Contents

Independent Auditors' Report

To the Board of Directors of
New York Independent System Operator, Inc.

We have audited the accompanying statements of financial position of New York Independent System Operator, Inc. ("NYISO") as of December 31, 2001 and 2000 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of NYISO'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, such financial statements present fairly, in all material respects, the financial position of NYISO as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 18, 2002

STATEMENTS OF FINANCIAL POSITION NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

		Years ended December 31		
		2001		2000
ASSETS				
Current Assets:				
Cash and cash equivalents	**$**	**51,744,667**	$	37,769,733
Accounts receivable		**10,406,760**		10,470,302
Prepaid expenses		**2,387,963**		1,315,092
Restricted cash		**48,442,287**		68,303,306
Total current assets		**112,981,677**		117,858,433
Noncurrent Assets:				
Regulatory transition asset, net (Note 2)		**32,965,466**		43,953,956
Property and equipment, net (Note 3)		**14,023,962**		8,244,124
Other noncurrent assets		**1,554,087**		1,517,572
Total noncurrent assets		**48,543,515**		53,715,652
Total Assets	**$**	**161,525,192**	$	171,574,085

See notes to financial statements.

STATEMENTS OF FINANCIAL POSITION NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

	Years ended December 31	
	2001	2000
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued expenses	**$ 17,664,431**	$ 32,742,459
Market participant security deposits	**35,126,966**	19,910,870
Short-term debt (Note 4)	**-**	6,500,000
Long-term debt - current portion (Note 5)	**11,618,351**	10,160,070
Capital lease obligations - current portion (Note 8)	**287,391**	1,370,661
Working capital reserve	**38,533,825**	2,561,998
Deferred revenue	**7,265,523**	6,822,257
Other current liabilities	**1,685,682**	42,445,916
Total current liabilities	**112,182,169**	122,514,231
Noncurrent Liabilities:		
Capital lease obligations (Note 8)	**104,333**	367,231
Accrued pension liability (Note 7)	**478,422**	2,607,585
Regulatory liabilities (Note 9)	**22,579,406**	10,277,008
Other noncurrent liabilities (Note 7)	**574,660**	-
Long-term debt (Note 5)	**25,606,202**	35,808,030
Total noncurrent liabilities	**49,343,023**	49,059,854
Commitments and Contingencies (Note 10)	**-**	-
Total Liabilities	**$ 161,525,192**	$ 171,574,085

See notes to financial statements.

STATEMENTS OF ACTIVITIES NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

	Years ended December 31	
	2001	2000
Revenues:		
Rate Schedule 1 tariff charge	$ 87,048,756	$ 61,373,324
Fees and services	1,842,693	215,764
Interest income	1,152,507	3,434,406
Total revenues	90,043,956	65,023,494
Operating Expenses:		
Compensation and related benefits	25,211,177	19,207,583
Pension expense (Note 7)	1,604,907	1,274,665
Professional fees and consultants	18,560,605	16,510,000
Building, equipment leases and facility costs	16,948,038	3,659,441
Telecommunications	2,009,198	1,844,823
Training, travel and meeting expenses	2,239,703	1,367,223
Depreciation and amortization	4,781,676	2,423,493
Amortization of regulatory transition asset (Note 2)	10,988,488	10,988,488
Northeast Power Coordinating Council fees	1,503,343	1,377,522
Administrative and other expenses	3,204,983	1,324,735
Total operating expenses	87,052,118	59,977,973
Interest Expense	$ 2,991,838	$ 5,045,521
Net Results of Activities	$ -	$ -

See notes to financial statements.

STATEMENTS OF CASH FLOWS NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

	Years ended December 31	
	2001	2000
Cash Flows from Operating Activities:		
Net results of activities	**$ -**	$ -
Adjustments to reconcile net results of activities to net cash provided by operating activities:		
Depreciation and amortization	**4,781,676**	2,423,493
Amortization of regulatory transition asset	**10,988,490**	10,988,488
Change in operating assets and liabilities:		
Accounts receivable and prepaid expenses	**(1,009,329)**	7,142,015
Accounts payable and accrued expenses	**(15,078,028)**	29,902,328
Restricted cash	**19,861,019**	(63,405,491)
Working capital reserve	**35,971,827**	(15,556,246)
Other assets	**(30,620)**	(1,382,572)
Other liabilities	**(14,352,977)**	74,029,514
Net cash provided by operating activities	**41,132,058**	44,141,529
Cash Flows from Investing Activities:		
Acquisition of property and equipment	**(10,567,408)**	(7,171,119)
Net cash used by investing activities	**(10,567,408)**	(7,171,119)
Cash Flows from Financing Activities:		
Net (repayment)/proceeds from revolving credit facilities	**(6,500,000)**	3,500,000
Net (repayment)/proceeds from term loan	**(10,493,548)**	45,968,100
Net proceeds from equipment term notes	**1,750,000**	-
Payment of note to NYPP member companies	**-**	(54,942,444)
Decrease in capital lease obligations	**(1,346,168)**	(1,704,181)
Net cash used in financing activities	**(16,589,716)**	(7,178,525)
Net Increase in Cash and Cash Equivalents	**13,974,934**	29,791,885
Cash and Cash Equivalents, Beginning of Year	**37,769,733**	7,977,848
Cash and Cash Equivalents, End of Year	**$ 51,744,667**	$ 37,769,733
Supplemental Disclosure of Cash Flow Information –		
Cash paid during the year for interest	**$ 3,104,922**	$ 5,758,456

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Description - The New York Independent System Operator, Inc. ("NYISO") was formed in April 1997 and commenced operations on December 1, 1999. NYISO is incorporated in the State of New York as a not-for-profit corporation. NYISO assumed the responsibilities of its predecessor, the New York Power Pool ("NYPP"), which had coordinated the reliability of New York's electric power grid for more than 30 years.

Formed as a result of Federal Energy Regulatory Commission ("FERC") policies, NYISO monitors a network of more than 10,775 miles of high-voltage transmission lines and serves approximately 140 market participants. NYISO's principal objective is to ensure the reliable, safe and efficient operation of the New York State transmission system and to administer an open, competitive and nondiscriminatory wholesale market for electricity in New York State.

NYISO is governed by an independent board of directors as well as a committee structure consisting of market participant representatives.

Basis of Accounting - The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with generally accepted accounting principles.

Revenue Recognition - NYISO's two FERC-approved tariffs, the Open Access Transmission Tariff ("OATT") and the Market Administration and Control Area Services Tariff ("Services Tariff"), allow recovery of NYISO's operating expenses through a surcharge assessed to market participants. The revenue from this surcharge, Rate Schedule 1, is earned when energy is scheduled and dispatched. Market participants are then billed for such energy charges in the subsequent month.

Cash Equivalents - NYISO considers short-term marketable securities with original maturities of three months or less to be cash equivalents. The cash equivalents at December 31, 2001 and 2000 were held in short-term repurchase agreements that invest in United States government obligations.

Restricted Cash - Restricted cash consists primarily of market participant security deposits held in escrow accounts, amounts due to market participants for overcollections under the voltage support tariff, and amounts reserved for funding employee benefit plans.

Property, Equipment and Capital Leases - Property and equipment are recorded at cost. NYISO capitalizes property and equipment additions in excess of $1,000 with a useful life greater than one year. Depreciation is computed on the straight-line method over the assets' estimated useful lives of three to five years. When assets are retired or otherwise disposed of, the cost and related depreciation are removed, and any resulting gain or loss is reflected in income for the period. Repairs and maintenance costs are charged to expense when incurred.

Costs incurred to acquire and develop computer software for internal use are capitalized and amortized using the straight-line method over three years.

Capital lease obligations are recorded at the present value of future minimum lease payments. Assets under capital leases are amortized on the straight-line method over the life of the leases, which approximates their useful lives of three to five years.

Working Capital Reserve - In order to maintain the liquidity and stability of NYISO's markets, NYISO accumulates a working capital fund through amounts charged to market participants under Rate Schedule 1. NYISO bills its estimated working capital needs monthly to market participants.

Deferred Revenue - Amounts collected from market participants through Rate Schedule 1 for capital purchases are deferred and recognized over the depreciable period of the assets' lives.

Fees for participation in the NYISO governance process are billed to market participants in advance of the year for which they apply and are amortized over the related governance period.

Regulation **-** NYISO's financial statements are prepared in accordance with generally accepted accounting principles for rate-regulated entities. Statement of Financial Accounting Standards ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation*, requires an entity that is rate regulated on a cost-of-service basis, to recognize regulatory assets and liabilities for amounts, which would otherwise be included in earnings, when authorized to do so by FERC.

Income Taxes **-** NYISO is not subject to income taxes because it is operating as a corporation described in Section 501(c)(3) of the Internal Revenue Code, exempt under Section 501(a) of the Internal Revenue Code.

Fair Value of Financial Instruments **-** The carrying amount of current assets and liabilities, and long-term debt approximates their fair values.

Concentration of Credit Risk **-** Financial instruments that subject NYISO to credit risk consist primarily of accounts receivable billings due from market participants. As provided in the OATT and Services Tariff, market participants are required to maintain either approved credit ratings or post specified financial security in an amount sufficient to cover their outstanding liability to NYISO.

Use of Estimates **-** Generally accepted accounting principles require management to make estimates and assumptions that affect 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 reporting period. Actual results could differ from those estimates.

Derivative Financial Instruments **-** On January 1, 2001, NYISO adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS No. 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. SFAS No. 133 requires that all derivatives be recognized as either assets or liabilities, measured at fair value. The accounting for changes in fair value of derivatives (i.e. gains or losses) depends on the intended use of the derivative and the corresponding designation.

NYISO did not have a transition adjustment upon adoption of SFAS No. 133. In January 2001, NYISO entered into a derivative instrument. See additional details in Note 6.

2. REGULATORY TRANSITION ASSET

The regulatory transition asset represents costs incurred and paid by the member companies of the NYPP to prepare NYISO for initial operations. In accordance with NYISO's tariffs, such costs are recovered from market participants through Rate Schedule 1, and are amortized over five years, beginning in January 2000.

At December 31, 2001 and 2000, the regulatory transition asset was comprised of:

	2001	2000
Computer and software development	**$ 24,363,819**	$ 24,363,819
Administrative and organizational development	**29,356,643**	29,356,643
Power control center building and land	**1,221,982**	1,221,982
	54,942,444	54,942,444
Accumulated amortization	**(21,976,978)**	(10,988,488)
Transition asset, net	**$ 32,965,466**	$ 43,953,956

3. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2001 and 2000 consisted of the following:

	2001	2000
Computer hardware, software and accessories	$ 11,051,301	$ 3,041,235
Software developed for internal use	3,906,644	1,803,887
Assets under capital leases	3,646,775	3,678,460
Furniture and fixtures	1,351,172	1,111,532
Building and leasehold improvements	785,315	546,952
Machinery and equipment	650,696	436,134
Construction work in progress	-	212,838
	21,391,903	10,831,038
Accumulated depreciation and amortization	(7,367,941)	(2,586,914)
Property and equipment, net	$ 14,023,962	$ 8,244,124

4. SHORT-TERM DEBT

NYISO has a $50 million Revolving Credit Facility that expires on October 26, 2005. The proceeds from this facility are to be used for working capital purposes. Interest on borrowings under this agreement is based on NYISO's option of varying rates of interest tied to either the prime rate or the London Interbank Offering Rate (LIBOR). At December 31, 2001 and 2000, there was $0 and $6,500,000 outstanding on the Revolving Credit Facility, respectively.

5. LONG-TERM DEBT

On September 8, 2000, NYISO borrowed $48,460,444 under a Term Credit Loan to reimburse NYPP member companies for their investment in the transition of the NYPP to the NYISO, and for the purchase of certain NYPP assets. Principal and interest payments are due monthly until December 2004. Under the Term Credit Loan, interest is variable based on the 30-day LIBOR plus 125 basis points. The interest rate on the Term Credit Loan at December 31, 2001 and 2000 was 3.39% and 7.87%, respectively. In January 2001, NYISO entered into an interest rate swap agreement on the Term Credit Loan, which fixed the interest rate on this loan at 6.99%. See additional information in Note 6.

On November 1, 2001, NYISO entered into a $6.5 million line of credit facility to be utilized for the purchase of information technology equipment. Borrowings against this facility are converted into Equipment Term Notes with principal and interest payable over three years. Interest on borrowings under this facility is based on NYISO's option of varying rates of interest tied to either the prime rate or LIBOR. On November 1, 2001, NYISO borrowed $1.8 million against this facility with interest varying based on the 30-day LIBOR plus 125 basis points. At December 31, 2001, the interest rate on the Equipment Term Notes was 3.39%. Computer hardware, software and accessories with a book value of $1.8 million was pledged as collateral for the first borrowing on the Equipment Term Notes.

At December 31, 2001, the following amounts were outstanding on the Term Credit Loan and the Equipment Term Notes, respectively:

	Term Credit Loan	Equipment Term Notes	Total
Outstanding balance	$35,474,553	$ 1,750,000	$37,224,553
Less: Current portion	11,018,351	600,000	11,618,351
Long-term portion	$24,456,202	$ 1,150,000	$25,606,202

At December 31, 2001, scheduled maturities of the Term Credit Loan and the Equipment Term Notes are as follows:

	Term Credit Loan	Equipment Term Notes	Total
2002	$11,018,351	$ 600,000	$11,618,351
2003	11,799,241	600,000	12,399,241
2004	12,656,961	550,000	13,206,961
Total	$35,474,553	$ 1,750,000	$37,224,553

6. DERIVATIVES AND HEDGING ACTIVITIES

On January 10, 2001, NYISO entered into an interest rate swap agreement with a commercial bank to fix the interest payments on its variable rate Term Credit Loan. The notional amount of the swap on the date of the agreement was $45,157,860. Under the swap agreement, NYISO pays a fixed interest rate of 6.99% on the outstanding principal amount of the Term Credit Loan on payments from February 2001 through December 2004. NYISO is exposed to credit loss in the event of nonperformance by the commercial bank. However, NYISO does not anticipate nonperformance by the commercial bank.

The fair value of derivative instruments is quoted by an external source. NYISO recorded a liability of $1,347,194 at December 31, 2001 related to this derivative instrument and a corresponding expense for the year then ended. Due to NYISO's regulated rates, regulatory liabilities are adjusted to offset this increase in expense.

7. EMPLOYEE BENEFIT PLANS

Pension Plan - NYISO has a defined benefit pension plan covering substantially all employees. Plan benefits are based on employee compensation levels and years of service, including service for certain employees previously employed by an NYPP member company. Employees become vested in pension benefits after five years of creditable service.

The schedules that follow show the benefit obligations, the plan assets, and the funded status as of December 31, 2001 and 2000 and the change in benefit obligations and the components of net periodic pension costs for the years ended December 31, 2001 and 2000.

	2001	2000
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 5,126,114	$ 3,625,621
Service cost	979,118	674,994
Interest cost	440,211	303,776
Actuarial loss	1,010,947	536,451
Benefits paid	(47,259)	(14,728)
Benefit obligation, end of year	$ 7,509,131	$ 5,126,114
Change in plan assets:		
Fair value of plan assets, beginning of year	$ 1,000	$ 0
Actual return on plan assets	35,362	-
Employer contributions	3,594,710	15,728
Benefits paid	(47,259)	(14,728)
Expenses paid	(13,654)	-
Fair value of plan assets, end of year	$ 3,570,159	$ 1,000
Funded status	$ (3,938,972)	$ (5,125,114)
Unrecognized prior service cost	3,141,415	3,437,310
Unrecognized loss	1,421,905	322,340
Additional minimum pension cost	(1,102,770)	(1,242,121)
Total accrued pension liability	$ (478,422)	$ (2,607,585)

Amounts recognized in the statement of financial position consist of:

For the year ended December 31,	2001	2000
Benefit obligation	$ (478,422)	$ (2,607,585)
Intangible asset	1,102,770	1,242,121

The components of net periodic pension cost are as follows:

	2001	2000
Service cost	$ 979,118	$ 674,994
Interest cost	440,211	303,776
Expected return on plan assets	(149,439)	-
Amortization of unrecognized prior service cost	295,895	295,895
Amortization of unrecognized loss	39,122	-
Total	$ 1,604,907	$ 1,274,665

The following table shows the assumptions used to calculate the pension benefit obligations as of December 31, 2001 and 2000:

	2001	2000
Discount rate	**7.25%**	7.50%
Rate of compensation increases	**5.56%**	5.56%
Expected return on plan assets	**9.00%**	n/a

Postretirement Plan - NYISO has committed to sponsor a defined benefit postretirement medical and life insurance plan for eligible employees and their beneficiaries. The terms of the plan have not been finalized yet. However, the plan is expected to be finalized during 2002. NYISO recovered $930,169 and $671,040 through Rate Schedule 1 for postretirement benefits during 2001 and 2000, respectively. These amounts are included in Regulatory Liabilities on the Statement of Financial Position, pending plan formation and approval. See additional information on Regulatory Liabilities in Note 9.

401(k) Plan - NYISO has a 401(k) Retirement and Savings Plan open to all nontemporary employees. This plan provides for employee contributions up to specified limits. NYISO matches 100% of the first 3% of employee contributions, and 50% of the next 2% of employee contributions. Employees are immediately vested in NYISO's matching contributions, which were $761,544 and $487,975 for 2001 and 2000, respectively.

Long Term Incentive Plan - In 2001, the NYISO Long Term Incentive Plan was adopted to provide certain members of senior management with deferred compensation benefits. The amount of benefits deferred for each performance year of a three-year performance cycle are based upon the achievement of performance goals established by the Board of Directors. Participants become fully vested in these deferred amounts after the completion of a three-year performance cycle. Distributions from the Plan are payable in the year following the completion of each three-year performance cycle. The first performance cycle is retroactive to 2000, with distributions anticipated for 2003. Accrued Long Term Incentive Plan benefits included in Other Noncurrent Liabilities at December 31, 2001 were $574,660.

Trust Share Option Agreement - NYISO provides a supplemental compensation program, granting eligible employees options to acquire debt and equity securities held by NYISO in a trust for an amount equal to 25% of the fair value of such securities. At December 31, 2001, and 2000, respectively, the fair market value of securities held by the trust was $451,317 and $275,451. Options outstanding at December 31, 2001 expire from November 16, 2009 through January 16, 2011. Compensation expense is recorded over the vesting period of the options.

8. LEASE COMMITMENTS

Operating Leases - NYISO has obligations under lease agreements primarily for rental of office space in Altamont, NY and Albany, NY. The lease of the Altamont facility expired in February 2002, and has been renewed for four additional years. The lease for the Albany facility expires in January 2006. NYISO has the option to renew both leases for two additional five-year periods at the current lease rate. The future minimum lease payments over the next five years under these operating leases at December 31, 2001 are as follows:

2002	$ 734,236
2003	$ 734,236
2004	$ 734,236
2005	$ 734,236
2006	$ 81,986
Total	$ 3,018,930

Capital Leases - Certain lease obligations assumed from NYPP for computers, furniture and fixtures include provisions which at the termination of the lease either transfer ownership of the leased property to NYISO or allow NYISO the option to purchase the leased equipment for a nominal cost. Accordingly, the cost of these agreements has been recorded as capital leases.

Future minimum capital lease payments were as follows at December 31, 2001:

2002	$ 287,391
2003	104,333
Total minimum lease payments	391,724
Less: Current maturities	287,391
Long-term obligation	$ 104,333

9. REGULATORY LIABILITIES

Certain amounts recovered under NYISO's rate-making mechanisms are based on estimates. The difference between actual results and these estimates result in overcollections or undercollections. Such amounts are deferred as regulatory assets or liabilities and are amortized, as such amounts are included in future rates. At December 31, 2001 and 2000, respectively, NYISO recorded the following amounts as regulatory liabilities:

Energy markets	$ 13,858,205	$ 6,825,131
Voltage support	6,828,560	1,045,237
Future funding of postretirement plan	1,601,209	671,040
ICAP	291,432	1,735,600
Total	$ 22,579,406	$ 10,277,008

10. COMMITMENTS AND CONTINGENCIES

NYISO is routinely involved in regulatory actions. In the opinion of management, none of these matters will have a material adverse effect on the financial position, results of operations or liquidity of NYISO.

11. SUBSEQUENT EVENTS

In January 2002, NYISO executed an agreement with ISO New England Inc. ("ISO-NE") to jointly develop a common electricity marketplace for their adjacent regions based on a common market design. ISO-NE oversees the electric power and wholesale market systems in New England. As part of this agreement, the two ISO's will also jointly evaluate the feasibility of creating a Northeast Regional Transmission Organization to facilitate the seamless interchange of power with the northeastern United States. These objectives are intended to enhance reliability and provide market benefits in both regions, while meeting FERC's objective of creating a seamless national marketplace and eliminating barriers to the flow of energy.

12. ENRON CORPORATION

On December 2, 2001, Enron Corporation ("Enron") and many of its subsidiaries filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Two of Enron's subsidiaries that are in the bankruptcy proceeding, Enron Energy Services and Enron Power Marketing, are NYISO market participants. Enron Energy Services is a load-serving entity. Enron Power Marketing is a trader in the energy market, and also owns Transmission Congestion Contracts ("TCC"). NYISO is taking the appropriate steps in the bankruptcy proceedings to protect its interests. NYISO believes it has no material exposure arising from the Enron bankruptcy that would preclude NYISO from satisfying its obligations to market participants.

13. MARKET ACTIVITY (UNAUDITED)

The following amounts represent the transactional volume of energy and energy-related products in NYISO's markets during the years ended December 31, 2001 and 2000 (in $ billions).

	2001	2000
Energy	**$ 4.6**	$ 4.5
Installed capacity (ICAP)	**0.7**	0.4
Transmission Congestion Contracts (TCC)	**0.1**	0.3
Total	**$ 5.4**	$ 5.2