

<sup>44</sup> The days of seeing the bulk electric power grid as a massive system of rigid infrastructure are coming to a close. <sup>99</sup>

REGIONAL ELECTRICITY OUTLOOK

2008 FINANCIAL REPORT

## 6.5 million

households and business; population 14 million

more than

## **300** generators

# over 8,000 miles

of high-voltage transmission lines

## **13** interconnections

to electric systems in New York and Canada

more than

### 31,000 megawatts (MW)

of total supply (plus approx. 2,000 MW of demand-response resources

all-time peak demand of

28,130 MW, set on

## August 2, 2006

more than

## **400** participants

in the marketplace

### \$12 billion

\$4 billion

in transmission investment since 2002;

another \$5 billion planned

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annual total energy market value (2008)

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## six new 345-kilovolt

transmission projects constructed

in four states

ISO New England is an independent, not-for-profit corporation responsible for providing the day-to-day reliable operation of New England's bulk power generation and transmission system, overseeing and ensuring the fair administration of the region's wholesale electricity markets, and managing comprehensive regional bulk power system planning.

Its board of directors and 450 employees have no financial interest in any company doing business in the region's wholesale electricity marketplace. ISO New England serves a six-state region that includes Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

# It's in Our Character



Vincent M. O'Reilly Chairman of the Board

he days of seeing the bulk electric power grid as a massive system of rigid infrastructure are coming to a close. We're quickly witnessing the rise of a new power grid that is steel and copper but is also wireless and green. It has thousands of disparate parts, some big and some small, some simple and some complex, and some that have yet to be invented.

How do you characterize the grid of the future? It can be defined by attributes such as reliability, efficiency, resiliency, responsiveness, quality, and involvement.

Reliability is a given—a mainstay of the grid for 40 years. But the future grid has to be cost effective, regardless of mounting material and technological costs. It must be resilient to take advantage of rapid innovation, equally responsive to the variability of new resources, and designed using ingenuity and collaboration. What's more, its interconnectivity to thousands of additional inputs will require much greater levels of involvement from the buyers and sellers of electricity than the grid of yesteryear that was run by a small number of utilities.

As the region's system operator, ISO New England possesses a similar character to that of the future grid. Of course, we strive to provide reliable, high-quality services-for the past decade we have kept the lights on and fostered increasingly competitive markets that have yielded plentiful benefits. We run our business efficiently, keeping costs in check while continuously taking on more complex responsibilities. We embody resiliency so that we may continue to ensure power system reliability and competitive markets amid an everchanging political and technological landscape. Finally, we are responsive to each diverse stakeholder and are actively involved in helping to make industry innovations and consumer aspirations become reality.

No matter how different the grid of the future looks, it still will be an interconnected network and so will the people who operate it, own its parts, set policies around it, and benefit from it. We will all play a role in defining and creating it. The board of directors and I are confident that the people of ISO New England have the character and fortitude to keep grid and market operations advancing in step with the needs and goals of our region.

Sincerely,

V M O'Reilly

# Fit to Survive

s Darwin saw it, people, processes, and systems evolve by nature. Depending on a great number of influences and forces, evolution can follow many paths. The paths naturally selected are those that best allow us to progress, compete, and thrive. To flourish in the electricity industry today, the paths we take and the choices we make must account for three core concepts: reliability, environmental benefits, and cost effectiveness.

ISO New England's *Regional Electricity Outlook and 2008 Financial Report* defines recent advancements in the industry and how they are resulting in quantum leaps in the way electricity is produced, delivered, and consumed. The report describes how the evolution of markets has yielded progress; how that progress has naturally led to a revolution in what industry and society has come to want and expect from the electricity system; and how the ISO and regional stakeholders adapt, plan for, and take action to meet these expectations.

As people, processes, and systems evolve, we tend to become more complex organisms. While the proposals and opportunities we're seeing in the marketplace are exciting, each brings increased complexity that we must solve and viewpoints that we must consider.

Fortunately, New England has ingrained stakeholder processes in place and we're maximizing these efforts to develop comprehensive, consensus-based strategies that will yield the best possible solutions for the region. Contributors include the market participants who comprise the New England Power Pool (NEPOOL); state regulators who form the New England Conference of Public Utilities Commissioners (NECPUC); the New England Governors Conference (NEGC); the New England States Committee on Electricity (NESCOE); state legislators, attorneys general, and consumer advocates; federal regulators and other public officials; end users; and environmental advocates.

It's an interesting and exciting time to be in the electricity business. The complexities and cost concerns can be daunting, but the innovation is inspiring and the level of collaboration unparalleled.

We look forward to exploring opportunities and tackling challenges to develop a grid for the region's residents and businesses that balances environmental standards and technological innovation with reliability and cost.

Sincerely,

Joanthi



**Gordon van Welie** President & CEO



# **Evolution**

### Advancements in Competition, Efficiency, and Investment

Carefully designed markets are fundamental to ensuring that New England's 14 million residents have the electricity they need as they go about their daily lives, whether at work or at home.



#### System is Continually Improving

10,000 megawatts of generation added since 1999

- Over \$10 billion in private investment
- Consumers shielded from investment risk
- Cleaner plants provide environmental benefits

Annual Additions Cumulative Additions



#### EVOLUTION



When markets are well designed, they produce transparent, accurate prices that spur competition among market participants—the entities that buy and sell wholesale electricity. Competition then compels market participants to make efficient and innovative decisions about how they consume, produce, and invest in electricity. These competitively-based decisions, combined with regional planning and state policies, guide the development of a bulk power system that is reliable, economical, and environmentally sound.

Since our inception in 1997, ISO New England has worked with the region's electricity stakeholders, including NEPOOL, state regulators who form NECPUC, and other public officials to develop successful, competitive wholesale electricity market products and services. **Today, the suite of markets is mostly complete.** 

#### SUITE COMPLETE

our years after the initial launch of wholesale electricity markets in 1999, ISO New England implemented a market makeover, called Standard Market Design (SMD). SMD added key features, including a day-ahead market, locational pricing, and risk-management tools, to improve both power system and market performance—fundamentally, to bring about more efficient and economical use of power plants and transmission lines in addition to competitive wholesale electricity prices.

Over the past few years, the ISO redesigned the markets for ancillary services to better secure electricity generation held in reserve for periods of heavy demand or system emergencies. The reserves markets encourage the development of dependable "peaking" power plants that can be called on to quickly start up and produce electricity when and where reserves are needed.

Most recently, in 2008, the ISO initiated the Forward Capacity Market (FCM), an innovative solution to ensure that the region has a continuous, adequate supply of electricity—called "capacity"—to meet reliability requirements. FCM provides efficient long-term signals that inform decisions for maintaining existing resources or investing in new generation and demand resources. FCM is the first market mechanism in the country to allow market participants on the demand side to offer a price for the capacity they do not use during peak periods—and that price competes against the price suppliers offer for the capacity they want to sell. It also enables the development of much-needed power plants that run on renewable fuels.

Future market design efforts will be aimed at completing elements of the Forward Capacity Market, such as developing the billing system, and enhancing the current suite of markets, including software upgrades, to make them more efficient where possible. The electricity system and the challenges the industry faces are complex and continuously changing. Through ongoing, transparent collaboration, all viewpoints and options are considered in creating and improving the markets.

#### FRUITFUL YIELD

ew England's suite of competitive energy, capacity, and ancillary services markets has succeeded in attracting new, more efficient, and less polluting private power plant development, critically needed transmission improvements, and a twenty-five-fold increase in the installation of demand resources. In 2008, more than 400 buyers and sellers in the marketplace completed in excess of \$12 billion of wholesale electricity transactions—that's more than double the number of participants in the inaugural marketplace of 1999.

**Transmission:** Markets, along with collaborative regional planning and consensus-driven allocation of transmission costs, have been instrumental in developing, siting, and constructing the most significant amount of needed transmission infrastructure in all New England states since the 1970s.

#### Projected Cumulative Transmission Investment



### Demand-Response Program Growth in New England



Enabling wholesale electricity to move more efficiently within and between regions provides reliability and economic benefits: it provides greater access to lower-cost power, reduces transmission congestion costs and line losses (both are components of market prices), reduces the need for costly reliability agreements, and improves our ability to import and export electricity outside the region.

**Supply:** The markets are providing accurate price signals for participants to make informed decisions regarding investment in new power plants to significantly increase supply. These plants have helped keep the system running smoothly despite record-high consumer demand. New power plants will be located where they are needed most, many of them will run on renewable fuels, and many will provide a quick source of electricity to meet peak demand. And under markets, power plants are paid only for performance and therefore operate more efficiently. The availability of plants to produce electricity when called upon has increased from 75% in 1996 to 87% in 2008.

**Demand Resources (DR):** The capability of wholesale electricity customers to temporarily reduce their electricity use contributes to system reliability, lessens the need to build expensive new infrastructure, stabilizes wholesale prices during peak periods, limits market power by wholesale electricity suppliers, and helps achieve environmental goals. ISO New England's traditional demand-response programs, which make payments to participants based on how much electricity they do not use, grew from 100 megawatts (MW) at the beginning of markets to about 2,000 MW in 2008.

Now with FCM enabling competition between demand and supply resources, New England is seeing even greater levels of energy efficiency, load management, and distributed generation, which have the potential to meet supply needs at a lower cost than traditional generating resources. Research has shown that DR between 5% and 15% of peak demand generally is sufficient to realize its full benefits in electricity markets. When the new resources that have been contracted to date through FCM go into service, demand resources will make up approximately 10% of the region's peak capacity.

**Environment:** Markets also are enabling significant growth and development of power supply resources that run on renewable and low-carbon-emitting fuels, thereby helping market participants respond to state, regional, and federal environmental goals. Because the polluting or high-carbon-emitting plants are older and gradually will become more expensive to operate, competitive markets will provide the opportunity for those plants to be upgraded or displaced by new, cleaner electricity supply resources. Wind and biomass make up a growing portion of projects proposed for development in the region.

**Technology:** As the markets spur advancement of these alternative resources, ISO New England is supporting new "smart grid" technologies to keep in step with these 21st-century developments. Technological innovations, stimulated by markets, are resulting in a more efficient, responsive, and reliable power system that can incorporate greater amounts of DR and renewable energy resources.

**Price:** The combined impact on wholesale prices of new investment and technological advancement has been positive. Factoring out the historically high prices of natural gas and oil, which fuel roughly 60% of the region's power plants, wholesale prices have remained steady in the face of rising demand and the costs of meeting environmental standards. In absolute terms, electricity prices have been volatile—a direct result of the region's reliance on natural gas and oil to produce electricity. The overreliance on these fuels and the associated price connection is perhaps the biggest strategic issue facing the region in the long run in this industry.

Cleaner, more efficient plants have decreased carbon dioxide emissions by 7.5%, nitrogen oxide emissions by 44%, and sulfur dioxide emissions by 65%—emissions that contribute to global climate change, smog, and acid rain.

Moreover, the establishment of FCM, in combination with state and federal environmental policies, has resulted in proposals for about 50 renewable projects totaling approximately 3,000 MW of capacity for the New England region, roughly 80% of which is wind power.

#### **Results of First Forward Capacity Auction** Conducted in February 2008 for delivery in 2010



**Results of Second Forward Capacity Auction** 

Conducted in December 2008 for delivery in 2011





New Supply Resources (1,157 MW)

**CT** 87%





# Revolution

### **Modern Expectations Extend Beyond Reliability**

Reliability is paramount. That mantra has guided the electricity industry for the forty-plus years since the Great Northeast Blackout of 1965.

Renewable Requirements as a % of Energy in New England (2020)
Renewable requirements projected to increase from nearly 7% of total energy in

- 2008 to 17% in 2020 adding energy efficiency increases the number to 27.8%
- 17% energy requirement in 2020 equivalent to 9,000 MW of wind capacity or 3,200 MW of biomass capacity
- Proposed renewable projects in New England as of March 2009: 3,000  ${\rm MW}$

State Requirements for Renewable Portfolio Standards New England Energy from Other Sources



#### REVOLUTION



The New England Power Pool, formed in 1971 to coordinate regional planning and grid operation, followed by ISO New England, have developed intricate systems and follow numerous, stringent regional and national requirements for keeping the lights on. The region's dedication to reliability has certainly paid off. Having been largely spared from the impact of the 2003 Northeast Blackout, the New England grid has not experienced a widespread system outage in the last four decades.

#### Peak Electricity Use Is Growing

Even with the current economic slowdown, trend is still for growth



New Englanders have come to expect that the lights will stay on, but now society is looking for something more from the grid—to push its boundaries beyond a structure that is reliable but slow to change to one that is "smarter" and more resilient amid rapid change.

Today, we're seeing a widespread understanding of the need to wring out all the possibilities the grid can offer and a changing political landscape that may produce the incentives needed to transform the aging infrastructure that residents and businesses have come to rely on. The Obama Administration and the 111th Congress are providing, through the economic stimulus package, grants, loans, and tax credits to stimulate investment in energyefficiency programs, renewable power development and research, and modernization of the grid. Down the road, national energy policy most likely will increase the call for clean energy programs, demand-side resources, and smart grid technologies. The New England states already are adopting similar, cutting-edge policies, goals, and initiatives.

Without a doubt, traditional generating resources will remain at the core of the power system for some time. However, New England with the rest of the country will move inevitably toward a future where 10, 20, or even 30% of our capacity comes from DR, wind and other renewables, new electricity storage technologies, and even plug-in hybrid electric vehicles.

The benefits of introducing new technologies and advanced operations to the grid are clear: more efficient electricity consumption, improved system reliability and efficiency, decreased carbon dioxide emissions, reduced need to build additional large-scale infrastructure, and better tools to manage electricity costs.

The grid of the future opens up exciting opportunities across the entire electricity supply chain, from production, to delivery, to use. However, with each opportunity comes complex challenges that must be surmounted to fulfill the promise technology offers. How we proceed will determine whether we reach the objectives of maintaining reliability, promoting environmental benefits, and realizing cost efficiencies.

#### CHALLENGE: DISPATCHING ELECTRICITY "OFF" THE GRID

major obstacle for New England is the imbalance between the amount of electricity used on hot summer days and the amount used on average days the rest of the year. The region's summer peak is more than 28,000 MW, while average electricity use the rest of the year is around 18,000 MW. Even with the current economic slowdown, the trend is still for growth in peak demand. That means the region will need to continue to build and maintain resources that are used only a few hot summer days a year—an expensive proposition that results in an inefficient system overall.

Demand resources, which include energy efficiency, load management, and distributed generation, are considered key to solving this challenge, essential to system reliability and market efficiency, and a critical component of the grid of the future. New England's six states are among several Northeast and Mid-Atlantic states that formed RGGI, which seeks to restrict the carbon dioxide output of power plants beginning in 2009. In addition, five of the six New England states have established RPSs, which require utilities and competitive suppliers to meet demand using a specified amount of electricity generated from renewable fuel sources.





Over the past few years, the states have passed laws to stimulate advances in energy efficiency and are adopting meaningful goals for deployment of DR. During this time, ISO programs have been successful in increasing DR capability, and FCM is stimulating even greater development and expansion of this resource, with nearly 3,000 MW expected into 2011. Moreover, the region anticipates that hybrid electric vehicles will interface with the grid in the next decade.

As New England reaches these higher levels of DR, the ISO is determining how it will operate the bulk power system with the addition of hundreds, possibly thousands, of small, dispersed resources. Integrating large amounts of DR into power system and market operations will require sophisticated communications infrastructure to send signals from the ISO to DR aggregators and on to their DR assets. For DR to work effectively as a significant part of the system, they cannot be overused, which can result in "DR fatigue." DR providers must be able to understand how often these resources may be called on so that they can ensure that they can meet these requirements. Finally, system operators and planners need to be able to understand how DR performs, study the impacts of interruptions, and dispatch DR more effectively to maintain system reliability.

#### CHALLENGE: MAKING THE MOST OF WIND

merging federal, regional, and state environmental regulations, including the Regional Greenhouse Gas Initiative (RGGI) and Renewable Portfolio Standards (RPSs), require a significant decrease in fossil fuel emissions from power plants and an increase in electricity produced from power plants that run on renewable fuels.

Currently, approximately 40% of New England's electricity is produced by plants that run on natural gas. These plants help support environmental goals since they are efficient and produce few emissions; however, they set the wholesale electricity price almost half of the time (and combined with oil units about 80% of the time), tying electricity prices closely to fossil fuel prices. Increasing the amount of this type of generation in the region would further expose us to the volatility of fossil fuel prices.

New England has significant potential to use wind to produce electricity; therefore, proposals for wind resources are expected to be a significant part of the solution to meeting the region's future electricity requirements. When 2008 began, New England had only about 20 MW of wind on the system; an additional 80 MW were developed by the end of the year. Another 200 to 300 MW of wind is expected to come online in the next year or two. In addition, more than 2,500 MW of wind have entered the interconnection queue as a result of state policies in support of clean energy and access to wholesale markets. This does not include any of the region's massive off-shore wind potential or other undeveloped wind-rich areas of the northeastern United States or eastern Canada.

The variable nature of wind makes integrating large amounts of this resource a challenge primarily because it's difficult to forecast when and how hard the wind will blow at the precise location of a wind turbine or farm. Without the ability to accurately forecast a wind farm's output on a day-ahead basis, system operators cannot determine that the commitment of generators for the next day will turn out to be secure and economic. System operators need to fully understand where megawatts will be flowing on the system at any point in real time, or in near real time, to plan and operate the system reliably.

Furthermore, to unlock the potential of renewable energy such as wind will require significant expansion of the transmission infrastructure because in New England, the places with plentiful renewable resources are in remote northern areas or offshore, far from where the electricity is actually consumed. This is paradoxical to another smart grid goal of reducing the need to build large-scale infrastructure. Therefore, an additional challenge for the region is to determine how best to evaluate, select, and finance transmission projects that would integrate renewable sources of energy.

#### CHALLENGE: KEEPING UP WITH COMPETING TECHNOLOGIES

he electricity industry has long discussed what can be accomplished with advanced grid technologies but also understands the adoption of these technologies poses many challenges. Chief among them are discrepancies over the allocation of costs for these types of investments across transmission and distribution systems and the lack of consistent standards and protocols for these technologies. Developing grid interoperability—the ability of all these smart devices to communicate with each other throughout each power system and between power systems—is key to developing the grid of the future.

#### New England Installed Generation Capacity by Primary Fuel Type (Summer 2009)



Proposed Renewable Energy Projects in New England by Type (March 2009) Total = Approx. 3,000 MW



A synergy exists between wind and DR in that DR can help compensate for the drop in power when the wind stops blowing or when wind turbines cut out during high wind events. The two resources have the potential to complement each other, while meeting reliability needs and increasing the efficiency of the system. The region also would benefit greatly from additional storage capability, ranging from conventional pumped storage to unconventional storage, such as electric flywheels and large batteries.

New England's success in developing wholesale electricity markets that are rapidly attracting renewable and demand-side resources, instituting renewable standards and greenhouse gas initiatives, and advancing needed transmission upgrades has garnered national attention and should put the six states in a favorable position to receive federal funding for progressive energy projects and to help shape national policies on these matters.



# Adaptation

### From the Grid of Today to the Grid of Tomorrow

The complexities surrounding the development of a "smart grid" are daunting, but we already are making strides toward a power system that is complete with the equipment and software that can communicate and react to what's happening on the grid anywhere, in real time.





#### ADAPTATION



ISO New England has several advanced-technology and demand-resource projects underway, while the states, utilities, and market participants are adopting policies and launching pilot projects that will move us closer to a smart grid. If New England fully realizes its vision, it will be an achievement of technology, policy, and engineering.

#### INTEGRATING DEMAND

ew England must continue to pursue and encourage ways to bring peak demand under control and use the existing system infrastructure more efficiently to delay the need to build costly new infrastructure. Therefore, integrating the growing level of demand resources into moment-to-moment bulk power system operations is a priority for ISO New England.

To help meet the challenge, we developed market rule improvements to more fully integrate higher levels of DR into operations. After an extensive stakeholder process, the proposed rules received uncontested approval by the Federal Energy Regulatory Commission (FERC) in October 2008. The revised rules establish zones that allow operators to pinpoint locations where DR can be called on when needed, rather than calling all DR across New England. This will help the ISO avoid DR fatigue and ensure that these resources are used only when, where, and in the right amount needed. We also are providing stakeholders with an analysis to estimate the number of hours a DR resource can expect to operate in future years. This allows stakeholders to determine how much DR they want to keep in the FCM auction. The ISO is developing operational practices and tools so that operators and planners can study the impacts of interruptions and then dispatch DR more effectively to maintain system reliability.

The ISO also has launched a demand-response reserves pilot to enable small resources to communicate with and be dispatched by system operators. In addition, we are working with stakeholders to replace the current DR communications infrastructure with a more secure network to effectively communicate with demand providers by June 2010. On the energy-efficiency front, we have established a working group that will compile and examine data on state energy-efficiency programs to better understand the magnitude, expected implementation, and potential impact these programs could have on the New England bulk power system, wholesale electricity markets, and grid planning. During 2009, state and utility representatives and other stakeholders will provide information on the timing, sequence, and potential energy savings of existing and future energy-efficiency programs. The complete data set will be summarized in the *2009 Regional System Plan*, published in the fall.

The ISO's demand- and price-response programs are scheduled to end on June 1, 2010, when the first delivery period for FCM begins. The ISO initiated a stakeholder process to determine the future of all price-based demand-response programs and filed a report with the FERC in 2009.

#### **ASSIMILATING WIND**

n 2009 through 2010, ISO New England will be conducting a comprehensive study to determine the best methods of forecasting onshore and offshore wind capability and the associated output of wind resources. The study will look at several wind-development scenarios and create a comprehensive model for the New England area. This exercise will help system operators understand how to best incorporate wind resources into daily operations for electricity, reserves, or other functions.

Another important component of the study will be to review previous operational studies from around the world and research the most effective tools and processes already in place elsewhere. The study will recommend best practices for forecasting wind, technical requirements for operation and interconnection of wind, and establishing a capacity factor for wind at various locations.

#### INCORPORATING TECHNOLOGY

R egulation service is an important component of secure and reliable grid operations. At four-second intervals, the ISO directs participating generators to raise or lower their output to balance the frequency of the system. Up to now, conventional generation resources have provided regulation services. In 2008, the ISO implemented the Alternative Technologies Regulation Pilot Program to demonstrate the capabilities of clean technologies such as flywheels; batteries or other forms of energy storage; certain types of DR; renewable resources; plug-in hybrid electric vehicles; and generators using fuels other than water, coal, oil, or gas to help provide regulation. The program is limited to 13 MW, which represents about 10% of the average hourly weekday requirement for regulation, and will run until at least May 2010.

In 2009, the ISO plans to start the development of an advanced grid simulator, which will model the operational characteristics of the grid as envisioned for 2020. The tool is intended to analyze the operational impacts of various alternative resources and smart grid technologies, such as renewables, DR, energy storage devices, and plug-in hybrid electric vehicles. This will provide us with critical information on how to best integrate these intermittent resources, which are likely to make up a larger percentage of our total electricity capacity in the coming years.

#### **DEVELOPING TRANSMISSION**

he six-state transmission system has been built over several decades as a regional asset based on the benefits and efficiencies achieved by sharing in its integration and use. In this regard, it also makes sense to take a regional approach to the development of transmission lines that will connect renewable resources—often located in remote sections of the region—to the power grid. For 2009, ISO New England has made it a priority to support the states in developing solutions to evaluating, selecting, and financing these types of transmission projects.

The governors of the six New England states have asked ISO New England to help develop a long-term transmission strategy focused on the integration

ISO New England and regional stakeholders conduct continuous, comprehensive planning and analysis of the bulk power system's near-, medium-, and long-term needs and requirements. The analyses identify electricity consumption patterns and growth, the levels of supply and demand resources needed and their most suitable locations, issues related to power plant fuel supplies and fuel diversity, the need for transmission upgrades and expansion, and environmental concerns. Planning works in conjunction with the markets to provide transparency to the industry about where and what types of investment and improvement the grid needs.

of renewable and carbon-free energy resources into the power grid. This blueprint will take into account the unique economic and environmental attributes and goals of each state, address the possibility of additional renewable or carbon-free electricity imports from neighboring regions, and analyze the performance and impact of various projects on the reliability and economics of the power system.

On another front, the ISO continues to work on economic analyses associated with transmission development. Through the annual regional planning process, ISO New England conducts assessments of the regional transmission system to identify reliability-based needs. Most of the transmission projects that would need to be built specifically to bring clean electricity from remote areas to demand centers would not be considered necessary for "reliability" purposes and therefore not eligible for cost sharing. In 2007, ISO New England received authority from the FERC to conduct studies of the power system to identify transmission projects that might be built to provide economic benefits to the region. ISO New England completed its first set of economic studies in 2008.

Moreover, a number of forums and planning activities dealing with inter-regional cost allocation, wind integration, and transmission are also underway within and among the ISO, the North American Electric Reliability Corporation (NERC), Northeast Power Coordinating Council (NPCC), Joint ISO/RTO Planning Committee (JIPC), and the Department of Energy (DOE).

#### **PEOPLE, PROCESS, TECHNOLOGY**

S ituated at the intersection of government and industry, ISO New England possesses a unique perspective. Because the ISO does not own power system infrastructure and does not set policy, it offers unbiased information for both sectors to draw on when developing regional solutions.

ISO New England is committed to using our experience to facilitate collaboration among all stakeholders to bring about change and progress for the region. ISO New England will help create and participate in working groups, provide data and analyses, and address any changes in the marketplace necessary to tackle these issues.

ISO New England reflects these actions in our business planning process so that it can efficiently dedicate our resources—our highly skilled workforce and sophisticated information technology systems—to helping secure the region's electricity future.

# **Our Bottom Line**



SO New England does not have a profit margin by which we can measure our bottom line. Rather our success can be measured by our ability to provide efficient, reliable, secure, responsive, and high-quality outcomes in the services we provide.

#### **CONTROLLING COSTS**

Although the breadth of services ISO New England provides and the technological innovations we develop continue to grow each year, stringent financial management has yielded level operating and capital costs. In fact, efficiencies have enabled the organization to undertake many new services and projects without adding to the budget. The benefits and value the ISO has been delivering for the past decade costs New England consumers only about 65 cents a month.

ISO New England's budget-setting and review process is open and inclusive. It involves collaboration with stakeholders, including input from NECPUC, review and an advisory vote by NEPOOL, review and approval by our independent board of directors, and final approval by FERC. We are the only ISO in the country to make annual budget filings with FERC. Our total approved operating and capital budget for 2009 is \$123.4 million.

#### ACCOUNTABILITY AND TRANSPARENCY

ISO New England assures accountability and transparency in many ways. Stakeholders are heavily involved in our processes, including our budget and business planning processes, regional system planning process, and processes for developing market rules and other operational documents. What's more, the ISO's stakeholders have ready access to ISO New England staff and our board of directors. Stakeholders participate in the nomination of our board, our CEO and other executives regularly attend stakeholder meetings, and several times during the year, our board members meet formally with participants and state public officials.

During 2009, ISO New England established the RTO Responsiveness and Governance Working Group to consider specific requirements set by FERC in its Order 719, which focuses on the responsiveness of all ISOs and RTOs to customers and stakeholders, as well as other broad governance-related issues. The effort was led by a steering committee made up of representatives from NECPUC, state attorneys general and consumer advocates, NEPOOL, and the ISO.

#### CUSTOMER SATISFACTION

Each year, ISO New England conducts a customer satisfaction survey among market participants. Results from the 450 survey respondents are strong for 2008. Overall customer satisfaction when measured using a six-point scale indicates that 93% of customers are extremely, moderately, or marginally satisfied with the ISO's performance, as compared with 91% in 2007 and a low of 75% in 2000. The percentage of dissatisfied customers declined significantly from a high of 22% in 2000 to 3% in 2007 and 2008. On a 0-100% scale, survey respondents gave ISO a grade of 86.2%, up more than 3% since 2004.

Survey respondents also rated satisfaction with stakeholder

communications at 85.7%, up 1.5% from 2005.

#### FINANCIAL SECURITY

ISO New England and NEPOOL regularly review the ISO's Financial Assurance Policies (FAPs) to ensure that the wholesale electricity markets continue to clear in a timely manner. The two primary areas that the ISO and NEPOOL began to address in 2008 were the exposure to the use of unsecured credit to cover market participant liabilities and the method of collateralizing positions in the Financial Transmission Rights (FTR) market. Unsecured credit as a financialassurance option, whether across all markets or targeted more toward FTR participants, is a continuing concern for the ISO. In 2008, FERC approved several changes to the ISO's FAPs, and in 2009, NEPOOL and the ISO are modifying FAP rule changes focused on issues regarding the use of unsecured credit and the FTR market. The FTR market, the only true futures market among our many markets, poses greater credit risk than any other. In addition, because of its complex nature, participants are now required to complete ISOsponsored training before they can begin transacting business in the FTR market. We also are adding language to characterize FTR transactions as forward contracts or swap agreements under the U.S. Bankruptcy Code, thus providing participants and the ISO additional protection should an FTR participant file for bankruptcy.

In 2009, NEPOOL and the ISO also are addressing bill-payment default risk by shortening the settlement lag between the dispatch day and bill issuance.

#### **RELIABILITY COMPLIANCE**

ISO New England has a demonstrated history of thorough and well-documented processes for compliance with FERC, NERC, and NPCC standards for reliable operation of the bulk power system. ISO New England promotes a culture of safety and reliability that is evident in the number of effective tools and knowledgeable support personnel, the control room design, and our solid commitment to training. We have full-time resources dedicated to ensuring the company complies with existing standards and follows the development of new standards that are not only mandatory but can be enforced with civil penalties. Each year, the ISO takes on many initiatives to enhance our reliability readiness. In 2009, the ISO will be among the first in the country to be audited for compliance with Critical Infrastructure Protection standards.

Last year, ISO New England implemented a new policy to safeguard Critical Energy Infrastructure Information (CEII) in compliance with federal requirements. The policy limits access to certain documents as well as access to meetings. Individuals must submit a CEII request form and sign a nondisclosure agreement to access CEII. According to FERC, CEII is specific engineering, vulnerability, or detailed design information about proposed or existing critical infrastructure that relates details about the production, generation, transportation, transmission, or distribution of energy; provides enough detail that could be useful to a person in planning an attack on critical infrastructure; and does not simply give the general location of the critical infrastructure.

This year, the ISO begins making enhancements to our Backup Control Center to increase high-speed connectivity between the Main and Backup Control Centers, which will significantly enhance recovery times for reliability and market systems, and to improve other computer network architecture.

#### **INTERNAL CONTROLS**

In 2008, the ISO received an external auditor's SAS 70 Type 2 Audit Report with an unqualified opinion that our controls over the bid-to-bill process were suitably designed and were operating with sufficient effectiveness to achieve our control objectives, with no test exceptions. We received the highestlevel opinion for the fifth year in a row. The Sarbanes-Oxley Act requires the management of publicly owned companies to sign off on their internal controls over financial statement preparation. Since the ISO's bid-to-bill processes materially impact market participants' financial statements, they rely on the ISO New England SAS 70 Audit to give assurance that our bid-to-bill control processes are adequate.

An audit team from KPMG, our SAS 70 auditor, visited the ISO four times during the 12-month audit period; reviewed 58 control objectives; and tested 331 control activities for bidding, accounting, billing and settlement of energy, regulation, reserves, capacity, transmission, demand response, and tariff areas. Many areas of the company are involved in this comprehensive audit, including market operations, settlements, market services, information technology, and finance.





# resiliency

## responsiveness

# involvement

#### 2008 FINANCIAL REPORT

quality

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# Management's Discussion and Analysis

#### THE COMPANY

ISO New England (ISO) is a regional transmission organization (RTO), serving Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. ISO New England meets the electricity demands of the region's economy and people by fulfilling three primary responsibilities:

- Minute-to-minute reliable operation of New England's bulk electric power system, providing centrally dispatched direction for the
  generation and flow of electricity across the region's interstate high-voltage transmission lines and thereby ensuring the constant
  availability of electricity for New England's residents and businesses.
- Development, oversight and fair administration of New England's wholesale electricity marketplace, through which bulk electric
  power has been bought, sold, and traded since 1999. These competitive markets provide positive economic and environmental
  outcomes for consumers and improve the ability of the power system to meet ever-increasing demand efficiently.
- Management of comprehensive bulk electric power system and wholesale markets' planning processes that address New England's
  electricity needs well into the future.

The ISO is an entity organized as a non-stock corporation under the General Corporation Law, as amended, of the State of Delaware. In a letter dated November 10, 2004 (the Determination Letter), the Internal Revenue Service (the IRS) determined (i) that the company is generally exempt from Federal income tax under Internal Revenue Code (IRC) Section 501(c)(3), and (ii) that contributions to the company are deductible under IRC Section 170. Before November 2004, the ISO was recognized as a 501 (C) (4) organization.

The company elected to update its filing with the IRS for the change in status to secure the most cost-effective financing for its Control Center Upgrade and Campus Consolidation project completed in 2007. The change in status of the organization allowed the ISO to take advantage of financing the new building using low-cost tax-exempt debt.

The company's advance ruling period, as defined in the Determination Letter ended on December 31, 2008. On November 10, 2008, the IRS issued a letter to the ISO stating that donors can rely on the company's current advance ruling letter.

#### **ACCOUNTING POLICIES**

Effective January 1, 2008, the company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FAS 109" (FIN48). FIN 48 clarifies the accounting for uncertainty in income tax recognized in an entity's financial statements. FIN 48 requires entities to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest or penalties. The company has assessed its tax position as of December 31, 2008, and has determined that the ISO currently meets the requirements for public charity status and would remain unless the company no longer meets the public charity status or a notice of change is published by the IRS. The adoption of FIN 48 has no impact on the Statements of Financial Position and Statements of Activities.

The company has evaluated the impact of FAS 157, "Fair Value Measurements," and determined that it has no material impact on the Statements of Financial Position and Statements of Activities.

In February 2007, FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FAS 115." FAS 159 gives entities the option to measure many financial instruments and certain other items at fair value. FAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The company has not elected to adopt FAS 159.

The ISO implemented Sarbanes Oxley 302 compliance in 2003. Sarbanes Oxley 302 is a set of internal procedures designed to ensure accurate financial disclosure and that material information relating to the company is made known to the signing officers of the company. The company developed disclosure checklists, which represent the essential internal controls for maintaining financial accuracy. Department managers, senior officers, and the chief executive officer (CEO) complete these checklists quarterly. The chief financial officer (CFO) reports the results of the disclosures quarterly to the Audit & Finance Committee of the board of directors. The committee requires that the Sarbanes 302 disclosure be reviewed by them before the release of the quarterly unaudited financial statements.

#### TARIFF RECOVERY

Each year since its inception, the ISO has filed with the Federal Energy Regulatory Commission (FERC) a new tariff to recover its operating costs and capital expenditure program for the subsequent year. The ISO's Administrative Costs Services Tariff (ACT) and Capital Funding

Tariff (CFT) recovery starts with the annual budgeting process. In preparing the company's budget, which ultimately becomes the revenue requirement collected under the ACT, ISO New England goes through a rigorous process to ensure that the budget submitted to stakeholders for review and to FERC for approval is in line with the initiatives and goals the company has established for the upcoming year and is just and reasonable.

The planning and budget process occurs throughout the previous year leading up to the budget year. Senior management begins to develop the business plan at the beginning of the preceding year and reviews the plan with the ISO's board of directors as well as stakeholders before establishing the budget. The ISO typically meets with the NEPOOL participants and other interested stakeholders, including regulators, in early summer to obtain feedback from them for input into the business plan and ultimately the budget.

The budget is constructed based on the business plan initiatives for the upcoming year as well as future years. The budget includes both operating and capital costs. ISO New England department managers are responsible for submitting their budgets by a specified due date in July of each year. The budgets are reviewed by the senior managers including the CFO and CEO. Budgets are then adjusted as a result of the senior staff review. ISO New England prepares a comprehensive presentation that provides information, including the budget process, new initiatives, summarized budget data, budget details, depreciation and interest rates, the capital budget with explanations for each project, cash flow and pro forma financial projections for future years, and comparison of cost data and services provided by other Independent System Operators and Regional Transmission Organizations, for review and amendment by the ISO's Audit & Finance Committee.

Subsequent to the meeting with the Audit & Finance committee, the budget is presented in August to the NEPOOL Budget and Finance subcommittee for review, input, and recommendation to the NEPOOL Participants Committee (NPC) that reviews and votes on the budget at the October meeting. The ISO's full board of directors must then approve the budget in October of each year before it is considered complete.

The budget then provides the basis for the revenue recovery that is filed with FERC on November 1 of each year. To recover the costs of the services the ISO performs, the company files its ACT and CFT each year with the FERC. Under the ACT, the company recovers its costs via three tariff schedules for services as follows: (1) Schedule 1 is for Scheduling, System Control, and Dispatch Service; (2) Schedule 2 is for Energy Administration Service; (3) Schedule 3 is for Reliability Administration Service. Each year during the budget completion process, department managers allocate their budgeted costs by activity. Each activity has an allocation to the three ACT schedules. An activity can be attributable to one, two, or all three tariff schedules. This process allows the company to compile the applicable year budget broken down by the three tariff schedules. The costs applicable to each schedule or set of activities become the revenue requirement for that schedule. The costs are then allocated based on the billing determinants that comprise the collection of the revenue requirement for that schedule to arrive at the billable rates. The billing determinants are both volumetric and transactional-unit based, depending on the schedule.

Since actual costs will vary from the budgeted costs, as well as the projected billing determinants, the ACT contains a true-up provision. The true-up provision is a two-step process whereby an estimate of any over or under collections for the current year are included in the subsequent year's ACT filing and the final over or under collection from the previous year is also included in the annual ACT filing. The adjustments for the true-up either increase or decrease that year's cost recovery.

#### LIQUIDITY AND CAPITAL RESOURCES

As a non-stock, nonprofit organization, the ISO has no equity nor any accumulated reserves. To fund its working capital needs, the ISO has a \$15.0 million line of credit provided by a bank. In addition, the company has a \$4.0 million line of credit provided by a bank that is used to support shortfall payments under the ISO New England Billing Policy. The lines of credit are due to expire on July 1, 2009. The ISO is currently in discussions with various lenders to renew these working capital lines at the current levels. The CFT is the backstop to all of the company's borrowings in the event that any of the debt repayments are accelerated.

As discussed above, the company files an annual CFT for approval of capital spending for the upcoming year. In 2004, the ISO completed a 10-year plan of funding for future capital expenditures. The program included funding for an average of \$20.0 to \$24.0 million in capital spending for the next 10 years. ISO reviewed many financing options that were available to cost effectively meet the needs of the spending program. As a result, the ISO issued 10-year Private Placement fixed rate notes in the amount of \$39.0 million and discontinued its practice of securing new term-loan debt each year. The fixed rate for the private placement debt is 5.6%. By issuing the 10-year notes, the company saves the cost of borrowing new money each year, as well as the cost of filing with FERC, and instills budgetary discipline in the capital expenditure program. As projects are placed in service and begin to depreciate, the depreciation expense recovered under the ACT becomes available for funding future capital spending requirements.

In 2005, the ISO secured \$45.5 million of tax-exempt debt to finance its new control center and renovate its existing office facilities. The debt consists of Multi-Mode Variable Rate Civic Facility Revenue Bonds, which re-price weekly. The bonds were issued by the Massachusetts Development Finance Agency and are being repaid over 25 years. The current weekly interest rate is .65%.

#### FERC AUDIT OF FORM 1 AND 3Q

In November 2008, the FERC Division of Audits in the Office of Enforcement, through the normal course of business, commenced an audit to evaluate the company's compliance with FERC's accounting regulations contained in the Uniform System of Accounts at 18 C.F.R. Part 101 (2008), the financial reporting requirements contained in the FERC Form Nos. 1 and 3-Q, and related regulations. The audit, which is on FERC Docket number FA09-6-000, will cover January 1, 2007 to September 30, 2008, and is currently ongoing.

#### **REGULATORY UPDATE**

The United States Congress and the Obama Administration have adopted legislation providing for incentives to promote the development of transmission to interconnect large-scale renewable resources and to stimulate the development of smart grid technologies. Similarly legislative proposals are also being considered to create interconnection-wide planning requirements and "renewable transmission plans" for the entire Eastern Interconnection. ISO New England transmission planners would need to participate in this broad planning process, if formed, to input New England's existing transmission plans and ensure that transmission development in the Eastern Interconnection is consistent with operation of the New England regional system. National renewable portfolio requirements and climate change legislation is also under consideration by Congress.

#### **RESULTS OF ACTUAL OPERATIONS**

The following table summarizes the actual amounts and percentages of total expenses for the years ended December 31, 2008 and 2007:

Year Ended December 31,	2008	2008	2007	2007
		\$ in <i>N</i>	Aillions	
Salaries and benefits	\$60.2	50.0%	\$57.8	48.4%
Depreciation and amortization expense	26.5	22.0	25.6	21.5
Professional and consultants	12.9	10.7	14.5	12.2
Computer services	5.7	4.7	5.4	4.5
Interest expense	2.8	2.3	3.9	3.3
Northeast Power Coordinating Council dues	2.5	2.1	2.2	1.8
Communication expense	1.7	1.4	1.5	1.3
Insurance expense	1.7	1.4	1.7	1.4
Utilities	1.0	0.8	1.0	0.8
Board of directors	0.9	0.7	0.8	0.7
Building services	0.9	0.7	0.8	0.7
Other	3.8	3.2	4.1	3.4
Total	\$120.6	100.0%	\$119.3	100.0%

Total expenses increased by \$1.3 million or 1.1% in 2008 over 2007. Expenses net of depreciation, amortization, and interest expense increased \$1.5 million or 1.7% in 2008 over 2007. Changes resulted primarily from the following factors:

- Salaries and benefits increased \$2.4 million or 4.2% in 2008 due to merit and promotion increases and, to a smaller extent, increased headcount.
- Depreciation and amortization expense increased by \$0.9 million or 3.5% in 2008. This increase was a result of a full year of depreciation for market-enhancement projects completed in 2007, including Combined Cycle/Northeast Reliability Interconnection, Energy Management System Upgrade, LIPA 1385, Daylight Savings Time, and depreciation on the Forward Capacity Market Phase I project that went live in 2008.
- Professional and consultant expense decreased in 2008 by \$1.6 million or 11.0%. In 2007, costs were incurred for Forward Capacity Market legal expenses that dropped significantly in 2008 as the majority of the rules were in place. Additionally, discontinued or nonrecurring professional fees for work such as Scenario Analysis, reduced spending in energy-efficiency campaign, less use of consultants in the information and technology area, the addition of a full-time credit manager to replace a consultant, and other various reductions, contributed to the savings.
- Interest expense decreased by \$1.1 million as a result of lower average interest rates of 2.3% for 2008 compared with 3.7% for 2007, on the company's tax exempt debt and from reduced borrowing on the company's available line of credit.

#### RISKS

The ISO is exposed to risk in three primary areas: interest rates, legal, and regulatory. The company has historically included in its annual budget two contingency funds to address unknown costs that arise. There is a CEO emerging-work allowance of \$700.0 thousand and a board contingency of \$1.0 million. These contingencies represent a combined 1.5% of the total amount to be recovered each year under the ACT. The CEO emerging-work allowance is utilized as part of the normal course of business, and disbursements are controlled by the CFO and CEO. The board contingency has never been utilized as long as it has been in place and is subject to use only through board approval. Since the ISO does not have any capital to draw upon for unknown expenses that may arise throughout the year, these two contingencies are necessary for the ISO to operate efficiently

A changing interest rate environment can have an impact on the costs of the ISO in several ways. The ISO earns interest on the settlement float, pays a floating interest rate on its tax exempt bonds, and utilizes interest-rate assumptions in establishing costs for its pension and post-retirement benefit plans. The average float in the settlement account is consistently higher than the outstanding principal of the taxexempt debt and therefore is an effective hedge against increasing interest rates. The recent market volatility in the latter part of 2008 has negatively impacted this hedge mechanism. The interest income rates have been dramatically reduced, producing much lower earnings, and the margin between the tax-exempt rates and the taxable rates has shrunk below one percent. The company regularly analyzes the variable interest rate environments. A decrease in settlement float will have a negative impact on the hedge against increasing interest rates. Interest rates are used in the discount rate assumptions for establishing the costs associated with the pension and post-retirement plans. A decrease in rates will increase costs.

The ISO also has an exposure to costs resulting from litigation. The company does not budget for litigation costs during the normal budgeting process. Therefore, any material litigation that arises during the course of the year would pose a risk to the ISO's ability to operate within the approved budget.

The company is always subject to new regulatory orders, such as those that may be issued by FERC and the North American Electric Reliability Corporation. If the ISO is not aware of the new requirement when the budget is prepared and submitted for approval to FERC, the company could be at risk for any additional cost associated with the new requirement.

#### **BILLING AND CREDIT**

The ISO is responsible for the billing of the wholesale electricity markets for New England's bulk power generation and transmission system, as well as ensuring that proper measures are in place to mitigate participant's exposure to credit risk from transacting the ISO's administered markets. The ISO does not take an ownership stake in the transactions that it clears. Before July 2004, the ISO issued invoices on a monthly basis for all market services. This resulted in unpaid financial obligations extending to as many as 50 days. As of July 2004, energy market activity, which represents more than 80% of the dollars cleared in the ISO's markets, has been billed on a weekly basis. The change to weekly billing reduced that unpaid exposure for hourly markets by over half to approximately 18 to 21 days. This reduction in credit risk permitted the ISO to amend its financial-assurance policies resulting in a commensurate reduction in financial-assurance requirements. The reduction in requirements was estimated at approximately \$350.0 million in 2004. As of now, the reduction of a single days' worth of hourly market credit risk would permit a reduction in financial-assurance requirements of approximately \$25.0 to \$30.0 million.

The ISO believes that further opportunities exist to reduce the credit risk for market participants. The ISO is continuing to work closely with its participants to reduce the settlement cycle time by shortening the billing and payment cycle. In March 2009, NEPOOL participants recommended changes to the ISO's Billing Policy that would reduce credit exposure by up to three days. This change will also reduce the aggregate financial assurance requirements by a conservative estimate of \$75.0 million.

Looking toward the future, the ISO and the participants have recently agreed in principal to implement significant modifications to the Financial Assurance and Billing Policies that would serve to further reduce the amount of default risk to the participants. The principal elements of this initiative are further shortening the settlement cycle by moving from weekly billing of hourly charges to twice-weekly billing, eliminating the extension of unsecured credit for all participants other than qualifying municipal and regulated electric distribution utilities, and distinguishing between the ISO serving as a clearing agent for energy market activity and performing as a billing and collection agent largely for the transmission owners. The proposal segregates the functions and shifts the default risk resulting from the billing and collection function away from market participants and places it with those that are subject to those charges.

#### VARIOUS MARKET SERVICES AND PARTICIPANT DATA

The table below compares key market information for the periods of 2007 and 2008 associated with the markets that the ISO oversees.

#### Key Market Operational Data for the Years Ended:

	2	2008	2	2007
		\$ in M	illions	
Energy Markets				
Day-Ahead Energy	\$	12,457	\$	10,356
Real-Time Energy	\$	275	\$	89
Total Energy Markets	\$	12,732	\$	10,445
Real-Time Load Obligation (MWh) (1)	14	2,998,622	14	13,422,496
Net Commitment-Period Compensation (NCPC)	\$	256	\$	247
Total NCPC	\$	256	\$	247
Reserve Markets				
Forward Reserve Markets, Net	\$	171	\$	164
Real-Time Reserve Markets	\$	16	\$	7
Total Reserve Markets	\$	187	\$	170
Degulation Market	đ	<b>F1</b>	¢	4.4
	φ	51 	ф	44
	Þ		φ	44
ICAP Transition Payments	\$	1,505	\$	1,280
Total ICAP Transition Payments	\$	1,505	\$	1,280
Financial Transmission Rights—Long Term Auction	\$	75	\$	69
Financial Transmission Rights—Monthly Auction	\$	42	\$	54
Total Auction Revenue Rights	\$	117	\$	123

(1) The Real-Time Load Obligation shown in the table above reflects load at all pricing locations in New England, including exports at the external nodes.

ISO New England's customer base has grown from 383 in 2007 to 423 in 2008. The company's customers are diverse and consist of generators, suppliers, publicly owned entities, transmission, demand response, alternative resources, and end users. In addition, to our customer base growing, the cash cleared through the ISO has also increased. The cash cleared in 2007 was \$7.1 billion compared to \$9.9 billion in 2008. The chart below depicts the cash-clearing amounts since inception of the ISO.

#### ISO New England — Annual Historical Market Clearing Activity



The mix of the generators in the New England region as of December 31, 2008 and 2007, are shown below. The total generating assets have increased from 666 in 2007 to 702 at the end of 2008, while the total claimed capability of both winter and summer have increased less than 1%.

#### Generator Assets By Type in New England

Number of Assets at December 31 and Claimed Capability

		2008		2007		
-	Assets	Winter Claimed Capability (MW)	Summer Claimed Capability (MW)	Assets	Winter Claimed Capability (MW)	Summer Claimed Capability (MW)
COAL	11	2,196.957	2,157.173	11	2,239.579	2,168.367
COAL/OIL	4	590.064	587.922	4	575.448	576.701
DIESEL OIL	73	294.679	297.811	65	269.095	268.012
GAS	54	10,112.790	8,740.161	51	10,142.718	8,769.220
HYDRO: PONDAGE	4	7.354	5.597	4	7.354	6.497
HYDRO: PUMPED STORAGE	8	1,694.039	1,689.075	8	1,694.039	1,689.081
HYDRO: RESERVOIR	25	894.097	874.146	25	873.441	871.279
HYDRO: RUN OF RIVER	278	1,074.446	894.469	270	1,053.472	879.476
JET FUEL	37	828.256	651.678	35	838.244	653.507
LANDFILL GAS	17	20.193	18.112	14	14.299	12.452
METHANE/REFUSE	9	7.153	5.700	8	6.962	6.839
NUCLEAR	5	4,673.781	4,541.403	5	4,587.862	4,548.164
OIL	31	4,043.871	3,688.821	30	3,949.680	3,588.770
OIL/GAS	49	7,661.691	7,078.954	46	7,601.617	7,029.463
REFUSE	44	417.785	391.408	44	426.055	403.228
SOLAR	3	0.457	0.457	3	0.478	0.478
STEAM	2	60.300	60.300	1	60.000	60.000
STEAM/REFUSE	3	5.187	5.187	3	5.520	5.520
WIND	10	30.377	29.877	6	5.646	5.646
WOOD/REFUSE	35	585.388	575.854	33	617.024	524.948
Total	702.000	35,198.865	32,294.105	666.000	34,968.533	32,067.648

# **Independent Auditors' Report**

The Board of Directors ISO New England, Inc.:

We have audited the accompanying statements of financial position of ISO New England, Inc. as of December 31, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. 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 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ISO New England, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 5 to the financial statements, the Company implemented the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefits and Other Post Retirement Plans*, as of December 31, 2007.

KPMG LLP

March 16, 2009

## **Statements of Financial Position**

for years ended december 31, 2008 and 2007

	2008	2007
	(In t	housands)
Assets		
Current assets:		
Cash and cash equivalents	\$ 114,192	\$ 49,318
Security deposits	274,389	290,437
Unbilled receivable, net	21,285	18,671
Prepaid expenses and other assets	389	547
Regulatory assets – current (Note 1)	-	2,135
Restricted cash on deposit	18,659	8,934
Noncurrent assets:		
Property and equipment in-service, net (Note 3)	64,059	74,813
Work in process (Note 3)	18,886	13,720
Deferred charges (Note 1)	121	136
Regulatory assets, net of current portion (Note 1)	26,980	10,887
Total assets	\$ 538,960	\$ 469,598
Liabilities and Net Assets		
Current liabilities:		
Accounts payable:		
Settlement, net	\$ 105,373	\$ 40,567
Administration	6,106	7,920
Deposits payable	281,902	296,674
Interest payable	886	1,068
Revolving credit (Note 4)	-	6,500
Accrued compensation	12,428	12,558
Deferred income - current	4,953	-
Restricted cash on deposit payable	18,659	8,592
Long-term debt-current portion (Note 4)	1,820	1,820
Long-term liabilities:		
Deferred income, net of current portion	358	1.697
Pension benefit liability (Note 5)	26 980	10 887
Long-term debt (Note 4)	79 495	81 315
Total liabilities	538,960	469,598
Unrestricted net assets	<u>-</u>	
Total liabilities and net assets	\$ 538,960	\$ 469,598

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

# **Statements of Activities**

for years ended december 31, 2008 and 2007

	2008	2007
	(In th	nousands)
Changes in unrestricted net assets:		
Revenues (Note 1):		
ISO tariff revenues	\$ 118,457	\$ 115,657
Interest income	1,776	3,315
Fees and services	338	306
Total unrestricted revenues	120,571	119,278
Expenses:		
General and administrative:		
Salaries and benefits	60,155	57,761
Professional and consultants	12,882	14,539
Computer services	5,650	5,401
Depreciation and amortization expense	26,514	25,571
Communication expense	1,706	1,471
Insurance expense	1,667	1,660
Utilities	1,032	1,030
Board of directors	942	821
Building services	859	805
Northeast Power Coordinating Council dues	2,511	2,160
Interest expense	2,853	3,886
Other	3,800	4,173
Total expenses	120,571	119,278
Change in unrestricted net assets	-	-
Unrestricted net assets, beginning of year	<u>-</u>	
Unrestricted net assets, end of year	\$ -	\$ -

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

# **Statements of Cash Flows**

for years ended december 31, 2008 and 2007

	2008	2007
	(In th	ousands)
Cash flows from operating activities:	¢	đ
A divertmente te reconcile change in unrectricted net assets te	⊅ -	¢ -
net cash provided by operating activities:		
Depreciation and amortization expense	26,514	25,571
Loss on impaired asset	144	
(Increase) in unbilled receivable, net	(2,614)	(183)
Decrease in prepaid expense	158	348
Decrease/(increase) in regulatory assets	2,135	(826)
Increase/(decrease) in accounts payable:		
Settlement	64,806	37,568
Administration	(1,519)	1,010
(Decrease)/increase in accrued compensation	(130)	1,837
(Decrease) in interest payable	(182)	(75)
Increase/(decrease) in deferred income	3,614	(3,608)
Net cash provided by operating activities	92,926	61,642
Cash flows from investing activities:		
Capital expenditures	(21,350)	(23,414)
Net cash used in investing activities	(21,350)	(23,414)
Cash flows from financing activities:		
Decrease/(increase) in security deposits	16,048	(95,963)
(Increase)/decrease in restricted cash on deposit	(9,725)	17,482
Increase/(decrease) in restricted cash on deposit payable	10,067	(12,961)
(Decrease)/increase in deposits payable	(14,772)	100,497
Repayment on long-term debt	(1,820)	(3,988)
(Decrease) in net borrowings on working capital line	(6,500)	(682)
Net cash (used in)/provided by financing activities	(6,702)	4,385
Net increase in cash and cash equivalents	64,874	42,613
Cash and cash equivalents, beginning of year	49,318	6,705
Cash and cash equivalents, end of year	\$ 114,192	\$ 49,318
Supplemental data:		
Amounts included in Accounts Payable - Administration related to work in process	\$2,263	\$2,558
Cash paid during the year for interest, net of interest capitalized	\$ 3,037	\$ 3,897
Non-cash activity - Change in pension liability is net of regulatory assets	\$16,093	\$10,887

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

# **Notes to Financial Statements**

for years ended december 31, 2008 and 2007

#### 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 ISO New England Inc. control area. During the period from July 1997 through January 31, 2005, the Company was operating under the Interim ISO Agreement and administered NEPOOL's tariff.

On February 1, 2005, the ISO became the Regional Transmission Organization ("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).

#### 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, 2008 and 2007 were held in overnight repurchase agreements and also in direct and indirect obligations of the United States, with original maturities of three months or less.

#### 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 receivable from or payable to each Participant.

Accounts payable on the balance sheet are segregated between (i) the amounts owed for energy transactions and transmission, for which the ISO functions as paying agent, which are included in accounts payable as "settlement, net," and (ii) the administrative expenses incurred by the Company in the course of operations. The reference to "settlement, net" is used due to the nature of billing and payment for the amounts owed for energy transactions and transmission markets, and represents the customer's net amount due, less any amounts which may have been owed to them.

The net unbilled receivables, the majority of which have been determined as a result of the settlement process, include those amounts that will be billed and included in the invoice or remittance advice to Participants in a subsequent weekly invoice issued. The balance at the end of the year represent mainly ISO tariff revenues. The net payables and receivables for those energy transactions stated above are settled with the Participants in the subsequent week.

#### **RESTRICTED CASH ON DEPOSIT**

The balance of approximately \$18,659,000 and \$8,934,000 at December 31, 2008 and 2007, respectively, recorded as restricted cash on deposit, represents the Congestion Revenue Fund for both years and net proceeds from tax-exempt bond financing for 2007 only. The balance is offset by liabilities on the Statements of Financial Position. The restricted cash on deposit at December 31, 2008 and 2007 was held in overnight repurchase agreements and also in direct and indirect obligations of the United States, with original maturities of three months or less.

#### **PROPERTY AND EQUIPMENT IN SERVICE AND WORK IN PROCESS**

Property and equipment is stated at cost, net of accumulated depreciation.

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 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 provisions 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 (e.g., computer hardware, software and accessories — three to five years; software development costs — three to five years; vehicles — three to seven years; furniture and fixtures and machinery and equipment — seven years; building and leasehold/building improvements — one to twenty-five years or remaining life of the lease or building; building — twenty-five years). Capitalized interest and fees are amortized over the same useful life of the asset to which it pertains, principally software development costs and building. No depreciation is recorded for assets classified as work in process until the assets are placed into service (Note 3).

#### DEFERRED CHARGES AND REGULATORY ASSETS AND LIABILITIES

The Company applies the provisions of 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. The Company incurred costs with the purchase of land located at Sullivan Road. A portion of these costs, which were deferred, have been included in the current year's ISO Tariff filing and therefore amortized. The remaining cost, also deferred, will be collected in future tariff filings.

The following table is a detail of the deferred charges and regulatory assets balances as presented in the Statements of Financial Position:

Deferred charges	2008	2007
Land located on Sullivan Road	\$ 121,000	\$ 136,000
	\$ 121,000	\$ 136,000
Regulatory assets — current	2008	2007
Projected 2007 under collection true-up	\$ -	\$ 826,000
2006 under collection true-up		1,309,000
	\$ -	\$ 2,135,000
Regulatory assets, net of current portion	2008	2007
Asset related to pension benefit liability (Note 5)	\$ 26,980,000	\$ 10,887,000
	\$ 26,980,000	\$ 10,887,000

#### **INCOME TAXES**

The Company is an entity organized as a non-stock corporation under the General Corporation Law, as amended, of the State of Delaware. In a letter dated November 10, 2004 (the "Determination Letter"), the Internal Revenue Service (the "IRS") determined (i) that the Company is generally exempt from Federal income tax under Internal Revenue Code ("IRC") Section 501(c)(3), and (ii) that contributions to the Company are deductible under IRC Section 170. In the IRS Determination Letter, the IRS stated that, during the advance ruling period, the Company will be treated as a public charity, and not as a private foundation. The Company's advance ruling period ends on December 31, 2008. On November 10, 2008, the IRS issued a letter to the Company stating that donors can rely on the Company's current advance ruling letter. The Company's public charity status remains unless the IRS changes that status based on the Company no longer meeting an applicable public support test and a notice of change is published.

Effective January 1, 2008, The Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — An Interpretation of FAS 109" (FIN48). FIN 48 clarifies the accounting for uncertainty in income tax recognized in an entity's financial statements. FIN 48 requires entities to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest or penalties. A tax position is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon settlement. The adoption of FIN 48 had no impact on the Statement of Financial Position and Statement of Activities.

#### SECURITY DEPOSITS

The NEPOOL Participants are required to comply with the Financial Assurance Policy under ISO's Transmission, Markets & Services Tariff. In the case of non-investment grade rated Participants that meet certain criteria, the Company's Financial Assurance Policy requires these Participants to put in place alternate forms of financial assurance. There are several options allowed under the Company's Financial Assurance Policy for compliance, one of which is to post cash as collateral. The cash collateral deposits at December 31, 2008 and 2007 were approximately \$274,400,000 and \$290,400,000, respectively, and are recorded in deposits payable.

#### **REVENUE RECOGNITION**

The Company recovers its operating and debt service costs pursuant to the ISO's Transmission, Markets & Services 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 costs 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 and will be recovered under future Tariff filings.

#### **DEFERRED ASSET/INCOME**

Deferred asset/income represents the amount of the ISO Tariff for Schedules 1, 2, and 3 that was over/under collected from 2006 through 2008. The over/under collection amount of the ISO Tariff will be returned to the Participants through the true-up mechanism provided for within the ISO Tariff.

#### CONCENTRATIONS

The Company's top 10 participants represented approximately 47% or \$58,907,000 and 51% or \$56,402,000 in tariff revenues for the years ended 2008 and 2007, respectively. The Company's top 10 participants represented approximately 44% or \$9,459,000 and 48% or \$9,007,000 in accounts receivables as of December 31, 2008 and 2007, respectively.

#### FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the Statements of Financial Position for assets and liabilities approximate their fair values except as noted in footnote four — private placement debt arrangement.

#### **USE OF ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowance for doubtful accounts, reserve for employee benefit obligation, and other contingencies. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.

#### 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.

#### **RECENTLY ISSUED ACCOUNTING STANDARDS**

In September 2006, FASB issued FAS 157 "Fair Value Measurements." FAS 157 defines fair value, establishes guidelines for measuring fair value, and expands disclosures about fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company has evaluated the impact of FAS 157, which has no material impact on the Statements of Financial Position and Statements of Activities.

In February 2007, FASB issued FAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities — including an amendment of FAS 115." FAS 159 gives entities the option to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reporting earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is expected to expand the use of fair value measurement, which is consistent with FASB's long-term measurement objectives for accounting for financial instruments. FAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company has not elected to adopt FAS 159.

In December 2008, the FASB issued FASB Staff Position (FSP)FAS 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets." FSP FAS 132(R)-1 provides guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. FSP FAS 132(R)-1 also includes a technical amendment to FASB Statement No. 132(R), effective immediately, which requires nonpublic entities to disclose net periodic benefit cost for each annual period for which a statement of income is presented. The Company has disclosed net periodic benefit cost in Note 5. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact of the FSP on its disclosures about plan assets.

#### **REVISED CLASSIFICATION**

The classification of certain amounts on the financial statements of the prior year have been revised to conform with the current year's basis of presentation.

#### 2. Commitments and Contingencies

#### **CAPITAL FUNDING TARIFF**

The FERC accepted ISO's "capital funding tariff" ("CFT") filing for 2008 and 2007. 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 involved in various claims and legal proceedings of a nature considered normal to its business. The claims are in various stages and some may ultimately be brought to trial. While it is not feasible to predict or determine the outcome of any of these claims, it is the opinion of management that final outcome of these claims will not materially impact the Company's financial position.

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

<b>2008</b> 139,474,000	\$	2007
139,474,000	\$	
		141,445,000
36,151,000		32,982,000
2,752,000		2,695,000
70,000		64,000
44,536,000		44,431,000
6,769,000		6,292,000
55,000		35,000
229,807,000		227,944,000
(165,748,000)		(153,131,000)
64,059,000	\$	74,813,000
18,886,000	\$	13,720,000
-	36,151,000 2,752,000 70,000 44,536,000 6,769,000 229,807,000 (165,748,000) 64,059,000	139,474,000       \$         36,151,000       2,752,000         70,000       44,536,000         64,769,000       55,000         (165,748,000)       \$         18,886,000       \$

Costs represented in WIP includes Forward Capacity Market phase II and Outage Scheduler, which began in 2007 and a number of new projects which began in 2008, such as SMD Software Upgrade phase I and II, System Enhancements for 2008 including L/T & S/T Outage reports for FOSS, NERC Cyber Security, RIG Enhancements, Q2 2009 Release, and various other market enhancement projects that have not been placed in service as of December 31, 2008.

In accordance with FAS 71, the associated interest cost capitalized for the years ended

	December 31,			
		2008		2007
Interest capitalized from the term loans and private placement debt	\$	533,000	\$	627,000
Net interest income and interest expense earned or paid on the building construction		(3,000)		(68,000)
Interest cost capitalized and recorded on the Statements of Financial Position	\$	530,000	\$	559,000

The amount of the interest capitalized and recorded on the Statements of Financial Position that was included in WIP for years ended December 31, 2008 and 2007 was \$498,000 and \$445,000, respectively.

Depreciation and amortization expense was \$26,514,000 and \$25,571,000 for 2008 and 2007, respectively.

#### 4. Credit Facilities

#### **REVOLVING CREDIT ARRANGEMENT**

In June 2004, the Company entered into a \$15,000,000 revolving credit arrangement, of which the outstanding balances at December 31, 2008 and 2007 were \$0 and \$6,500,000, respectively. Interest accrues on the revolving credit at either Base Rate or 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 outstanding balance must be paid by this date. The Company is charged an annual fee of .15% on the entire line of credit. For the years ended December 31, 2008 and 2007, the weighted average interest rate is approximately 4.21% and 5.98% respectively.

The Company is currently in negotiation with various banking institutions to secure a new \$15,000,000 revolving credit arrangement to replace the arrangement expiring in 2009. The Company will be making a 204 filing with the FERC to issue this new debt.

In June 2004, the Company also entered into a \$4,000,000 revolving credit arrangement, which was requested as a result of the change in the billing policy under ISO's Transmission, Markets & Services Tariff to go from monthly billing to weekly billing. The outstanding balance at December 31, 2008 and 2007 was \$0 for both years with no borrowings made in the reported periods. This arrangement serves as a line of credit to cover any potential payment defaults by a Participant. Interest accrues on the revolving credit at either Base Rate or 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 Company is currently in negotiation with various banking institutions to secure a new \$4,000,000 revolving credit arrangement to replace the arrangement expiring in 2009. The Company will be making a 204 filing with the FERC to issue this new debt.

#### **PRIVATE PLACEMENT DEBT ARRANGEMENT**

In September 2004, the Company entered into a \$39,000,000 private placement loan, which is made up of ten year 5.60% senior notes. Payment is due in full on September 2, 2014, with no mandatory prepayments and interest accrued and paid bi-annually. This loan is included in long-term debt on the Statements of Financial Position. The fair market value of the private placement loan at December 31, 2008, was estimated at \$38,195,000.

In 2004, the Company incurred \$202,000 in debt issuance costs. These costs have been capitalized and are being amortized on a straight-line basis over the term of the loan. Total amortization expense for 2008 and 2007 was \$20,000 for each year respectively.

#### **TAX-EXEMPT BOND FINANCING**

In February of 2005, the Company entered into tax exempt financing of \$45,500,000 in the form of Multi-Mode Variable Rate Civic Facility Revenue Bonds ("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. Principal payments of \$455,000 paid quarterly, began in May 2007 with the final repayment due on February 1, 2032. The tax exempt financing is backed by a letter of credit that the Company entered into in February of 2005. The letter of credit expires in 2013. Interest accrues quarterly on the \$45,500,000 tax exempt bonds, at a weekly variable rate based upon the Bond Market Association "BMA" Swap Index plus an average spread of two basis points. For the years ended December 31, 2008 and 2007, the weighted average floating interest rate was approximately 2.33% and 3.66%, respectively.

The total long-term debt at December 31, 2008 and 2007 was \$81,315,000 and \$83,135,000, respectively. Principal payments on the private placement debt and tax-exempt bonds are due annually as follows:

2009	\$ 1,820,000
2010	1,820,000
2011	1,820,000
2012	1,820,000
2013	1,820,000
Thereafter	 72,215,000
	\$ 81,315,000

Interest incurred on the revolving credit, the term loans, private placement debt, and tax-exempt bonds for the years ended December 31, 2008 and 2007 was approximately \$3,386,000 and \$4,513,000, 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 (one for union and the other for nonunion employees), each of which is funded solely by Company contributions. Benefits are determined based on years of service and average compensation.

The Company sponsors two defined benefit postretirement plans (one for union and the other for nonunion employees), which provide medical, dental and life insurance benefits for 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 benefits are noncontributory. The measurement date used to determine pension and other postretirement benefit obligations for the pension plans and the postretirement benefit plan is December 31.

The Company has adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("FAS 158"). FAS 158 requires the booking of an asset, if the plan is over funded or a liability, if the plan is under funded, rather than disclosing the funded status in a note to the financial statements. The amount recorded is the difference between the fair value of plan assets and the benefit obligation. The Company adopted the provision for the year ended December 31, 2007.

The following table sets forth the plans' benefit obligations, fair value of the plans' assets, and the plans' funded status:

	Pension	Benefits	Other Postretirement Benefits		
	Years Ended [	December 31,	Years Ended D	ecember 31,	
	2008	2007	2008	2007	
Change in benefit obligation:					
Benefit obligation at beginning of year	\$ 57,488,000	\$ 52,003,000	\$ 6,761,000	\$ 5,097,000	
Service cost	3,654,000	3,392,000	896,000	665,000	
Interest cost	3,260,000	2,976,000	495,000	340,000	
Benefits paid	(1,289,000)	(1,194,000)	(290,000)	(212,000)	
Change in plan provisions	-	-	-	(18,000)	
Plan participants' contributions	-	-	30,000	29,000	
Actuarial (gain) loss	(3,792,000)	311,000	1,426,000	860,000	
Benefit obligation at end of year	59,321,000	57,488,000	9,318,000	6,761,000	
Change in plan assets:					
Fair value of plan assets at beginning of year	47,448,000	42,763,000	5,914,000	5,066,000	
Actual return on plan assets	(13,260,000)	2,446,000	(1,683,000)	262,000	
Employer contributions	3,645,000	3,433,000	1,144,000	769,000	
Plan participants' contributions	-	-	30,000	29,000	
Benefits paid	(1,289,000)	(1,194,000)	(290,000)	(212,000)	
Fair value of plan assets at end of year	36,544,000	47,448,000	5,115,000	5,914,000	
Funded status at end of the year	(22,777,000)	(10,040,000)	(4,203,000)	(847,000)	
Transition obligation	-	-	-	-	
Net actuarial (gain) loss	-	-	-	-	
Prior service cost					
Net amount recognized as non-current liabilities	\$ (22,777,000)	\$ (10,040,000)	\$ (4,203,000)	\$ (847,000)	

The Company has determined that the pension liability is probable of recovery through the ISO Tariff and has recorded a regulatory asset as of December 31, 2008 and 2007, in the accompanying Statements of Financial Position.

	Pension Benefits Years ended December 31,		0	Other Postretirement Benefits Years ended December 31,			
		2008	2007		2008		2007
Components of net periodic benefit cost:							
Service cost	\$	3,654,000	\$ 3,392,000	\$	896,000	\$	665,000
Interest cost		3,261,000	2,976,000		494,000		340,000
Expected return on plan assets		(3,640,000)	(3,290,000)		(460,000)		(397,000)
Amortization of transition obligation		125,000	125,000		56,000		56,000
Amortization of net actuarial loss		244,000	228,000		143,000		-
Amortization of unrecognized Prior Service Cost		2,000	 2,000		15,000		51,000
Net periodic benefit cost	\$	3,646,000	\$ 3,433,000	\$	1,144,000	\$	715,000

	Pension Benefits Years ended December 31,			<b>Other Postretirement Benefits</b>			
				Years ended December 31,			oer 31,
	2008	2(	007	2	2008		2007
Prepaid benefit cost at beginning of year	\$	- \$	-	\$	54,000	\$	-
Employer contributions	3,646,000	) 3	3,433,000		1,144,000		769,000
Net periodic benefit cost	(3,646,000)	) (3,	433,000)	(	1,144,000)		(715,000)
Prepaid benefit cost at end of year	\$	\$	-	\$	54,000	\$	54,000

The following table sets forth the amount expected to be amortized into net periodic benefit cost over the next fiscal year ending December 31, 2009:

	Pensior	Benefits	Other Benefits		
Expected amortization of transition obligation	\$	125,000	\$	56,000	
Expected amortization of net actuarial loss		1,050,000		275,000	
Expected amortization of prior service cost		2,000		-	

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 B	enefits
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Discount rate	5.75%	5.75%	5.75%	5.75%
Expected long-term rate of return on plan assets	7.50%	7.50%	7.50%	7.50%
Rate of compensation increase	3.50%	3.50%	3.50%	3.50%
Health Care cost trend rates - initial	-	-	10.00%	8.00%
Health Care cost trend rates - ultimate	-	-	5.00%	5.00%
Ultimate year	-	-	2015	2010

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

	Pension	Pension Benefits		enefits
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Discount Rate	6.13%	5.75%	6.27%	5.75%
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 either increase the Accumulated Post Retirement Benefit ("APBO") as of December 31, 2008, by approximately \$450,000 or decrease the APBO by approximately \$407,000. Additionally, a one percentage point change in the assumed health care cost trend rates would increase or decrease the net post retirement cost for 2008 by approximately \$93,000 and \$83,000, respectively.

In 2008, the methodology for selecting the discount rate for the Plan is to match the plan's expected benefit payments to that of a yield curve that provides the equivalent yield on zero-coupon corporate bonds and estimate a single interest rate that produces a present value equal to the present value produced by the full yield curve as of the annual measurement date, subject to change each year. For 2007, the discount rate for the Plan was based on the annualized Moody's Aa rate at the measurement date, rounded to the nearest 25 basis points.

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

#### Pension and Postretirement Plan Assets

	Target	Percenta	ge of Plan	Weighted Average		
	Allocation	Assets at D	December 31	Expected Long-Term		
	2009	2008	2007	Rate of Return - 2009		
Equity Securities	60%	61%	59%	5.40%		
Debt Securities	40%	39%	41%	2.10%		
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 Inc. 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 \$5,746,000 to its pension plan and \$1,381,000 to its postretirement benefit plan in 2009.

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

		ion Benefits	Other Benefits
2009	\$	1,420,000	\$ 370,000
2010		1,560,000	454,000
2011		1,685,000	549,000
2012		1,910,000	610,000
2013		2,112,000	687,000
Years 2014-2018		13,977,000	4,990,000
Total	\$	22,664,000	\$ 7,660,000

#### 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 \$1,616,000 and \$1,508,000 for 2008 and 2007, respectively.

#### 7. Leases

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

2009	\$ 46,000
2010	46,000
2011	27,000
Total minimum lease payments	\$ 119,000

The Company currently houses its back-up facilities at a separate location on a net lease basis which includes the cost of utilities with three year renewal periods through 2017. Additionally, the Company was leasing office space in one other building in 2007. The Company terminated this lease on July 1, 2007, paying an early termination payment of \$37,000, representing 50% of the last month's rent. For fiscal years 2008 and 2007, rental payments for operating leases were \$46,000 and \$511,000, respectively.

#### **BOARD MEMBERS**

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John G. Kassakian

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Richard E. Kessel

Paul F. Levy

V. Louise McCarren

\*As of January 1, 2009

#### SENIOR MANAGEMENT

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Vamsi Chadalavada, Ph.D. senior vice president, chief operating officer

Jamshid A. Afnan vice president, information services

Peter T. Brandien vice president, system operations

Janice S. Dickstein vice president, human resource

Robert Ethier, Ph.D. vice president, market development

Anne C. George vice president, external affairs and corporate communications

Raymond W. Hepper vice president and general co

Kevin A. Kirby vice president, market operation

David LaPlante vice president, market monitoring

Robert C. Ludlow vice president and chief financial offici

Stephen J. Rourke vice president, system planni

\*As of January 1, 2009



The ISO New England Regional Electricity Outlook and 2008 Financial Report is printed on Finch Fine text and cover using domestically produced vegetablebased inks. Finch Paper was the first integrated paper manufacturer in the United States to receive both the Forest Management and Chain-of-Custody certifications from the Forest Stewardship Council (FSC).

This report is printed by a wind-powered solution provider.

Design: Rob & Damia Design, Northampton, MA Printing: Meridian Printing, East Greenwich, RI

