

A stylized graphic featuring a white circle with an orange outline, representing a sun, positioned on the right side. A thin orange arc curves from the top left towards the sun, crossing the boundary between the blue and orange background sections.

ISO New England

annual report  
2005

# New England's Electric Power System at a Glance

- 6.5 million households and businesses; population of 14 million in an area of approximately 68,000 square miles
- More than 350 electric power generators
- Over 8,000 miles of high-voltage transmission lines
- 12 interconnections to electricity systems in New York and Canada
- More than 32,000 megawatts of total supply (includes more than 500 megawatts of demand-response capacity)
- All-time peak demand of 26,885 megawatts (July 27, 2005)
- More than 280 participants in the wholesale marketplace (generating, buying, selling, transporting, and using electricity)
- \$10 billion total annual energy market value (2005)

## About ISO New England

ISO New England, an independent, not-for-profit corporation, helps promote the health of New England's economy and protect the well-being of its people by ensuring the constant availability of electricity, today and for future generations. ISO New England meets this obligation in three ways: by reliably operating New England's 32,000-megawatt bulk electric power generation and transmission system, by overseeing and ensuring the fair administration of the region's \$10 billion wholesale electricity markets, and by managing comprehensive regional electric power planning.

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# Message from President & CEO Gordon van Welie



**The year 2005 will be remembered as a time of transformation and transition. In early 2005, ISO New England became a regional transmission organization (RTO), a transformation that was more than four years in the making. The RTO designation helps to ensure the independence of the region's wholesale electricity marketplace while securing strong oversight of the region's bulk power system.**

Signals were also abundant in 2005 to tell a tale of an industry in transition. Price increases resulting from rising fossil fuel costs and record-setting electricity use served as staunch reminders that the region needs to increase and diversify its power resources.

In the past few years, natural gas has become the fuel of choice to produce electricity in New England. However, as fuel supplies were stretched thin in the fall and winter due to decreased production in the Gulf of Mexico, New England's electricity prices trended upward, tracking closely to increased natural gas costs. Our susceptibility to price swings signals that fuel diversity is a must for our regional electric generation—for both cost and reliability reasons.

New England's wholesale electricity marketplace is providing clear signals that point us to less expensive, alternative energy sources, such as wind, biomass, clean coal, and even nuclear, that will help insulate New England from the effects of overreliance on fossil fuels such as oil and natural gas.

During the summer of 2005, the region broke record after record for electricity use. Although New England's power grid expanded in the first half of the decade with the development of more than 9,000 megawatts of new generation, investment is now at a virtual standstill. Forecasts made in 2005 indicated that in just a few short years, the region will need additional resources to keep up with record-breaking consumer demand.

To spur the addition of power resources at a steadier rate, ISO New England and its stakeholders worked in 2005 to create a more attractive investment climate in the region. This effort led to a new capacity-market design to value power resources through competitive forces and encourage development of needed energy resources.

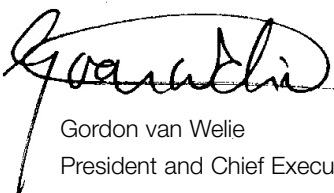
Developing new energy resources takes time—at a minimum, up to two to three years. Therefore, as a region, we must begin today to use our power system infrastructure more wisely. Energy efficiency is one means to reduce growth in electricity demand and slow the need to build costly energy infrastructure, such as new plants and transmission lines.

In 2005, ISO New England increased the participation options for large industrial customers willing to reduce their electricity use during periods of high prices or peak demand in exchange for financial incentives. Moving forward, more companies should take advantage of this program, and smaller customers—eventually residential consumers—should have similar opportunities. States should consider retail price structures that enable consumers to make informed decisions about electricity use based on the true cost of electricity at different times of the day.

ISO New England recently concluded an analysis to quantify the impact of these types of solutions to rising electricity costs. Based on 2005 prices, adding 1,000 megawatts of lower-cost power that is not fueled by natural gas or oil would result in about \$600 million in annual savings for consumers at the wholesale level. Likewise, reducing electricity use by five percent during peak hours would save consumers approximately \$580 million per year.

Going forward, New England's energy future will be defined by the choices we make today. These choices require tough decisions, since they are rooted in our past infrastructure choices and how we price electricity at the retail level. It is clear that prices will continue to rise if no action is taken and the status quo remains intact. ISO New England stands ready to inform and work with public policy makers on these choices to encourage the type of progress that will ensure a reliable power system and effective wholesale markets for the region.

Sincerely,



Gordon van Welie  
President and Chief Executive Officer



# 2005 in Review

On February 1, 2005, ISO New England began operations as a Regional Transmission Organization, ensuring the continued independent and efficient management of the region's electricity system and wholesale power markets with a steadfast focus on the needs of New England. Throughout the year, this focus was realized as ISO New England made advances on several other fronts.

ISO New England continued to develop the region's wholesale electricity markets, building on the Standard Market Design introduced in 2003. Starting in June, Demand-Response Program participants were allowed to bid into the Day-Ahead Energy Market. These scheduled demand reductions can reduce volatility in the day-ahead market, which helps keep wholesale electricity costs down for all consumers.

October saw the successful launch of the first phase of market enhancements bundled together as part of the Ancillary Services Market (ASM) project. These upgrades included the redesign of the Regulation Market, re-offer period enhancements, and the ability for external transactions to set price—all resulting in more efficient pricing and use of resources.

Progress continued on the implementation of transmission solutions, as five of six major 345-kilovolt projects were sited in four states, with progress being made in planning the sixth.

July 27 saw a new all-time record for demand in New England—26,885 megawatts. Despite record-breaking demand, power supplies were adequate, and the regional power system operated reliably—clear evidence of how the investment in generation and a commitment to demand-response programs have paid off.

The year also saw the launch of a redesigned Web site (at [www.iso-ne.com](http://www.iso-ne.com)) that is easier to use and improves access to information, thereby helping to improve communications with market participants, public officials, and other stakeholders.

## Milestones: 2005 in Review

**February 1** Began operations as an RTO

**April 1** Allowed negative bids into Financial Transmission Rights auctions, improving participants' ability to hedge price risk

**May 1** Accepted partial delisting of generating resources from the capacity market, allowing a portion of a unit's generating capacity to be sold to external control areas

**May 13** Hosted annual Demand-Response Summit, attracting more than 160 attendees

**June 1** Launched Day-Ahead Load-Response program

**June 7** Released *2004 Annual Markets Report*

**June 12** Awarded patent for business process documentation, "Methods for the Management of a Bulk Electric Power Market"

**June 27** Launched redesigned Web site

**July 27** Reached new all-time record demand for New England: 26,885 megawatts

**September 29** Released *2006 Wholesale Markets Plan*

**October 1** Implemented Phase I enhancements of the ASM project

**October 14** Adopted new Generating Availability Data System submission system

**October 17** Held Regional Energy Forum on connecting wholesale and retail markets

**October 20** Released *2005 Regional System Plan*

**November 17** Implemented Market Rule 1, Appendix H—revised rules and procedures for power system operations during cold-weather conditions

**November 29** Passed second SAS 70 Type 2 Audit

**December 1** Put Winter Action Plan into effect to mitigate impact of potential fuel shortages and ensure reliability through the cold-weather season

**December 31** During 2005, Customer Services call center fielded 7,413 inquiries; Web site received more than 640,000 visits with more than 265 million pages served

# 2005: Illuminating New England's Energy Challenges

For nearly a decade, the electric power industry in New England has been undergoing the most fundamental changes since the introduction of electric utilities in the late 19th century.

To promote competitive wholesale markets for electric power, Congress and the Federal Energy Regulatory Commission (FERC) enacted laws and regulations in the 1990s designed to ensure equal access to transmission grids. These rules also encourage states to require utilities to sell off power plants and gradually eliminated regulatory-based rates in favor of prices determined by the markets.

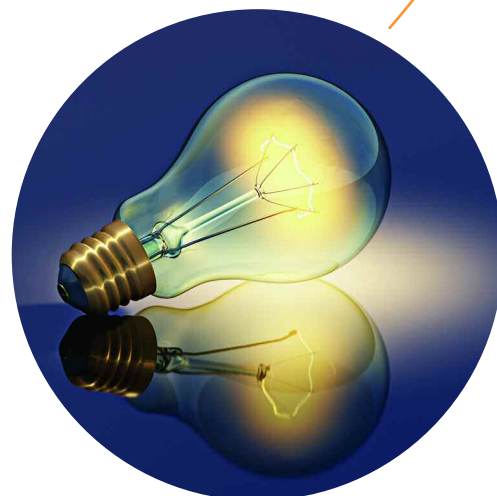
FERC also created independent system operators, or ISOs, to oversee restructuring on a regional basis. These ISOs were given responsibility for ensuring reliability and establishing and overseeing competitive wholesale electricity markets.

Created by FERC in 1997, ISO New England has helped lead the nation's most advanced effort at restructuring; to date, five of the six states in the region have required utilities to sell off their power plants, and 88 percent of the region's generation is unregulated.

Although New England has made enormous progress, the transition from highly-regulated, vertical monopolies to competitive markets with hundreds of players has not been, and will not be, an easy one. Observers who have witnessed the restructuring of other sectors, such as transportation, telecommunications, and financial services, understand that the process can be difficult.

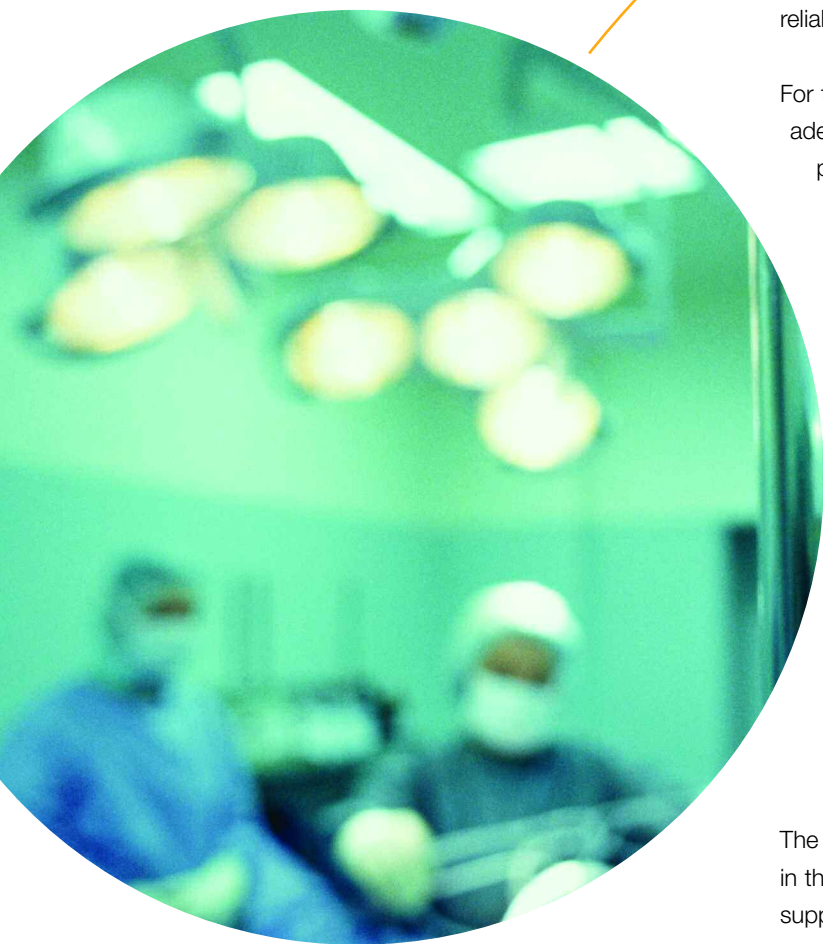
In 2005, New England faced specific challenges that will require commitment on the part of the entire industry to ensure power system reliability and efficiency through wholesale electricity markets. These challenges include:

- **Resource Adequacy**  
Producing sufficient power to meet demand
- **Fuel Diversity**  
Addressing the region's growing reliance on natural gas to fuel power plants and the need for greater fuel diversity
- **Power System Reliability**  
Moving power to where it needs to go
- **Oversight and Governance**  
Providing experienced and independent leadership



# Resource Adequacy:

## Keeping the Lights On



In 2005, growing demand and hot and humid conditions combined to produce eight of the top 10 demand days of all time—and seven of the top 10 weekend demand days as well.

The weather conditions during 2005 may not recur every year, but there is little question that New England's growing population and developing economy will require ever-increasing amounts of electricity. To meet this demand, New England must ensure the region has adequate resources to meet regional electricity use reliably and efficiently.

For the time being, the generation situation in New England is adequate due to \$6 billion of investment in new and expanded power plants. This investment increased the region's generating capacity by 30 percent, or more than 9,000 megawatts, in the five years after the opening of wholesale electric power markets in 1999. This additional capacity has helped the region keep pace with record-breaking electricity use.

However, the adequacy of New England's power resources will not last forever. Growing consumption and retirements of aging, less-efficient power plants mean that demand will begin to outstrip supply during peak periods. The region's summer-peak demand under normal weather conditions has increased by 28 percent over the past 10 years and is expected to continue to grow by 20 percent over the next decade.

The evolving situation presents three challenges.

The first challenge is to **ensure continued resource adequacy** in the future, with particular emphasis on flexible, quick-start power supply sources—known as peaking units.

A second challenge is **locating supply close to where it is needed**. The cost of building in urbanized areas and the Not-In-My-Backyard (NIMBY) syndrome conspire to discourage new construction in areas closest to demand, which increases transmission costs and strains the power grid.

A third challenge is the **need for consumers' direct participation in the markets**. If customers can begin responding to changes in wholesale prices, the existing electricity system will be used more efficiently, which will reduce price volatility, the need for additional generating resources, and overall prices in the wholesale market. ISO New England's Demand-Response Programs have successfully engaged larger users of electricity—namely commercial and industrial consumers—in interacting with wholesale market signals. But with essentially flat retail rates set by legislation or regulation for default service, residential and small business end users have no incentive to change how they use electricity, nor do they have the signals needed to respond in real time to pricing.

There are no quick solutions to these challenges. Recognizing that doing nothing is not an option and that it is essential to develop and maintain reliable sources of generation to meet demand and reserve requirements, ISO New England is working with regulators, market participants, and other stakeholders to develop solutions that will secure long-term resource adequacy for meeting the region's needs.

In 2006, ISO New England hopes to finalize the design of a new capacity market. Experience has shown that the most effective way to induce necessary investment in energy infrastructure is through market forces. By better pricing the true cost of capacity and demand-response resources, this market would promote long-term investment in generation and also promote energy efficiency and conservation where needed.

ISO New England also plans to implement the second phase of the Ancillary Services Market project in 2006. This project will lead to better valuation of operating reserves and provide both forward and real-time price signals for investment in local, quick-start plants in high-demand areas. Moreover, the second phase of the ASM project will include measures allowing demand participants to bid their services directly into the energy and reserve markets, on equal footing with generating plants. This added opportunity expands demand participation in the wholesale marketplace and will make New England's markets more competitive.

## All-time top ten demand days

### ALL DEMAND DAYS

Date	Demand (Megawatts)
July 27, 2005	26,885
July 19, 2005	26,736
August 5, 2005	25,983
July 26, 2005	25,555
August 14, 2002	25,348
August 11, 2005	25,282
June 13, 2005	25,231
July 20, 2005	24,983
August 9, 2001	24,967
July 22, 2005	24,912

### WEEKEND DEMAND DAYS

Date	Demand (Megawatts)
August 13, 2005	24,065
August 14, 2005	22,688
June 26, 2005	22,393
June 25, 2005	21,945
August 18, 2002	21,452
August 28, 2004	21,414
August 17, 2002	21,388
June 11, 2005	21,059
August 21, 2005	20,971
June 12, 2005	20,866



# Fuel Diversity:

## Powering New England's Generators



The call for fuel diversity for New England's power generators has been underscored by the region's growing reliance on natural gas. State siting councils have readily approved generation powered by natural gas because it is a relatively clean fuel and, for many years, it was economical. Since 1999, the region has added more than 9,000 megawatts of generating supply—most of which is gas-fired—making it the fuel of choice for New England in recent years.

Today, about 40 percent of the region's installed capacity uses natural gas as its primary fuel, up from 17 percent in 1999. This trend is expected to continue with the commercialization of additional gas-fired generators and the conversion of existing generators to gas. However, the increasing dependence on natural gas has implications for both reliability and cost.

Natural gas and dual-fueled generators fired by oil or natural gas set the "clearing price" in the wholesale electricity market the majority of the time in 2005. As a result, natural gas prices have had a large impact on the cost of wholesale electricity.

Although natural gas supplies in the U.S. and Canada have been tightening year-round due to declining production and increasing competition, this issue is especially acute during the winter, when gas is also in demand for home heating. Generators that hold firm gas contracts can either use the gas to generate electricity or sell it back into the natural gas market for the purpose of home heating. The January 2004 "Cold Snap," when regional electricity supplies were strained due in part to such sales, illustrated this.

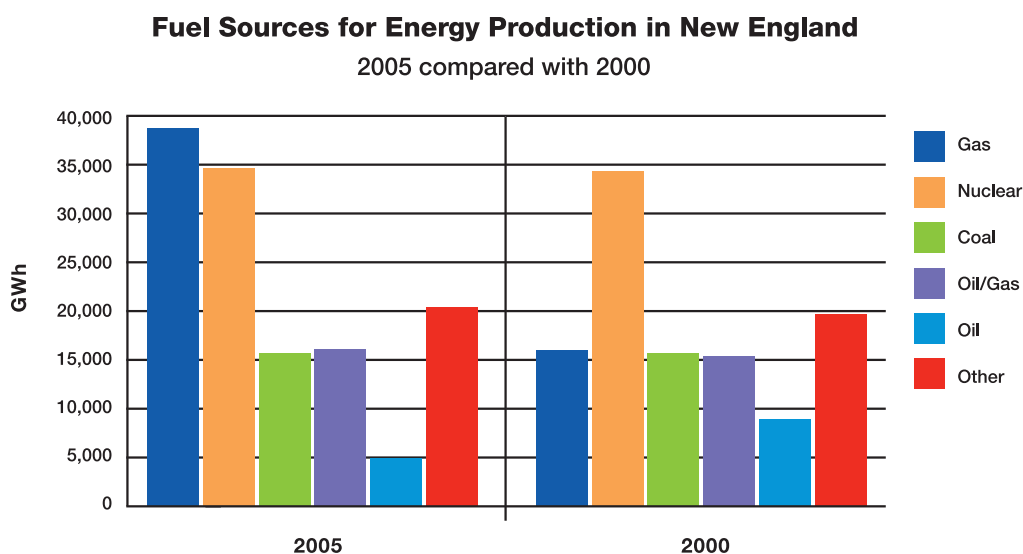
Since a quarter of New England's peak-day natural gas comes from the Gulf of Mexico, Hurricanes Katrina and Rita have also had a significant impact on natural gas prices. The wholesale energy markets have made those impacts more transparent and are guiding decisions about how to respond.

In addition to the short-term supply disruptions from 2005's hurricanes, growing demand for gas has placed upward pressure on prices across the continent. Since 2002, the commodity price of natural gas has more than doubled, while the price of oil has experienced significant increases.

The immediate concern in New England is the possibility of cold winter weather exacerbating gas supply and price issues for generators, resulting in gas-fired generation being insufficient to meet peak demand for electricity. ISO New England has taken steps to remedy this situation by promoting energy efficiency and conservation, securing additional dual-fuel capability, improving demand-response programs, and readying energy emergency procedures.

In the long term, another strategy is diversification. Dual-fuel power plants using natural gas and a secondary fuel, such as oil, are an important way to provide alternatives, especially in emergencies. But with more than 60 percent of the region's electricity supply derived from either natural gas or oil, the region must focus on developing greater fuel diversity for its electricity supply for the long term. Going forward, the region also needs to consider diversifying its fuel mix by increasing its use of alternative fuels, such as renewable energy sources.

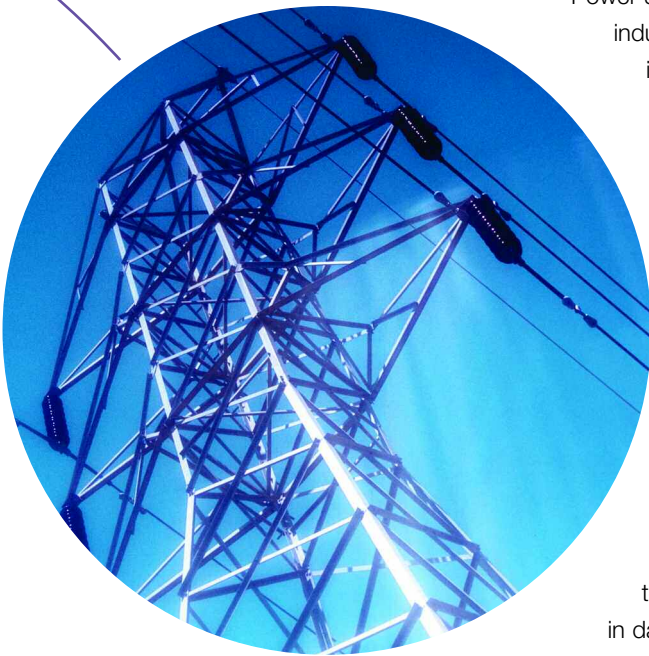
Additionally, New England needs to improve its natural gas supply and transportation infrastructure by adding new liquefied natural gas facilities and developing adequate pipeline capacity. FERC and state regulators are responsible for addressing these issues, and there is hope for progress in 2006.



"Other" includes fuels such as hydro, refuse, or coal/oil.  
Data remain subject to the resettlement process.

# Power System Reliability:

## Moving Power to Where It Is Needed



Power system reliability has been one of the greatest concerns for many industry observers since the August 2003 Blackout that originated in the Midwest and affected much of the northeastern and mid-western United States and southern Canada. The blackout and other, more localized, outages over time have raised public awareness about how fragile and interconnected the nation's electric power system actually is.

Markets, by their very nature, promote system efficiency and maximize the use of the transmission system. This necessitates the development of a transmission system capable of reliably delivering the lowest-cost electricity under a wide variety of system conditions.

ISO New England's open, stakeholder planning process recognizes the need to employ technological innovations to ensure the system runs reliably and economically, not only in day-to-day operations, but also under the most likely conditions of system stress.

From an infrastructure standpoint, ISO New England's *2005 Regional System Plan* identified 272 transmission projects, estimated to cost between \$2 and \$4 billion, required for the reliability of the New England system, including not only major 345-kilovolt projects but also other transmission projects throughout the system, especially within load pockets. By the end of 2005, five major 345-kilovolt projects, worth more than \$1.5 billion, had been sited in four states. Apart from the various reliability benefits, this transmission investment also results in substantial economic benefits to the region due to more efficient dispatch of the bulk power system.

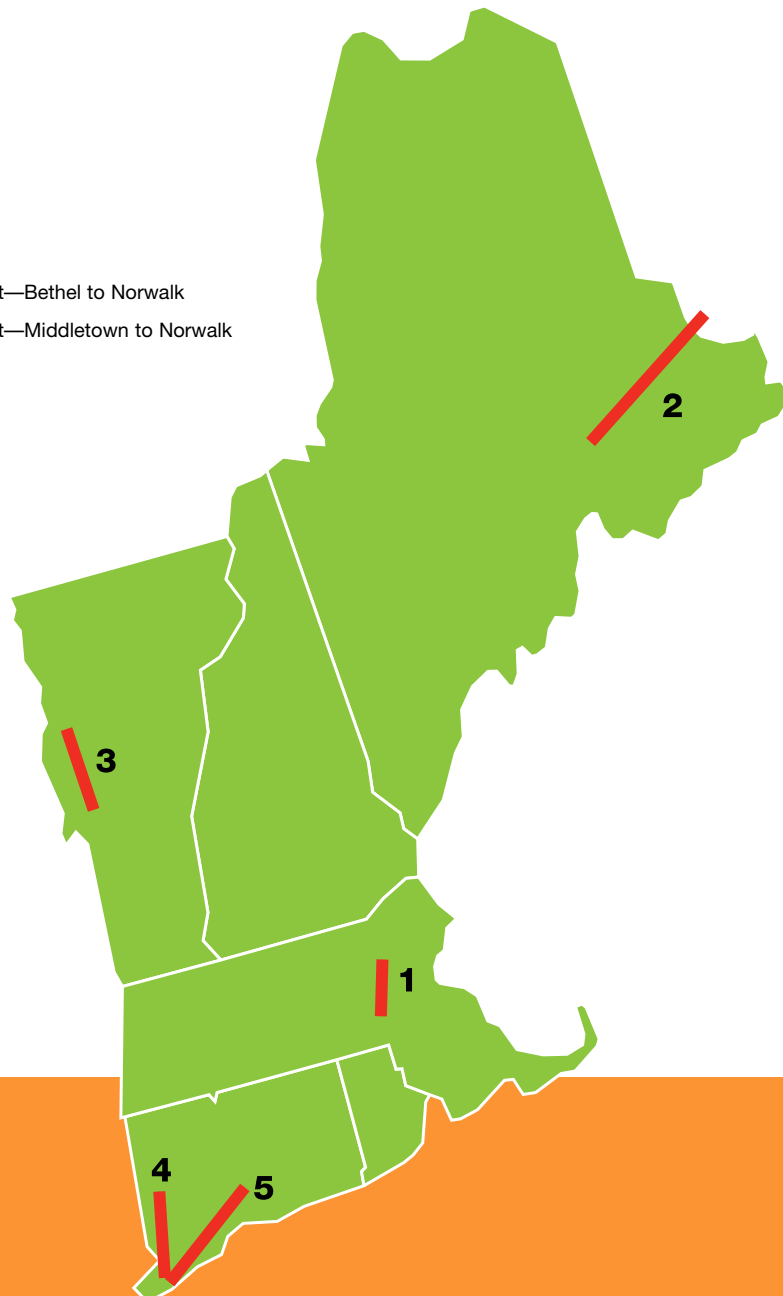
A new procedure was introduced in 2005 to streamline and coordinate all classifications of transmission outages to ensure close communications with transmission owners, prompt notification to market participants, and prioritization of critical projects. This effort promotes improved operational efficiency for the entire New England power system.

Operationally, ISO New England has initiated a long-term program to improve the monitoring and control of the grid. This effort will assess the data-communication and substation monitoring and control equipment presently installed on the grid and the effectiveness of the methods and facilities system operators use to respond to contingencies, including controlled power outages.

No matter how individual control areas handle emergencies, reliability is key; it is one of the essentials of the electric power industry, and electricity providers must have the proper tools available to help maintain service.

### Major 345-kilovolt Projects

1. NSTAR 345-kilovolt Reliability Project
2. Northeast Reliability Interconnect Project
3. Northwest Vermont Reliability Project
4. Southwest Connecticut Reliability Project—Bethel to Norwalk
5. Southwest Connecticut Reliability Project—Middletown to Norwalk



# Oversight and Governance:

## Independence Guiding ISO New England

The oversight and governance issues in the corporate world that led to the passage of the Sarbanes-Oxley Act of 2002 have reminded all organizations how important it is to have independent and experienced leaders. Within the electric power industry, this is especially true for Regional Transmission Organizations and Independent System Operators, which have important and growing responsibilities.

Finding tested and proven leaders to sit on boards of directors is a challenge for these organizations in that there is a limited field of experienced candidates. In terms of independence, ISO New England's oversight structure has always required the elimination of any candidate who has a relationship with any of the participants in the region's wholesale electricity markets or their affiliates, whether through employment, stock ownership, or otherwise. Given that there are hundreds of participants and they have thousands of affiliates, this significantly limits the field.

For ISO New England, the difficulty in finding independent and experienced directors has become more evident since becoming a Regional Transmission Organization in 2005. The regular turnover that results from the age and term limits for directors creates a continuing need for a pool of strong candidates. These candidates must pass muster, not only with the existing board, but also with market participants and state regulators who also take part in the election process now that ISO New England is a Regional Transmission Organization.

The requirements outlined above are necessary to ensure the board's experience, independence, and integrity. An additional challenge, in the form of FERC's strict construction of its "interlock" rules, prohibits directors from serving on the boards of more than one public utility without FERC approval, even if the public utilities are unrelated and geographically remote.

Through its Code of Conduct, ISO New England avoids genuine conflicts and preserves board independence without needing to screen out every candidate who has some tangential relationship to a public utility. This alone ensures that Regional Transmission Organization and Independent System Operator board members are independent, while giving them the experience to handle ever-greater responsibilities.



# Robust Partnerships Building for the Future

The relationship between ISO New England and its stakeholders has evolved and strengthened through the years. Today, as the power system and wholesale electricity markets progress, ISO New England's close working partnerships with stakeholders across the six-state region is as important as ever.

With its 6.5 million households and businesses, the New England states appropriately play a critical role in guiding New England's energy future. The New England Conference of Public Utilities Commissioners (NECPUC) represents the region's utility regulatory bodies. NECPUC draws upon six decades of experience and know-how to evaluate and address industry issues, while keeping the needs of the region in sharp focus.

The New England Power Pool (NEPOOL), created in 1971, is a voluntary association of market participants. Having served as the administrator for the regional power system for 25 years, NEPOOL has a unique perspective on New England's market and power system. Today, NEPOOL's more than 280 members serve as key representatives on ISO New England's committees and working groups. NEPOOL's membership also reviews ISO New England's annual budgets as well as nominations to ISO New England's Board of Directors.

Although ISO New England and its stakeholders have different responsibilities and sometimes different goals, all continue to share a common dedication to ensuring a reliable, efficiently priced supply of power and a commitment to doing what is best for the end user. For example, during 2005, ISO New England and its stakeholders accomplished the following:

- Worked together to address proposals for a capacity-market model for New England that would encourage the production of the electricity needed by the region's residents and businesses
- Successfully launched the first round of upgrades for the Ancillary Services Market project, with services obtained through the wholesale electric power markets that include regulation, operating reserves, and installed capacity
- Quickly and efficiently developed, filed with FERC, and implemented a Winter Action Plan for operating the power system during cold-weather conditions when natural gas and oil shortages might have occurred
- Analyzed, proposed, and approved dozens of plans to modify or build new transmission and generation facilities in New England, as well as the cost allocation for more than \$600 million of new transmission

ISO New England and its stakeholders have forged strong partnerships during the past eight years and are working together to ensure future progress in New England.

### Report of Independent Auditors

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

In our opinion, the accompanying statements of financial position and the related statements of activities and cash flows present fairly, in all material respects, the financial position of ISO New England Inc. (the "Company") at December 31, 2005 and 2004, and the results of changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*PricewaterhouseCoopers US*

March 16, 2006

**Statements of Financial Position**  
**For Years Ended December 31, 2005 and 2004**

	2005	2004
	(In thousands)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 138,927	\$ 40,562
Security deposits	144,281	67,643
Unbilled receivable, net	21,486	21,147
Prepaid expenses	636	606
Restricted cash on deposit	91,699	17,774
Noncurrent assets:		
Property and equipment in-service, net (Note 3)	33,088	52,667
Work in process (Note 3)	45,586	22,164
Deferred charges	297	364
Swap asset (Note 4)	53	156
Regulatory asset	<u>1,956</u>	<u>1,504</u>
Total assets	<u>\$ 478,009</u>	<u>\$ 224,587</u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable:		
Settlement, net	\$ 133,114	\$ 26,151
Administration	9,335	7,878
Deposits payable	145,134	68,249
Interest payable	1,081	887
Revolving credit (Note 4)	1,968	-
Accrued expenses	9,022	7,782
Minimum pension liability (Note 5)	1,956	1,504
Regulatory liability	53	156
Deferred income - current	4,547	13,995
Restricted cash on deposit payable	67,176	17,774
Term loan payable - current (Note 4)	13,833	21,687
Long-term liabilities:		
Deferred income, net of current portion	3,667	2,357
Term loan, net of current portion (Note 4)	<u>87,123</u>	<u>56,167</u>
Total liabilities	478,009	224,587
Unrestricted net assets	-	-
Total liabilities and net assets	<u>\$ 478,009</u>	<u>\$ 224,587</u>

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

**Statements of Activities**  
**For Years Ended December 31, 2005 and 2004**

	2005	2004
	(In thousands)	
Changes in unrestricted net assets:		
Revenues (Note 1):		
ISO tariff revenues	\$ 122,327	\$ 115,262
Interest income	1,567	462
Fees and services	<u>527</u>	<u>461</u>
Total unrestricted revenues	<u>124,421</u>	<u>116,185</u>
Expenses:		
General and administrative:		
Salaries and benefits	50,947	46,310
Professional and consultants	17,400	16,127
Rents and leases	1,077	2,509
Computer services	4,064	3,684
Depreciation and amortization expense	38,921	35,227
Communication expense	1,578	1,586
Interest expense	2,458	2,561
Other	<u>7,976</u>	<u>8,181</u>
Total expenses	<u>124,421</u>	<u>116,185</u>
Change in unrestricted net assets	-	-
Unrestricted net assets, beginning of year	<u>-</u>	<u>-</u>
Unrestricted net assets, end of year	<u>\$ -</u>	<u>\$ -</u>

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

**Statements of Cash Flows**  
**For Years Ended December 31, 2005 and 2004**

	2005	2004
	(In thousands)	
Cash flows from operating activities:		
Increase in unrestricted net assets	\$ -	\$ -
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:		
Depreciation expense	38,850	34,481
Loss on disposal of asset	-	1,024
(Increase) in accounts receivable	(339)	(1,797)
Decrease in deferred charges	67	470
(Increase) in prepaid expense	(30)	(464)
(Increase)/decrease in regulatory asset	(452)	718
(Increase)/decrease swap asset	103	(156)
Increase/(decrease) in accounts payable:		
Settlement	106,963	25,658
Administration	(13)	(1,469)
(Decrease) in daily billing advance collections	-	(20,643)
Increase/(decrease) in minimum pension liability	452	(484)
(Decrease) in swap liability	-	(234)
Increase/(decrease) regulatory liability	(103)	156
Increase in accrued expenses	1,240	1,069
Increase in interest payable	194	595
Increase/(decrease) in deferred income	<u>(8,138)</u>	<u>6,498</u>
Net cash provided by operating activities	<u>138,794</u>	<u>45,422</u>
Cash flows from investing activities:		
Capital expenditures	<u>(41,223)</u>	<u>(25,930)</u>
Net cash used in investing activities	<u>(41,223)</u>	<u>(25,930)</u>
Cash flows from financing activities:		
(Increase)/decrease in security deposits	(76,638)	69,839
(Increase)/decrease in restricted cash on deposit	(73,925)	24,354
Increase/(decrease) in restricted cash on deposit payable	49,402	(24,354)
Increase/(decrease) in deposits payable	76,885	(70,053)
Proceeds from term loan	-	9,450
Repayment on term loan	(22,398)	(72,495)
Proceeds from private placement debt	-	39,000
Proceeds from tax-exempt bond financing	45,500	-
Net borrowings on working capital line	<u>1,968</u>	<u>-</u>
Net cash provided/(used) by financing activities	<u>794</u>	<u>(24,259)</u>
Net increase/(decrease) in cash and cash equivalents	98,365	(4,767)
Cash and cash equivalents, beginning of year	<u>40,562</u>	<u>45,329</u>
Cash and cash equivalents, end of year	<u>\$ 138,927</u>	<u>\$ 40,562</u>
Supplemental data:		
Amounts included in accounts payable -		
Administration related to work in process	<u>\$ 5,075</u>	<u>\$ 3,605</u>
Cash paid during the year for interest	<u>\$ 2,731</u>	<u>\$ 2,671</u>

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

# Notes to Financial Statements

## 1. Summary of Significant Accounting Policies

### Description of Business

ISO New England Inc. (the "Company" or "ISO") commenced operations on July 1, 1997, as the New England electric transmission independent system operator for the New England Power Pool ("NEPOOL") in compliance with the requirements of the Federal Energy Regulatory Commission ("FERC"). On May 1, 1999, the competitive marketplace opened in the ISO New England 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, 2005 and 2004, were held in overnight repurchase agreements and also in direct and indirect obligations of the United States, with 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 the amounts owed for energy transactions and transmission, for which the ISO functions as paying agent, which are included in accounts payable settlement, net and for 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, which represents the customer's net amount due, less any amounts which may have been owed to them.

The net unbilled receivables, 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 the next weekly invoice issued. 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 \$91.7 million and \$17.8 million in 2005 and 2004, respectively, recorded as Restricted Cash on Deposit represents the Congestion Revenue Fund, Net proceeds from tax-exempt bond financing, NRG Cost of Service Agreement Escrow and Pre-petition funds, which are restricted by Market Rule 1, FERC Orders or Bankruptcy Law. The balance is offset by liabilities on the Statement of Financial Position. The restricted cash on deposit at December 31, 2005 and 2004, were held in overnight repurchase agreements and also in direct and indirect obligations of the United States. Additionally, the net proceeds from the tax-exempt bond financing are held at cost. The fair market value as of December 31, 2005 and 2004, was \$91.7 million and \$17.8 million, respectively.

### 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. 34, "Capitalization of Interest Costs" ("FAS 34"), and Statement of Financial Accounting Standards No. 62, "Capitalization of Interest Costs in situations involving certain tax-exempt borrowings and certain gifts and grants" ("FAS 62"), an amendment of FASB Statement No. 34, which requires the Company to capitalize the interest and fees associated with the borrowings that the Company has entered into for the acquisition of assets related to a project that has a material effect on the Company's financial position.

In addition, the Company follows the 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 25 years (computer hardware, software and accessories – 3 to 5 years, software development costs – 3 to 5 years, furniture and fixtures and machinery and equipment – 7 years, leasehold improvements – 10 years or remaining useful life whichever is shorter, vehicles – 3 years, building – 25 years). Capitalized interest and fees is amortized over the same useful life of the asset that it pertains to. No depreciation is recorded for assets classified as work in process (Note 3).

### Derivative Policy

The Company follows the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), as amended by FAS 138, in establishing its derivative policy. The policy states that the Company's Management will make the determination with the approval of the Company's Audit and Finance Committee to enter into fixed interest rate swaps when the fixed interest rate offered at the time will outweigh the risk of leaving the borrowings to fluctuations in the market, taking into consideration the length of the borrowing, the state of the economy, and the direction in which the Management team believes the economy is moving.

### Deferred Charges and Regulatory Assets and Liabilities

The Company applies the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("FAS 71"), which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because it is probable to be collected or refunded through future customer billings. ISO New England incurred pension cost and the purchase of land located at Sullivan Road, which were not included in the 2003 and 2004 ISO Tariff rates, respectively. Additionally in 2005, the ISO incurred costs associated with the Intra-Hour Transaction Scheduling Pilot Program ("ITS"), which were not included in the 2005 ISO Tariff Rates. A portion of these costs, which were deferred, have been included in the current year's ISO Tariff filing and will therefore be amortized. The remaining cost, also deferred, will be collected in future Tariff filings.

The following table is a detail of the balances as presented in the Statement of Financial Position:

<b>Deferred Charges</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
ITS Pilot Program	4,000	-
Pension costs	142,000	213,000
Land located on Sullivan Road	<u>151,000</u>	<u>151,000</u>
	<u>\$ 297,000</u>	<u>\$ 364,000</u>
<b>Regulatory Assets</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Minimum pension liability	<u>1,956,000</u>	<u>1,504,000</u>
	<u>\$ 1,956,000</u>	<u>\$ 1,504,000</u>
<b>Regulatory Liability</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Swap asset	<u>53,000</u>	<u>156,000</u>
	<u>\$ 53,000</u>	<u>\$ 156,000</u>

### Income Taxes

There is no provision for federal or state (Massachusetts and Connecticut) income taxes because the Company is exempt from such taxes under section 501(a) of the Internal Revenue Code (the "Code") and state law as an organization described in Code section 501(c)(3). The Company, previously determined to be a Code section 501(c)(4) organization, has been determined to be a Code section 501(c)(3) organization since May 27, 2004. The Company does not have liability for any tax on unrelated business income.

### **Security Deposits**

The NEPOOL Participants are required to comply with the Financial Assurance Policy under ISO's Transmission, Markets and 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, 2005 and 2004, were approximately \$144,281,000 and \$67,643,000, 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 and 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 cost through a pre-approved rate applied to each month's activity. Schedules 1, 2, and 3 are subject to true-up through subsequent years' rates, and any over or under collection is recorded as deferred charges or deferred income and will be recovered under future Tariff filings.

### **Deferred Income**

Deferred income represents the amount of the ISO Tariff for Schedules 1, 2, and 3 that was over/under collected from 2003 through 2005 and offsets to the net fixed assets of the Company that were purchased and placed in service in 1997 and 1998. 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. The pre-funded fixed asset deferred income is being amortized to income over the life of the assets at the rate depreciation is recognized. The amortization of these assets was complete at December 31, 2005.

### **Concentrations**

The Company's top 10 participants represented approximately 54%, or \$61.8 million, and 55%, or \$67.2 million, in Tariff revenues for the years ended 2005 and 2004, respectively.

### **Fair Values of Financial Instruments**

The carrying amounts reported in the Statement of Financial Position for current assets and liabilities approximate their fair values.

### **Use of Estimates**

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

### **Liquidity Information**

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

### **Revised Classification**

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

## **2. Commitments and Contingencies**

### **Capital Funding Tariff**

The FERC accepted the ISO's "capital funding tariff" ("CFT") filing for 2004 and 2005. These filings support the ISO's loan arrangements with various banks and note holders to fund the capital and working capital requirements of the Company.

### **Legal Proceedings**

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

### Locational Installed Capacity Market Contingency

The Company is currently involved in on-going settlement hearings with the Participants in NEPOOL and the FERC regarding the Locational Installed Capacity Market ("LICAP"). The Company has capitalized, as a part of work in process, software development costs totaling approximately \$3,434,000 at December 31, 2005, associated with the development of the LICAP market. The outcome of the settlement may impair the carrying value of this asset. At this time, the outcome of these hearings and any related asset impairment are unknown.

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

	December 31,	
	<u>2005</u>	<u>2004</u>
Computer hardware, software and accessories	\$ 108,692,000	\$ 91,313,000
Software development costs	24,938,000	21,528,000
Furniture and fixtures	888,000	853,000
Machinery and equipment	59,000	-
Building and leasehold improvements	4,101,000	6,163,000
Capitalized interest and fees	4,325,000	3,885,000
Vehicles	<u>85,000</u>	<u>75,000</u>
	143,088,000	123,817,000
Less: accumulated depreciation and amortization	<u>(110,000,000)</u>	<u>(71,150,000)</u>
Property and Equipment In-Service, net	<u>\$ 33,088,000</u>	<u>\$ 52,667,000</u>
Work in process (WIP)	<u>\$ 45,586,000</u>	<u>\$ 22,164,000</u>

There were a number of new projects as of 2005 such as the building construction at the Main Control Center, Ancillary Service Markets Phase II, Enterprise Data Architecture Plan, and various other market enhancement projects, which have not been placed in service as of December 31, 2005, and are included in WIP. In accordance with "FAS 34" and "FAS 62," the associated interest cost, which was capitalized as work in process in 2005 and 2004, was \$949,000 and \$508,000, respectively. Of the capitalized interest included in WIP for 2005, \$68,000 has been carried over from 2004 and \$87,000 represents the net of interest income and interest expense earned or paid on the building construction, which has been recorded in its entirety on the Balance Sheet.

### 4. Credit Facilities

#### Revolving Credit Arrangement

In June 2004, the Company entered into a \$15 million revolving credit arrangement, of which the outstanding balances at December 31, 2005 and 2004, were \$1,968,000 and \$0, respectively. Interest accrues on the revolving credit at a London Inter-bank Offering Rate ("LIBOR") of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a .60% spread. Interest is paid at the earlier of the selected LIBOR term or 30 days. The arrangement expires June 1, 2009, and any outstanding balance must be paid by this date. The Company is charged an annual fee of .15% on the entire line of credit. The weighted average interest rate incurred for the year ended December 31, 2005, was 4.5%.

In June 2004, the Company also entered into a \$4 million revolving credit arrangement, which was requested as a result of the change in the billing policy under ISO's Transmission, Markets and Services Tariff to go from monthly billing to weekly billing. This arrangement serves as a line of credit to cover any potential payment defaults by a Participant. Interest accrues on the revolving credit at a London Inter-bank Offering Rate ("LIBOR") of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a .60% spread. Interest is paid at the earlier of the selected LIBOR term or 30 days. The arrangement expires July 1, 2009, and any unpaid balances must be paid as of this date. The Company is charged an annual fee of .15% on the entire line of credit. There have not been any borrowings on this debt since the establishment of this working capital line in June 2004.

### Term Loan

The Company entered into a \$43.0 million term loan in 2001, a \$40.0 million term loan in 2002, and \$24.5 million and \$20.0 million term loans in 2003. Principal is payable monthly with the final repayments due between June 2006 – June 2007. Interest accrues on the \$20.0 million term loan at LIBOR of which the Company has the option of selecting the 30, 60, 90, or 180-day rate, plus a 1.375% spread. For the years ended December 31, 2005 and 2004, the weighted average floating interest rate is approximately 3.85% and 3.21%, respectively.

The Company has entered into interest rate exchange agreements (Swaps) to mitigate the interest rate risks associated with its floating-rate term loans. On March 17, 2003, the Company entered into three interest rate exchange agreements whereby the Company pays at a fixed interest rate for predetermined notional amounts as scheduled at the time of execution of the agreements.

On July 1, 2004, interest rate Swaps number 2 and 3 were terminated and resulted in a net gain in 2004 of \$206,657 and \$73,998, respectively. The gain on these Swaps is reflected as a reduction of interest expense, in the accompanying Statement of Activities.

	Swap 1	Swap 2	Swap 3
Notional amount at the time of execution	\$43,000,000	\$40,000,000	\$24,500,000
Notional amount at December 31, 2005	\$ 7,200,000	\$ 0	\$ 0
Termination date	June 1, 2006	July 1, 2004	July 1, 2004
Rate paid	3.3750%	3.5550%	3.4550%
Rate received	LIBOR plus 1.375%	LIBOR plus 1.375%	LIBOR plus 1.375%

The fair market value of the interest rate Swap as of December 31, 2005 and 2004, was \$53,000 and \$156,000, respectively. The fair market values are derived from proprietary models. The offset is recorded as a liability on the Statement of Financial Position.

### Private Placement Debt Arrangement

In September 2004, the Company entered into a \$39.0 million private placement loan, which is made up of 10-year 5.60% senior notes. Payment is due in full on September 2, 2014, with no mandatory prepayments.

### Tax-Exempt Bond Financing

In February 2005, the Company entered into tax exempt financing of \$45.5 million in the form of Multi-Mode Variable Rate Civic Facility Revenue Bonds, which were issued by the Massachusetts Development Finance Agency. The proceeds of the Bonds were loaned to the Company to assist in financing and refinancing a project located at the Main Control Center. Principal payments are scheduled to begin May 2007 with the final repayment due on February 1, 2032. Interest accrues 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 2 basis points. For the years ended December 31, 2005 and 2004, the weighted average floating interest rate was approximately 2.59% and 0%, respectively.

The total outstanding debt at December 31, 2005 and 2004, was \$101.0 million and \$77.9 million, respectively.

Principal payments on the term loan, private placement debt, and tax-exempt bonds are due annually as follows:

2006	\$ 13,833,000
2007	3,988,000
2008	1,820,000
2009	1,820,000
2010	1,820,000
Thereafter	<u>77,675,000</u>
	<u>\$ 100,956,000</u>

These credit agreements contain both affirmative and negative covenants, the most restrictive of which is the maintenance of a financial ratio related to revenue and expense plus debt service. The Company was in compliance with these ratios at December 31, 2005 and 2004.

Interest incurred on the revolving credit, the term loans, and private placement debt for the years ended December 31, 2005 and 2004, was approximately \$3,253,000 and \$3,259,000, respectively. Interest capitalized from the term loans and private placement debt for the years ended December 31, 2005 and 2004, was approximately \$794,000 and \$508,000, respectively.

## 5. Pension and Other Employee Benefits

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

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

The Company sponsors two defined benefit postretirement plans that provide medical, dental, and life insurance benefits for union and nonunion eligible employees and their beneficiaries. The medical benefits are contributory with participants' contributions adjusted annually, and participants are responsible for deductible and coinsurance amounts. Dental benefits are noncontributory, but participants are responsible for deductible and coinsurance amounts. The life insurance benefits are noncontributory.

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31, 2005	2004	Years Ended December 31, 2005	2004
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 40,336,000	\$ 34,493,000	\$ 3,337,000	\$ 2,786,000
Service cost	2,910,000	2,536,000	498,000	427,000
Interest cost	2,338,000	2,064,000	186,000	161,000
Benefits paid	(696,000)	(560,000)	(73,000)	(43,000)
Plan participants' contributions	-	-	8,000	6,000
Actuarial (gain) loss	<u>2,656,000</u>	<u>1,803,000</u>	<u>29,000</u>	<u>-</u>
Benefit obligation at end of year	<u>47,544,000</u>	<u>40,336,000</u>	<u>3,985,000</u>	<u>3,337,000</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	29,847,000	24,360,000	3,359,000	2,674,000
Actual return on plan assets	2,680,000	2,908,000	313,000	305,000
Employer contributions	3,416,000	3,139,000	468,000	417,000
Plan participants' contributions	-	-	8,000	6,000
Benefits paid	<u>(696,000)</u>	<u>(560,000)</u>	<u>(73,000)</u>	<u>(43,000)</u>
Fair value of plan assets at end of year	<u>35,247,000</u>	<u>29,847,000</u>	<u>4,075,000</u>	<u>3,359,000</u>
Funded status	(12,297,000)	(10,489,000)	90,000	22,000
Unrecognized transition obligation	1,062,000	1,187,000	642,000	697,000
Unrecognized net actuarial (gain) loss	11,204,000	9,268,000	(865,000)	(904,000)
Unrecognized prior service cost	<u>31,000</u>	<u>34,000</u>	<u>133,000</u>	<u>185,000</u>
Prepaid (accrued) benefit cost	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

Amounts recognized in the Statement of Financial Position consist of:

	Pension Benefits		Other Benefits	
	12/31/2005	12/31/2004	12/31/2005	12/31/2004
(Accrued) benefit cost	\$ (1,956,000)	\$ (1,504,000)	-	-
Regulatory assets	<u>1,956,000</u>	<u>1,504,000</u>	<u>-</u>	<u>-</u>
Net amount recognized	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

The accumulated benefit obligation for all defined benefit pension plans was:

	<b>December 31,</b>	
	<u>2005</u>	<u>2004</u>
Projected benefit obligation	\$ 47,544,000	\$ 40,336,000
Accumulated benefit obligation	\$ 37,210,000	\$ 30,791,000
Fair value of plan assets	\$ 35,247,000	\$ 29,847,000

The Company follows the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," and Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and other Postretirement Benefits," in determining the minimum liability requirements. A liability has been recorded on the Statements of Financial Position in the amount of \$1,956,000 and \$1,504,000 for the years ended December 31, 2005, and December 31, 2004, respectively. The accumulated benefit obligation exceeded the fair value of plan assets for one defined benefit plan, which was in an under-funded position, as follows:

	<b>December 31,</b>	
	<u>2005</u>	<u>2004</u>
Accumulated benefit obligation	\$ 35,832,000	\$ 29,506,000
Fair value of plan assets	(33,994,000)	(28,433,000)
Prepaid benefit cost	<u>118,000</u>	<u>431,000</u>
Minimum pension liability	<u>\$ 1,956,000</u>	<u>\$ 1,504,000</u>

The Company has determined that the minimum pension liability is probable of recovery through the ISO Tariff and has recorded a regulatory asset at December 31, 2005, and December 31, 2004.

	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>Years Ended December 31,</b>		<b>Years Ended December 31,</b>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Components of net periodic benefit cost:				
Service cost	\$ 2,910,000	\$ 2,536,000	\$ 498,000	\$ 426,000
Interest cost	2,338,000	2,064,000	185,000	161,000
Expected return on plan assets	(2,347,000)	(1,947,000)	(265,000)	(213,000)
Amortization of transition obligation	125,000	125,000	56,000	56,000
Amortization of net actuarial loss	388,000	359,000	-	-
Amortization of unrecognized prior service cost	2,000	2,000	51,000	51,000
Amortization of unrecognized (gain)/loss	<u>-</u>	<u>-</u>	<u>(57,000)</u>	<u>(64,000)</u>
Net periodic benefit cost	<u>\$ 3,416,000</u>	<u>\$ 3,139,000</u>	<u>\$ 468,000</u>	<u>\$ 417,000</u>

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

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

	Pension Benefits		Other Benefits	
	<u>12/31/2005</u>	<u>12/31/2004</u>	<u>12/31/2005</u>	<u>12/31/2004</u>
Discount rate	5.75%	6.00%	5.75%	6.00%
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	-	-	7.00%	7.00%
Health care cost trend rates – ultimate	-	-	4.00%	4.00%
Ultimate year	-	-	2007	2007

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

	Pension Benefits		Other Benefits	
	<u>12/31/2005</u>	<u>12/31/2004</u>	<u>12/31/2005</u>	<u>12/31/2004</u>
Discount rate	5.50%	5.75%	5.50%	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 increase the Accumulated Postretirement Benefit (APBO) as of December 31, 2005, by approximately \$169,000 or decrease the APBO by approximately \$154,000. Additionally, a one percentage point change in the assumed health care cost trend rates would increase or decrease the net postretirement cost for 2005 by approximately \$40,000 and \$36,000, respectively.

The 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	Percentage of Plan		Weighted-Average
	Allocation	Assets at December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>Expected Long-Term</u>
				<u>Rate of Return - 2005</u>
Equity securities	60%	62%	65%	5.35%
Debt securities	<u>40%</u>	<u>38%</u>	<u>35%</u>	<u>2.15%</u>
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 U.S. large cap, U.S. small cap, international developed markets, and emerging markets equity securities.

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

The Company expects to contribute \$3,767,000 to its pension plan and \$540,000 to its postretirement benefit plan in 2006.

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

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2006	\$ 778,000	\$ 132,000
2007	851,000	143,000
2008	962,000	158,000
2009	1,111,000	187,000
2010	1,280,000	263,000
Years 2011-2015	<u>9,847,000</u>	<u>2,470,000</u>
Total	<u>\$ 14,829,000</u>	<u>\$ 3,353,000</u>

#### **6. 401(k) Savings Plan:**

The Company has a 401(k) Retirement and Savings Plan open to substantially all employees. This savings plan provides for employee contributions up to specified limits. The Company matches employee contributions up to 3% of eligible compensation and provides a 50% match on the next 2% of eligible compensation. The matching contributions for the Company were \$1,344,000 and \$1,131,000 for 2005 and 2004, respectively.

#### **7. Leases**

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

2006	\$ 940,000
2007	570,000
2008	<u>42,000</u>
Total minimum lease payments	<u>\$ 1,552,000</u>

The Company currently houses its back-up facilities at a separate location for a nominal annual payment.

Additionally, the Company leases office space in one other building. The additional office space is leased with an initial term of six years with an automatic month-to-month renewal option ending on July 1, 2007.

For fiscal years 2005 and 2004, actual rental payments for operating leases were \$958,000 and \$2,277,000, respectively.





# 2005 ISO New England Board of Directors and Corporate Officers

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