

ISO New England Inc.

Financial Statements

For the Years Ended December 31, 2004 and 2003

ISO New England Inc.
Financial Statements
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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, 2004 and 2003, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 22, 2005

ISO New England Inc.
Statements of Financial Position
For Years Ended December 31, 2004 and 2003

	2004	2003
	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 40,562	\$ 45,329
Security deposits	67,643	137,482
Unbilled receivable, net	21,147	19,350
Prepaid expenses	606	142
Restricted cash on deposit	17,774	42,128
Noncurrent assets:		
Property and equipment in-service, net (Note 3)	52,667	78,625
Work in process (Note 3)	22,164	4,839
Deferred charges	364	834
Swap asset (Note 4)	156	-
Regulatory asset	1,504	2,222
	<u>224,587</u>	<u>330,951</u>
Total assets	<u>\$ 224,587</u>	<u>\$ 330,951</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable:		
Settlement, net	\$ 26,151	\$ 493
Administration	7,878	8,405
Deposits payable	68,249	138,302
Interest payable	887	292
Billing advance collections	-	20,643
Accrued expenses	7,782	6,713
Minimum pension liability (Note 5)	1,504	1,988
Swap liability (Note 4)	-	234
Regulatory liability	156	-
Deferred income - current	13,995	71
Restricted cash on deposit payable	17,774	42,128
Term loan payable-current (Note 4)	21,687	35,421
Long-term liabilities:		
Deferred income, net of current portion	2,357	9,783
Term loan, net of current portion (Note 4)	56,167	66,478
	<u>224,587</u>	<u>330,951</u>
Total liabilities	<u>224,587</u>	<u>330,951</u>
Unrestricted net assets	<u>-</u>	<u>-</u>
Total liabilities and net assets	<u>\$ 224,587</u>	<u>\$ 330,951</u>

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

ISO New England Inc.
Statements of Activities
For Years Ended December 31, 2004 and 2003

	2004	2003
	(In thousands)	
Changes in unrestricted net assets:		
Revenues (Note 1):		
ISO tariff revenues	\$ 115,262	\$ 100,942
Interest income	462	504
Fees and services	1,117	1,478
	<u>116,841</u>	<u>102,924</u>
Total unrestricted revenues	<u>116,841</u>	<u>102,924</u>
Expenses:		
General and administrative:		
Salaries and benefits	46,310	41,417
Professional and consultants	16,783	12,441
Rents and leases	2,509	2,850
Computer services	3,684	3,831
Depreciation and amortization expense	35,227	31,908
Communication expense	1,586	2,007
Interest expense	2,561	3,066
Other	8,181	5,404
	<u>116,841</u>	<u>102,924</u>
Total expenses	<u>116,841</u>	<u>102,924</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, 2004 and 2003

	2004	2003
	(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 expense	34,481	28,802
Loss on disposal of asset	1,024	51
(Increase) in accounts receivable	(1,797)	(8,557)
Decrease in deferred charges	470	2,767
(Increase) in prepaid expense	(464)	(70)
Decrease in regulatory asset	718	296
(Increase) swap asset	(156)	-
Increase/(decrease) in accounts payable:		
Settlement	25,658	(118)
Administration	(4,132)	(4,748)
(Decrease) in daily billing advance collections	(20,643)	(32,533)
(Decrease) in accrued pension and postretirement benefits	-	(1,866)
(Decrease) in minimum pension liability	(484)	(530)
Increase/(decrease) in swap liability	(234)	234
Increase regulatory liability	156	-
Increase in accrued expenses	1,069	1,002
Increase in interest payable	595	163
Increase in deferred income	6,498	9,338
Net cash provided/(used) by operating activities	<u>42,759</u>	<u>(5,769)</u>
Cash flows from investing activities:		
Capital expenditures	<u>(23,267)</u>	<u>(17,382)</u>
Net cash used in investing activities	<u>(23,267)</u>	<u>(17,382)</u>
Cash flows from financing activities:		
Decrease in security deposits	69,839	6,149
(Increase)/decrease in restricted cash on deposit	24,354	(40,517)
Increase/(decrease) in restricted cash on deposit payable	(24,354)	40,517
(Decrease) in deposits payable	(70,053)	(6,087)
Proceeds from term loan	9,450	27,050
Repayment on term loan	(72,495)	(16,151)
Proceeds from private placement debt	39,000	-
Repayment on revolving credit, net	-	(5,000)
Net cash provided/(used) by financing activities	<u>(24,259)</u>	<u>5,961</u>
Net decrease in cash and cash equivalents	(4,767)	(17,190)
Cash and cash equivalents, beginning of year	<u>45,329</u>	<u>62,519</u>
Cash and cash equivalents, end of year	<u>\$ 40,562</u>	<u>\$ 45,329</u>
Supplemental data:		
Amounts included in Accounts Payable and Accrued expenses related to work in process	<u>\$ 3,605</u>	<u>\$ 2,663</u>
Cash paid during the year for interest	<u>\$ 2,671</u>	<u>\$ 3,258</u>

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

ISO New England Inc.

Notes to Financial Statements

1. Summary of Significant Accounting Policies

Description of Business

ISO New England Inc. (the "Company" or "ISO") commenced operations on July 1, 1997 as the New England electric transmission independent system operator for the New England Power Pool ("NEPOOL") in compliance with the requirements of the Federal Energy Regulatory Commission ("FERC"). On May 1, 1999, the competitive 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.

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, 2004 and 2003 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 week 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 week include those amounts that will be billed and included in the invoice or remittance advice to Participants in the subsequent week. The net payables and receivables for energy transactions are settled with the Participants in the subsequent week.

Restricted Cash on Deposit

The balance of \$17.8 million and \$42.1 million in 2004 and 2003, respectively, recorded as Restricted Cash on Deposit represents the Congestion Revenue Fund, NRG Cost of Service Agreement 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. The restricted cash on deposit at December 31, 2004 and 2003 were held in overnight repurchase agreements and also in direct and indirect obligations of the United States.

ISO New England Inc.

Notes to Financial Statements

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. 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") and Statement of Financial Accounting Standards No. 62, "Capitalization of Interest Costs in situations involving certain tax-exempt borrowings and certain gifts and grants, an amendment of FASB Statement No. 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 twenty-five years (computer hardware, software and accessories – 3 to 5 years, software development costs – 3 to 5 years, capitalized interest and fees – 3 to 5 years, furniture and fixtures – 7 years, leasehold improvements – 10 years or remaining useful life whichever is shorter, vehicles – 3 years, building – 25 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"), as amended by FAS 138, 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/Liabilities

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 it is probable to be collected or refunded through future customer billings. During 2002, in response to a FERC Ruling, all post September 11, 2001 security enhancement costs incurred above and beyond the amount filed in the ISO Tariff for 2002 were allowed to be capitalized and recovered in future ISO Tariff filings. Additionally, ISO New England incurred pension cost and the purchase of land located at Sullivan Road which were not included in the 2003 and 2004 ISO Tariff rates, respectively. These costs were deferred and will be collected in future ISO Tariff filings.

ISO New England Inc.
Notes to Financial Statements

Deferred Charges	2004	2003
Post September 11, 2001 security enhancement costs	-	324,000
Pension costs	213,000	510,000
Land located on Sullivan Road	151,000	-
	<u>\$ 364,000</u>	<u>\$ 834,000</u>
Regulatory Assets	2004	2003
Minimum pension liability	1,504,000	1,988,000
Swap liability	-	234,000
	<u>\$ 1,504,000</u>	<u>\$ 2,222,000</u>
Regulatory Liability	2004	2003
Swap asset	156,000	-
	<u>\$ 156,000</u>	<u>\$ -</u>

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)(3) effective November 10, 2004, and was previously 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. The Company 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, 2004 and 2003 were approximately \$67,643,000 and \$137,482,000, respectively.

Billing Advance Collections

In 2002, the ISO, NEPOOL, and a certain Participant entered into a Weekly Billing Agreement, which continued into 2003. The Weekly Billing Agreement required the ISO to issue an invoice weekly to the affected Participant, who was required to pay the invoice on a weekly basis, which represented the amount of estimated charges they had incurred for the week. The amounts collected in advance were then true-up at the end of each month through the normal settlement billing process. There were no such agreements in place in 2004.

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), Energy Administration Service (Schedule 2) and Reliability Administration Service (Schedule 3) recover related cost 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, and any over or under collection is recorded as deferred charges or deferred income. Schedule 2 of the 2004 ISO Tariff has been redesigned to include an additional basis for recovery. The basis for this recovery is a per transaction charge for increment offers and decrement bids submitted into the Day Ahead Market.

ISO New England Inc.

Notes to Financial Statements

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 2004. 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 Financial Accounting Standards Board (“FASB”) issued FASB Staff Position 106-2, “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003” (“FSP106-2”), which is effective December 31, 2004 for the Company.

The Company has evaluated the effects of FSP 106-2 on the accumulated postretirement benefit obligation and the net periodic postretirement benefit cost, and determined the impact of this is immaterial.

Concentrations

The Company’s top 10 participants represented approximately 55% or \$67.2 million and 56% or \$61.4 million in tariff revenues for the years ended 2004 and 2003, respectively.

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.

ISO New England Inc.

Notes to Financial Statements

2. Commitments and Contingencies

Funding Arrangements

The Company has incurred significant 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. The amount of these costs to be repaid by the current NEPOOL membership to the members that originally funded the expenses was approximately \$0 and \$4,482,000 at December 31, 2004 and 2003, respectively.

Capital Funding Tariff

The FERC accepted ISO's "capital funding tariff" ("CFT") filing for 2003 and 2004. These filings support the ISO's loan arrangements with various banks and note holders to fund the capital and working capital requirements of the Company.

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 \$7,418,000 and \$4,950,000 at December 31, 2004 and 2003, respectively. Settled disputes are paid by the Participants.

ISO New England Inc.
Notes to Financial Statements

3. Property and Equipment In-Service, net and Work in Process

	December 31,	
	2004	2003
Computer hardware, software and accessories	\$ 91,313,000	\$ 89,509,000
Software development costs	21,528,000	20,195,000
Furniture and fixtures	853,000	839,000
Building and leasehold improvements	6,163,000	3,537,000
Capitalized interest and fees	3,885,000	3,843,000
Vehicles	75,000	75,000
	<u>123,817,000</u>	<u>117,998,000</u>
Less: accumulated depreciation and amortization	<u>(71,150,000)</u>	<u>(39,373,000)</u>
Property and Equipment In-Service, net	<u>\$ 52,667,000</u>	<u>\$ 78,625,000</u>
Work in process	<u>\$ 22,164,000</u>	<u>\$ 4,839,000</u>

There were a number of new projects as of 2004 such as the ancillary service, market project web redesign and various market enhancement projects, which have not been placed in service as of December 31, 2004. Interest capitalized as work in process in 2004 and 2003 was \$508,000 and \$0, respectively.

Implementation of the Standard Market Design software system ("SMD") in 2003 necessitated the Company's disposal of assets related to the interim markets software system. This asset disposal resulted in a loss of \$1,024,000 in 2004, and is reflected in "other" on the accompanying Statements of Activities.

4. Credit Facilities

Revolving Credit Arrangement

In June 2001, the Company entered into a \$15 million revolving credit arrangement which expired in 2004. The Company entered into a new \$15 million revolving credit arrangement in June 2004. The outstanding balances at December 31, 2004 and 2003 were \$0. 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 .60% spread. Interest is paid at the earlier of the selected LIBOR term or 30 days. The arrangement expires June 1, 2009 and any outstanding balance must be paid by this date. The Company is charged an annual fee of .15% on the entire line of credit. The weighted average interest rate incurred for the years ended December 31, 2004 and 2003 was 0% and 2.37%, respectively.

In June 2004, the Company also entered into a \$4 million revolving credit arrangement, which was requested as a result of the change in the NEPOOL billing policy to go from monthly billing to weekly billing. This arrangement serves as a line of credit to cover any potential payment defaults by a Participant. 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 .60% spread. Interest is paid at the earlier of the selected LIBOR term or 30 days. The arrangement expires July 1, 2009 and any unpaid balances must be paid as of this date. The Company is charged an annual fee of .15% on the entire line of credit. The weighted average interest rate for the year ended December 31, 2004 was 0%.

ISO New England Inc.

Notes to Financial Statements

Term Loan and Private Placement Debt Arrangement

The Company entered into a \$43.0 million term loan in 2001, a \$40.0 million term loan in 2002, a \$24.5 million, and a \$20.0 million term loan in 2003. Principal is payable monthly with the final repayments due between June 2006 – June 2007. The Company also entered into a \$39.0 million private placement loan which is made up of ten 5.60% senior notes. Payment is due in full on September 2, 2014 with no mandatory prepayments. The total outstanding debt at December 31, 2004 and 2003 was \$77.9 million and \$101.9 million, respectively. Interest accrues on the \$20.0 and \$24.5 million term loans at LIBOR of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a 1.375% spread.

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, 2004 is \$21.5 million with a fixed rate of 3.375%. The second interest rate exchange agreement for \$40.0 million which was effective March 17, 2003 to January 1, 2007 with a fixed interest rate of 3.555%, was terminated in July of 2004 and resulted in a net gain of \$206,657 to the ISO, which is reflected as a reduction of interest expense, in the accompanying Statement of Activities. The third interest rate exchange agreement for \$24.5 million which was effective March 17, 2003 to June 30, 2006 with a fixed interest rate of 3.455%, was terminated in July 2004 and resulted in a net gain of \$73,998 to the ISO which is also reflected in the accompanying Statement of Activities. For the years ended December 31, 2004 and 2003, the weighted average floating interest rate is approximately 3.21% and 3.31%, respectively.

The fair market value of the out-of-market interest rate swaps as of December 31, 2004 and 2003 was \$156,000 and (\$234,000), respectively. The fair market values are derived from proprietary models. The offset is recorded as a liability on the Statement of Financial Position.

Principal payments on the term loan and private placement debt are due annually as follows:

2005	\$ 21,687,000
2006	13,833,000
2007	3,334,000
2008	-
2009	-
Thereafter	39,000,000
	<u>\$ 77,854,000</u>

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, 2004 and 2003.

Interest incurred on the revolving credit and the term loans for the years ended December 31, 2004 and 2003 was approximately \$3,259,000 and \$3,421,000, respectively. Interest capitalized from the term loans for the years ended December 31, 2004 and 2003 was approximately \$508,000 and \$355,000, respectively.

ISO New England Inc.
Notes to Financial Statements

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.

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,		Years Ended December 31,	
	2004	2003	2004	2003
Change in benefit obligation:				
Benefit obligation at beginning of year	\$34,493,000	\$27,390,000	\$2,786,000	\$2,461,000
Service cost	2,536,000	2,102,000	427,000	380,000
Interest cost	2,064,000	1,851,000	161,000	153,000
Benefits paid	(560,000)	(329,000)	(43,000)	(33,000)
Plan participants' contributions	-	-	6,000	5,000
Actuarial (gain) loss	1,803,000	3,479,000	-	(180,000)
Benefit obligation at end of year	<u>40,336,000</u>	<u>34,493,000</u>	<u>3,337,000</u>	<u>2,786,000</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	24,360,000	17,078,000	2,674,000	-
Actual return on plan assets	2,908,000	4,535,000	305,000	227,000
Employer contributions	3,139,000	3,076,000	417,000	2,475,000
Plan participants' contributions	-	-	6,000	5,000
Benefits paid	(560,000)	(329,000)	(43,000)	(33,000)
Fair value of plan assets at end of year	<u>29,847,000</u>	<u>24,360,000</u>	<u>3,359,000</u>	<u>2,674,000</u>
Funded status	(10,489,000)	(10,133,000)	22,000	(112,000)
Unrecognized transition obligation	1,187,000	1,312,000	697,000	753,000
Unrecognized net actuarial (gain) loss	9,268,000	8,785,000	(904,000)	(876,000)
Unrecognized prior service cost	34,000	36,000	185,000	235,000
Prepaid (accrued) benefit cost	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Amounts recognized in the statement of financial position consist of:

	Pension Benefits		Other Benefits	
	12/31/2004	12/31/2003	12/31/2004	12/31/2003
(Accrued) benefit cost	\$ (1,504,000)	\$(1,988,000)	-	-
Regulatory Assets	<u>1,504,000</u>	<u>1,988,000</u>	<u>-</u>	<u>-</u>
Net amount recognized	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

The accumulated benefit obligation for all defined benefit pension plans was \$30,791,000 and \$25,906,000 at December 31, 2004 and 2003, respectively.

	December 31,	
	<u>2004</u>	<u>2003</u>
Projected benefit obligation	\$40,336,000	\$34,493,000
Accumulated benefit obligation	\$30,791,000	\$25,906,000
Fair value of plan assets	\$29,847,000	\$24,360,000

ISO New England Inc.
Notes to Financial Statements

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 \$1,504,000 and \$1,988,000 for the years ended December 31, 2004 and December 31, 2003, respectively. The accumulated benefit obligation exceeded the fair value of plan assets for one defined benefit plan, which was in an under funded position, as follows:

	December 31,	
	<u>2004</u>	<u>2003</u>
Accumulated benefit obligation	\$ 29,506,000	\$ 24,621,000
Fair value of plan assets	28,433,000	22,955,000
Prepaid benefit cost	<u>431,000</u>	<u>322,000</u>
Minimum pension liability	<u>\$ 1,504,000</u>	<u>\$ 1,988,000</u>

The Company has determined that this amount is probable of recovery through the ISO Tariff and has recorded a regulatory asset at December 31, 2004 and December 31, 2003.

	Pension Benefits		Other Postretirement Benefits	
	Years ended December 31,		Years ended December 31,	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Components of net periodic benefit cost:				
Service cost	\$ 2,536,000	\$ 2,102,000	\$ 426,000	\$ 379,000
Interest cost	2,064,000	1,851,000	161,000	153,000
Expected return on plan assets	(1,947,000)	(1,462,000)	(213,000)	-
Amortization of transition obligation	125,000	125,000	56,000	56,000
Amortization of net actuarial loss	359,000	458,000	-	-
Amortization of unrecognized Prior Service	2,000	2,000	51,000	51,000
Amortization of unrecognized (gain)/loss	<u>-</u>	<u>-</u>	<u>(64,000)</u>	<u>(30,000)</u>
Net periodic benefit cost	<u>\$ 3,139,000</u>	<u>\$ 3,076,000</u>	<u>\$ 417,000</u>	<u>\$ 609,000</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>12/31/2004</u>	<u>12/31/2003</u>	<u>12/31/2004</u>	<u>12/31/2003</u>
Discount rate	6.00%	6.50%	6.00%	6.50%
Expected long-term rate of return on plan assets	7.50%	8.00%	7.50%	N/A
Rate of compensation increase	3.50%	4.00%	3.50%	4.00%
Health Care cost trend rates - initial	-	-	7.00%	9.00%
Health Care cost trend rates - ultimate	-	-	4.00%	4.00%
Ultimate year	-	-	2007	2007

ISO New England Inc. Notes to Financial Statements

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

	Pension Benefits		Other Benefits	
	12/31/2004	12/31/2003	12/31/2004	12/31/2003
Discount Rate	5.75%	6.00%	5.75%	6.00%
Rate of compensation increase	3.50%	3.50%	3.50%	3.50%

A one percentage point change in the assumed health care cost trend rates would increase the Accumulated Post Retirement Benefit (APBO) as of December 31, 2004 by approximately \$150,000 or decrease the APBO by approximately \$134,000. Additionally, a one percentage change in the assumed health care cost trend rates would increase or decrease the net post retirement cost for 2004 by approximately \$34,000 and \$31,000, respectively.

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 - 2004
	2005	2004	2003	
Equity Securities	60%	65%	61%	5.50%
Debt Securities	40%	35%	39%	2.00%
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 - 2004
	2005	2004	2003	
Equity Securities	60%	65%	61%	5.50%
Debt Securities	40%	35%	39%	2.00%
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 \$3,599,000 to its pension plan and \$484,000 to its postretirement benefit plan in 2005.

ISO New England Inc.
Notes to Financial Statements

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension Benefits	Other Benefits
2005	\$ 519,000	\$ 85,000
2006	609,000	109,000
2007	746,000	138,000
2008	933,000	165,000
2009	1,129,000	217,000
Years 2010-2014	<u>10,380,000</u>	<u>2,338,000</u>
Total	<u>\$ 14,316,000</u>	<u>\$ 3,052,000</u>

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 \$1,131,000 and \$976,000 for 2004 and 2003, respectively.

7. Leases

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

2005	\$ 906,000
2006	853,000
2007	<u>496,000</u>
Total minimum lease payments	<u>\$ 2,255,000</u>

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 2004 and 2003, actual rental payments for operating leases were \$2,277,000 and \$2,191,000, 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. The lease was terminated in 2004 and all outstanding balances were paid. The annual payments were approximately \$120,000 and \$534,000 for the years 2004 and 2003, respectively.

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8. Expiration of ISO Interim Agreement

The Company operates under an Interim ISO Agreement with NEPOOL, which was scheduled to expire on December 31, 2004. The Company and NEPOOL agreed to extend this agreement through April 1, 2005 or the effective date of operation as a Regional Transmission Organization (RTO), whatever comes earlier. Subsequently, the Company filed a Notice of Operations date with the FERC, which stated the Company would operate as a RTO effective February 1, 2005. As of February 1, 2005 the Company is operating as an RTO.

9. Subsequent Events

Regional Transmission Organization

On March 24, 2004 FERC conditionally approved the implementation of a Regional Transmission Organization ("RTO") in New England. Throughout 2004, the ISO made a number of filings with the FERC to comply with the conditions imposed by the FERC. On December 30, 2004, the ISO and the New England transmission owners filed a notice of a February 1, 2005 Operations Date for the RTO. On February 1, 2005, the ISO became the RTO for New England, with enhanced responsibilities as the transmission provider for New England and new governing documents (Transmission Operating Agreement, Participants Agreement, Market Participants Service Agreement, ISO New England Transmission, Markets and Services Tariff) in place of the existing governing documents (the Interim ISO Agreement, NEPOOL Tariff). It is anticipated that the ISO will experience an increase in legal costs as a result of taking over the responsibility of making the FERC filings. All anticipated increased costs as a result of becoming the RTO were included in the revenue requirements of the 2005 Administrative Cost of Services Tariff filing with the FERC.

Tax Exempt Financing

In February of 2005 the Company obtained tax exempt financing of \$45,500,000 in the form of Multi-Mode Variable Rate Civic Facility Revenue Bonds, which were issued by the Massachusetts Development Finance Agency. The proceeds of the Bonds were loaned to the Company, to assist in financing and refinancing a project located at the main control center. The project will entail the acquisition of a 13 acre parcel of property and attached existing 64,000 square foot facility (which acquisition took place in December 2004); the renovation, equipping and furnishing of the existing facility, including construction of a 3,200 square foot expansion, a new lobby and mechanical penthouses; construction, equipping and furnishing of a three-story, 100,000 square foot facility; and construction of site improvements, including but not limited to additional parking spaces, a retaining wall and security curtain, a pedestrian connecting bridge between the existing and new facilities and a guard house. The project is expected to take up to 18 months to complete.