003</b>	<b>2002</b>
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:

	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>12/31/2003</b>	<b>12/31/2002</b>	<b>12/31/2003</b>	<b>12/31/2002</b>
(Accrued) benefit cost	\$ (1,988,000)	\$(2,518,000)	\$ 0	\$ (1,866,000)
Regulatory Assets	<u>1,988,000</u>	<u>2,518,000</u>	<u>0</u>	<u>0</u>
Net amount recognized	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>(\$1,866,000)</u>

## ISO New England Inc.

### Notes to Financial Statements

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.

	December 31,	
	<u>2003</u>	<u>2002</u>
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, <u>2003</u>	Years ended December 31, <u>2002</u>	Years ended December 31, <u>2003</u>	Years ended December 31, <u>2002</u>
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	
	<u>12/31/2003</u>	<u>12/31/2002</u>	<u>12/31/2003</u>	<u>12/31/2002</u>
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	
	<u>12/31/2003</u>	<u>12/31/2002</u>	<u>12/31/2003</u>	<u>12/31/2002</u>
Discount Rate	6.00%	6.50%	6.00%	6.50%
Rate of compensation increase	3.50%	4.00%	3.50%	4.00%

## ISO New England Inc. Notes to Financial Statements

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

Pension Plan Assets	Target Allocation	Percentage of Plan Assets at December 31		Weighted Average Expected Long-Term Rate of Return - 2003
	2004	2003	2002	
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 Allocation	Percentage of Plan Assets at December 31		Weighted Average Expected Long-Term Rate of Return - 2003
	2004	2003	2002	
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.

## ISO New England Inc.

### Notes to Financial Statements

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#### 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.