# FINANCIAL STATEMENTS 2012

KPMG LLP
515 Broadway
Albany, NY 12207

# Independent Auditors' Report

The Board of Directors
New York Independent System Operator, Inc.:

**Report on the Financial Statements**

We have audited the accompanying financial statements of New York Independent System Operator, Inc. which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of activities, and cash flows for the years then ended, and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of New York Independent System Operator, Inc. and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Albany, New York
March 15, 2013

# Statements of Financial Position

December 31, 2012 and 2011

| **Assets** | | **2012** | **2011** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 43,304,540 | 41,060,857 |
| Restricted cash | | 335,744,418 | 349,255,168 |
| Accounts receivable – net (note 2) | | 6,867,609 | 5,060,630 |
| Prepaid expenses | | 6,059,965 | 5,371,658 |
| Regulatory assets – current portion (note 3) | | 1,999,522 | — |
| Other current assets | | 210,792 | 40,257 |
| Total current assets | | 394,186,846 | 400,788,570 |
| Noncurrent assets: | | | |
| Regulatory assets (note 3) | | 16,802,444 | 15,581,749 |
| Property and equipment – net (note 4) | | 101,710,411 | 79,701,455 |
| Other noncurrent assets (note 7) | | 7,853,676 | 8,838,152 |
| Total noncurrent assets | | 126,366,531 | 104,121,356 |
| Total | $ | 520,553,377 | 504,909,926 |
| **Liabilities** | | | |
| Current liabilities: | | | |
| Accounts payable and accrued expenses | $ | 119,669,931 | 95,512,918 |
| Market participant security deposits | | 234,068,551 | 267,412,535 |
| Market participant prepayments | | 2,148,389 | 1,298,539 |
| Working capital reserve (note 10) | | 33,014,603 | 33,025,562 |
| Long-term debt – current portion (note 6) | | 27,674,341 | 25,116,275 |
| Deferred revenue (note 11) | | 4,358,125 | 3,373,015 |
| Regulatory liabilities – current portion (note 12) | | 1,253,357 | 2,579,060 |
| Other current liabilities (note 8) | | 2,184,757 | 567,790 |
| Total current liabilities | | 424,372,054 | 428,885,694 |
| Noncurrent liabilities: | | | |
| Accrued pension liability (note 8) | | 5,031,928 | 4,702,434 |
| Accrued postretirement liability (note 8) | | 5,027,984 | 4,479,953 |
| Regulatory liabilities (note 12) | | 6,578,991 | 6,235,818 |
| Other noncurrent liabilities (notes 7 and 8) | | 18,724,947 | 11,756,697 |
| Long-term debt (note 6) | | 60,817,473 | 48,849,330 |
| Total noncurrent liabilities | | 96,181,323 | 76,024,232 |
| Commitments and contingencies (note 13) | | | |
| Total liabilities | | 520,553,377 | 504,909,926 |
| Unrestricted net assets | | — | — |
| Total liabilities and net assets | $ | 520,553,377 | 504,909,926 |

*See accompanying notes to financial statements.*

# Statements of Activities

Years ended December 31, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| Revenues: | | | |
| Rate Schedule 1 tariff charge | $ | 145,159,810 | 147,799,883 |
| Grant revenue (notes 14 and 15) | | 15,554,109 | 3,861,203 |
| Planning studies revenue | | 2,252,893 | 2,144,776 |
| Fees and services | | 940,368 | 858,688 |
| Interest income | | 4,005 | 7,652 |
| Total revenues | | 163,911,185 | 154,672,202 |
| Operating expenses: | | | |
| Compensation and related benefits (note 8) | | 69,904,942 | 63,852,206 |
| Professional fees and consultants | | 20,029,274 | 24,614,700 |
| Depreciation and amortization | | 19,573,767 | 18,911,245 |
| Maintenance, software licenses and facility costs | | 17,243,537 | 18,451,821 |
| Federal energy regulatory commission fees | | 11,007,320 | 11,291,541 |
| Grant expenses – New York transmission owners (note 14) | | 10,091,002 | 570,633 |
| Telecommunication expenses | | 4,809,169 | 4,001,117 |
| Administrative and other expenses | | 4,273,282 | 3,221,646 |
| Interest expense | | 2,954,414 | 2,953,357 |
| Insurance expense | | 2,810,703 | 2,720,834 |
| Training, travel, and meeting expenses | | 1,396,045 | 1,611,569 |
| Northeast power coordinating council fees | | 240,034 | 88,234 |
| Change in fair value of interest rate swaps and caps (note 7) | | (422,304) | 2,383,299 |
| Total operating expenses | | 163,911,185 | 154,672,202 |
| Change in unrestricted net assets | | — | — |
| Unrestricted net assets, beginning of year | | — | — |
| Unrestricted net assets, end of year | $ | — | — |

*See accompanying notes to financial statements.*

# Statements of Cash Flows

Years ended December 31, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Change in unrestricted net assets | $ | — | — |
| Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities: | | | |
| Depreciation and amortization | | 19,573,767 | 18,911,245 |
| Loss on disposition of assets | | 428,215 | — |
| Change in operating assets and liabilities: | | | |
| Decrease (increase) in accounts receivable and prepaid expenses | | (2,495,286 ) | 13,348,506 |
| Decrease in restricted cash | | 13,510,750 | 42,621,187 |
| Decrease (increase) in regulatory assets | | (2,791,259) | 553,627 |
| Decrease (increase) in other assets | | 813,941 | (1,250,086) |
| Increase in accounts payable and accrued expenses | | 22,296,109 | 62,531,914 |
| (Decrease) increase in market participant prepayments | | 849,850 | (59,458,307) |
| Decrease in market participant security deposits | | (33,343,984) | (49,445,595) |
| Decrease in working capital reserve | | (10,959) | (13,466,245) |
| Decrease in regulatory liabilities | | (982,530) | (862,266) |
| Increase in deferred revenue and other liabilities | | 10,018,894 | 858,809 |
| Net cash provided by operating activities | | 27,867,508 | 14,342,789 |
| Cash flows from investing activities: | | | |
| Acquisition of property and equipment (including capitalized interest) | | (40,150,034) | (33,743,369) |
| Net cash used in investing activities | | (40,150,034) | (33,743,369) |
| Cash flows from financing activities: | | | |
| Proceeds from revolving credit facility loan | | 9,000,000 | 8,500,000 |
| Repayment of revolving credit facility loan | | (9,000,000) | (8,500,000) |
| Proceeds from 2007 – 2010 budget facility loan | | — | 7,000,000 |
| Repayment of 2007 – 2010 budget facility loan | | (16,385,714) | (21,595,238) |
| Proceeds from 2011 – 2013 budget facility loan | | 25,800,000 | 25,000,000 |
| Repayment of 2011 – 2013 budget facility loan | | (8,333,333) | — |
| Proceeds from 2011 Infrastructure Loan | | 7,419,046 | 3,240,232 |
| Repayments of 2011 Infrastructure Loan | | (10,659,278) | — |
| Proceeds from 2012 Infrastructure Loan | | 17,582,715 | — |
| Repayment of Mortgage and Renovations loans | | (897,227) | (848,734) |
| Net cash provided by financing activities | | 14,526,209 | 12,796,260 |
| Net increase (decrease) in cash and cash equivalents | | 2,243,683 | (6,604,320) |
| Cash and cash equivalents – beginning of year | | 41,060,857 | 47,665,177 |
| Cash and cash equivalents – end of year | $ | 43,304,540 | 41,060,857 |
| Supplemental disclosure of cash flow: | | | |
| Information – cash paid during the year for interest, net of capitalized interest | $ | 2,917,938 | 2,978,396 |
| Noncash operating activity: | | | |
| Change in pension and postretirement liabilities | | 428,958 | 5,138,950 |
| Noncash investing activities: | | | |
| Property and equipment additions which were accrued but not paid | $ | 5,396,646 | 3,535,742 |
| Property and equipment additions previously accrued which were paid | | 3,535,742 | 4,140,689 |

*See accompanying notes to financial statements.*

## (1) Summary of Significant Accounting Policies

### (a) 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 organization. NYISO assumed the responsibilities of its predecessor, the New York Power Pool (NYPP), which had coordinated the reliability of New York State'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 11,000 circuit miles of high-voltage transmission lines and serves approximately 360 market participants.

NYISO's mission, in collaboration with its stakeholders, is to serve the public interest and provide benefit to consumers by maintaining and enhancing regional reliability, operating open, fair and competitive wholesale electricity markets, planning the power system for the future, and providing factual information to policy makers, stakeholders and investors in the power system. The NYISO facilitates fair and open competition in the wholesale electricity markets in which electricity and related services are purchased and sold on the basis of competitive bidding. Billing invoices are issued by NYISO to each market participant to settle transactions occurring in the NYISO markets.

NYISO is governed by an independent board of directors, as well as a committee structure consisting of market participant representatives. In addition to FERC oversight, NYISO is also subject to regulation in certain aspects by the New York State Department of Public Service.

### (b) Basis of Accounting and Presentation

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

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, regulatory assets and liabilities, the valuation of derivatives, compensation, and liabilities for employee benefit obligations.



### (c) Regulatory Accounting

NYISO's financial statements are prepared in accordance with generally accepted accounting principles for rate-regulated entities, Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 980, *Regulated Operations*. As such, regulators may permit specific incurred costs, typically treated as expenses by unregulated entities, to be deferred and expensed in future periods when it is probable that such costs will be recovered in customer rates. Incurred costs are deferred as regulatory assets when NYISO concludes that it is probable future revenues will be provided to permit recovery of the previously incurred cost. A regulatory liability is recorded when amounts that have been recorded by NYISO are likely to be refunded to customers through the rate-setting process.

### (d) Revenue Recognition

Settlements of market participants' energy transactions are not reflected in NYISO's Statements of Activities since they do not represent revenues or expenses of NYISO, as NYISO merely acts as an intermediary in the settlement process. In this role, NYISO receives and disburses funds to/from market participants for each settlement period.

Effective July 1, 2012, NYISO's two FERC-approved tariffs, the Open Access Transmission Tariff (OATT) and the Market Administration and Control Area Services Tariff (Services Tariff), were amended to clarify NYISO's role as the single counterparty to market participant transactions in the NYISO markets. For all market participant transactions in the NYISO markets, flash title passes through NYISO immediately prior to passing to the ultimate buyer and seller of the product. This arrangement reinforces NYISO's authority to continue to net a market participant's offsetting financial positions in NYISO markets for credit and billing purposes; provides clarity in NYISO's legal standing to pursue collection from a bankrupt market participant; and, also complies with the FERC directives on credit policy requirements for competitive wholesale electricity markets.

Prior to October 2011, NYISO issued settlement invoices to market participants each month for transactions occurring in the previous month. In October 2011, NYISO began invoicing market participants each week for transactions occurring in the previous week as well as issuing a monthly invoice consisting of remaining uninvoiced days within that month and a "true-up" of the weekly invoices in that given month.

NYISO's tariffs allow recovery of NYISO's capital requirements, operating expenses and debt service costs 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 charges in the subsequent settlement period's invoice.

NYISO's Rate Schedule 1 includes a timing mechanism that effectively meets the requirements of an alternative revenue program set forth in ASC Topic 980, *Regulated Operations*, Subtopic 602, *Revenue Recognition.* Accordingly, revenue is recognized for net financing obligations and capital costs incurred during the reporting period based on the revenue requirement formula in the tariffs. NYISO has recorded an Other Noncurrent Liability of $9,463,626 and $3,222,136, respectively, in the accompanying 2012 and 2011 Statements of Financial Position in connection with this rate-making recovery mechanism.

Revenues recorded as planning studies revenues arise from billing and collection services in the study service agreement process performed by NYISO. These revenues are offset by the corresponding study expenses, recorded in operating expenses, which were incurred in performing such studies. A portion of the deposits related to planning studies are nonrefundable and recorded as revenue when received.



**(e) Government Grants**

NYISO recognizes government grants when there is reasonable assurance that NYISO will comply with the conditions attached to the grant arrangement and the grant will be received. Government grants are recognized in the Statements of Activities in the period in which NYISO recognizes the related costs for which the government grant is intended to compensate.

**(f) Cash and 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, 2012 and 2011 were held in certificates of deposit and money market accounts invested primarily in short-term U.S. government obligations. NYISO's cash and cash equivalents consist primarily of funds accumulated for the working capital reserve, amounts for funding employee benefit plans, and for general operating purposes. In accordance with certain loan agreements, NYISO is required to maintain compensating balances.

(g) **Restricted Cash**

Restricted cash consists primarily of market participant security deposits held in escrow accounts, amounts prepaid by market participants in advance of settlement billing dates, amounts collected on settlement invoices, amounts due to market participants for overcollections on the voltage market, amounts collected for Transmission Congestion Contract (TCC) auctions, and amounts deposited for planning studies. Security deposits are invested at the market participant's choice in money market funds or short or intermediate-term bond funds. NYISO presents changes in restricted cash in the operating activities section of the Statements of Cash Flows instead of in the investing activities section. NYISO has determined that this classification is more suitable to the nature of its operations.

(h) **Other Assets**

Other assets consist primarily of timing differences on certain rate-making recoveries, the fair value of interest rate swap agreements, noncurrent prepaid expenses, and miscellaneous receivables.

(i) **Property and Equipment**

Property and equipment are recorded at cost. NYISO capitalizes property and equipment additions in excess of $5,000 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, except for building and building improvements, which are depreciated on a straight-line basis over 20 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 expense for the period. Repairs and maintenance costs are charged to expense when incurred.

In accordance with ASC topic 350, *Intangibles – Goodwill and Other,* Subtopic 40*, Internal Use Software,* labor, overhead, interest, consulting, and related costs incurred to acquire and develop computer software for internal use are capitalized and amortized using the straight-line method over three years. Costs incurred prior to the determination of feasibility of developed software and following the in-service date of developed software are expensed.

In accordance with ASC topic 835, *Interest,* Subtopic 20, *Capitalization of Interest*, NYISO capitalizes the interest cost as part of the historical cost of acquiring certain assets.

Long-lived assets are recorded at cost, and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. Management is not aware of any events or changes in circumstances that would necessitate a review of any long-lived assets as of the years ended December 31, 2012 and 2011.

(j) **Working Capital Reserve**

In order to maintain the liquidity and stability of NYISO's markets, NYISO has accumulated a working capital fund through amounts charged to market participants under the Rate Schedule 1. Any change to NYISO's working capital needs would be billed to market participants in future Rate Schedule 1 charges. Market participants are entitled to interest on their principal contributions to the working capital reserve. Each market participant is allocated interest based on the respective ratio share of each market participant's principal contributions to the total working capital fund. Accumulated interest on the working capital fund is distributed annually to market participants.

**(k) Market Participant Prepayments**

Amounts received from certain market participants who do not provide an alternate form of financial assurance and must prepay their obligations to NYISO in advance of settlements billing dates are recorded as market participant prepayments.

**(l) Deferred Revenue**

Advance payments from developers for planning studies are reflected as deferred revenue. Fees for participation in NYISO's governance process are billed to market participants in advance of the year for which they apply and are amortized over the related governance period. All such unamortized amounts are also included in deferred revenue.

**(m) Income Taxes**

The organization has been recognized by the Internal Revenue Service as an organization described in Internal Revenue Code (The Code) Section 501(c)(3) and is generally exempt from income taxes under Section 501(a) of the Code. During the calendar years 2012 and 2011, no unrelated business taxable income was generated by NYISO, and therefore no disclosure is made for federal or state income taxes.

**(n) Fair Value**

In accordance with ASC Topic 820, *Fair Value Measurement*, NYISO utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. Fair value is determined based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between the observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 inputs: Unadjusted quoted prices in active markets for identical assets or liabilities that NYISO has the ability to access at the measurement date.
- Level 2 inputs: Other than quoted prices included within Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3 inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for a situation in which there is little, if any, market activity for the asset or liability at the measurement date.



The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is available for that particular financial instrument.

NYISO's financial instruments consist primarily of cash and cash equivalents, restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued expenses, short-term debt, long-term debt and benefit plan assets. The carrying value of long-term debt approximates fair value. The fair value of derivative financial instruments and benefit plan assets are discussed in notes 7 and 8, respectively.

**(o) Pension and Other Postretirement Benefit Plans**

NYISO has a defined benefit pension plan covering certain of its employees. The benefits are based on years of service and employee's compensation during the five years before retirement. NYISO also sponsors a defined benefit medical plan for retired employees and their dependents. NYISO records annual amounts relating to its pension and postretirement plans based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, turnover rates, and healthcare costs and trend rates. Assumptions are reviewed on an annual basis and modifications are made to the assumptions based on current rates and trends. The effect of modifications made to those assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

The net periodic costs are recognized as employees render the services necessary to earn the pension and postretirement benefits. Unamortized amounts that are expected to be recovered in rates in future years are recorded as a regulatory asset or liability. See note 8 for additional information.

**(p) Concentration of Credit Risk**

Financial instruments that subject NYISO to credit risk consist primarily of market settlement invoices and Rate Schedule 1 revenue due from market participants. As provided in the OATT and Services Tariff, NYISO reviews the creditworthiness of market participants, who are required to either maintain certain financial statement criteria and/or approved credit ratings, to post specified financial security in an amount sufficient to cover their outstanding liability to NYISO, or to prepay their obligations in advance of settlement billing dates.

NYISO's tariffs establish specific periods for the adjustment of settlement invoices and for market participant challenges to amounts billed for a particular service period. Settlement invoices can be adjusted for up to four months after the date of the monthly invoice issuance, and these invoices can be challenged for an additional one month after the issuance of all settlement adjustment invoices. Subsequent invoices issued during the settlement adjustment period "true up" amounts previously billed. After all true-up invoices are issued during the settlement adjustment period, market participants may challenge the amounts billed for a particular service period. If NYISO agrees with the provisions of the challenge, a final invoice is issued for that service period. As a result, NYISO is exposed to credit risk until all settlement adjustment and final invoices for each service period are finalized and liquidated. As of December 31, 2012, the adjustments and true-ups of all settlement invoices through March 2012 were completed. However, in the event of a market participant default and bad debt loss, Rate Schedule 1 of the OATT allows NYISO to recover bad debt losses from all remaining market participants on future invoices.

**(q) Derivative Financial Instruments**

NYISO records derivative financial instruments in accordance with ASC Topic 815, *Derivatives and Hedging.* ASC Topic 815 requires that all derivative financial instruments be recognized as either assets or liabilities, measured at fair value. The accounting for changes in fair value of derivatives (i.e., gains and losses) depends on the intended use of the derivative and the corresponding designation. The fair values of NYISO's derivative instruments are quoted by external sources. The changes in the fair value of these derivatives are recorded as a change in fair value of interest rate swaps in the Statement of Activities. Due to NYISO's regulated rates, the offset to the changes in fair value of these derivatives is recorded as either Other Current Assets or Other Noncurrent Assets.

NYISO uses derivative instruments primarily to hedge the cash flow effects of fluctuations in its interest rate costs. NYISO is exposed to credit loss in the event of nonperformance by the commercial banks under the interest rate swap agreements. However, NYISO does not anticipate nonperformance by the commercial banks. See note 7 for additional information.

(2) **Accounts Receivable**

NYISO's accounts receivable at December 31, 2012 and 2011, consisted of the following:

| | | 2012 | 2011 |
|---|---|---|---|
| Billed: | | | |
| Past due settlement invoices | $ | 997,376 | 998,673 |
| Grants billed receivables | | 889,486 | 28,036 |
| Miscellaneous billed receivables | | 290,846 | 405,425 |
| Reserve for doubtful accounts – past due settlement invoices | | (996,466) | (996,979) |
| | | 1,181,242 | 435,155 |
| Unbilled: | | | |
| Rate Schedule 1 revenue for December | | 4,128,477 | 2,989,782 |
| Grants unbilled receivables | | 1,283,112 | 813,644 |
| Miscellaneous unbilled receivables | | 274,472 | 821,230 |
| Replenishments of working capital reserve | | 306 | 306 |
| Bad debt losses recoverable from market participants | | — | 513 |
| | | 5,686,367 | 4,625,475 |
| Total | $ | 6,867,609 | 5,060,630 |

Rate Schedule 1 of the OATT allows NYISO to recover bad debt losses from market participants and provides guidance on the provisions of such recoveries. NYlSO's reserve for doubtful accounts at December 31, 2012 and 2011, results primarily from past due settlement invoices related to a subsidiary of Enron Corporation. As of December 31, 2012 and 2011, NYISO recorded unbilled receivables of $0 and $513, respectively, to reflect amounts yet to be recovered from remaining market participants in connection with other bad debt losses.

NYISO recovers its Rate Schedule 1 revenue in the invoice following the period of service. Therefore, a portion of unbilled Rate Schedule 1 revenues for December are billed and recovered in January of the subsequent year.



(3) **Regulatory Assets**

At December 31, 2012 and 2011, regulatory assets were comprised of the following:

| | | 2012 | 2011 |
|---|---|---|---|
| Pension and postretirement funding | $ | 13,301,346 | 12,872,388 |
| Funding for deferred charges | | 3,501,098 | 2,709,361 |
| Rate Schedule 1 transactional volume undercollections | | 1,999,522 | — |
| Total | | 18,801,966 | 15,581,749 |
| Less current portion | | (1,999,522) | — |
| Long-term portion | $ | 16,802,444 | 15,581,749 |

ASC Topic 715, *Compensation – Retirement Benefits*, requires an employer to recognize the overfunded or underfunded status of a defined pension benefit or postretirement plan (other than a multiemployer plan) as an asset or liability in its Statement of Financial Position and to recognize changes in the funded status in the year in which the changes occur. For NYISO, this recognition creates a deferred noncurrent regulatory asset or liability for accumulated actuarial losses or gains to be recognized in future periods.

NYISO recovers its costs through a surcharge assessed to market participants via Rate Schedule 1 of the OATT and Services Tariff. To the extent that transactional volumes billed under Rate Schedule 1 fall short of the amount expected when the Rate Schedule 1 surcharge is established, NYISO reflects a regulatory asset for the undercollection amounts.

## (4) Property and Equipment

As of December 31, 2012 and 2011, property and equipment consisted of the following:

| | | 2012 | 2011 |
|---|---|---|---|
| Software developed for internal use | $ | 115,485,965 | 116,582,122 |
| Computer hardware and software | | 54,816,807 | 67,062,892 |
| Building, building improvements, and leasehold improvements | | 52,828,737 | 34,734,833 |
| Work in progress | | 32,428,353 | 24,714,344 |
| Machinery and equipment | | 4,748,123 | 4,491,407 |
| Furniture and fixtures | | 3,054,652 | 3,429,648 |
| Land and land improvements | | 2,091,376 | 2,091,376 |
| | | 265,454,013 | 253,106,622 |
| Accumulated depreciation and amortization | | (163,743,602) | (173,405,167) |
| Property and equipment – net | $ | 101,710,411 | 79,701,455 |

Property and equipment includes interest of $330,375 and $53,028 capitalized during 2012 and 2011, respectively. Depreciation and amortization expense for the years ended December 31, 2012 and 2011 was $19,573,767 and $18,911,245, respectively.

Total capitalized labor as of December 31, 2012 and 2011 was $6,972,492 and $4,435,905, respectively.

## (5) Short-Term Debt

On July 21, 2010, NYISO entered into a $50.0 million Revolving Credit Facility that expires on December 31, 2013. The proceeds from this Revolving Credit Facility are to be used for working capital purposes. Interest on borrowings under the Revolving Credit Facility is based on NYISO's option of varying rates of interest tied to either the prime rate or the London Interbank Offered Rate (LIBOR). At December 31, 2012 and 2011, respectively, there were no amounts outstanding on the Revolving Credit Facility. During 2012 and 2011, $9.0 million and $8.5 million in borrowings were made under this credit agreement, respectively, at an interest rate of 1.85%.

## (6) Long-Term Debt

At December 31, 2012, the following amounts were outstanding on NYISO's long-term debt:

| | 2012 Infrastructure loan (v) | 2011 – 2013 Budget facility loan (ii) | 2007 – 2010 Budget facility loan (i) | Mortgage (iii) | Renovations (iii) | Total |
|---|---|---|---|---|---|---|
| Outstanding balance | $ 17,582,715 | 42,466,667 | 9,785,714 | 10,490,331 | 8,166,387 | 88,491,814 |
| Less current portion | — | (16,933,333) | (9,785,714) | (575,537) | (379,757) | (27,674,341) |
| Long-term portion | $ 17,582,715 | 25,533,334 | — | 9,914,794 | 7,786,630 | 60,817,473 |

At December 31, 2011, the following amounts were outstanding on NYISO's long-term debt:

| | 2011 Infrastructure loan (iv) | 2011 – 2013 Budget facility loan (ii) | 2007 – 2010 Budget facility loan (i) | Mortgage (iii) | Renovations (iii) | Total |
|---|---|---|---|---|---|---|
| Outstanding balance | $ 3,240,232 | 25,000,000 | 26,171,428 | 11,031,396 | 8,522,549 | 73,965,605 |
| Less current portion | — | (8,333,333) | (15,885,715) | (541,065) | (356,162) | (25,116,275) |
| Long-term portion | $ 3,240,232 | 16,666,667 | 10,285,713 | 10,490,331 | 8,166,387 | 48,849,330 |

(i) On January 22, 2007, NYISO entered into an unsecured $80.0 million line of credit facility (2007 – 2010 Budget Facility), the proceeds of which could be drawn until January 2011 to fund capital purchases and the development of significant projects during 2007 – 2010. NYISO was required to convert each year's annual borrowings to term loans, with principal and interest payments payable over three years. Interest on borrowings under this facility is based on NYISO's option of varying rates of interest tied to LIBOR plus 40 basis points for borrowings during the draw periods, LIBOR plus 65 basis points for borrowings converted to term loans, or the prime rate. Interest payments on borrowings are due monthly.

On January 23, 2007, NYISO entered into four interest rate swap agreements to fix interest payments on $60.0 million of the $80.0 million available on this line of credit facility. Under the swap agreements, NYISO will pay fixed interest rates ranging between 5.392% to 5.515% during the annual borrowing periods and 5.642% to 5.765% on the four annual term loan conversions. See additional information in note 7.



During 2007, $15.0 million was drawn on the 2007 – 2010 Budget Facility, which was converted to a term loan in January 2008 with monthly principal and interest payments payable from January 2008 through December 2010. At December 31, 2010, these borrowings were fully repaid. During 2008, an additional $16.7 million was drawn on the 2007 – 2010 Budget Facility, which was converted to a term loan in January 2009 with monthly principal and interest payments payable from January 2009 through December 2011. At December 31, 2011, these borrowings were fully repaid. During 2009, an additional $18.3 million was drawn on the 2007 – 2010 Budget Facility, which was converted to a term loan in February 2010 with monthly principal and interest payments payable from February 2010 through December 2012. At December 31, 2012, these borrowings were fully repaid. During 2010, an additional $23.0 million was drawn on the 2007 – 2010 Budget Facility and in January 2011, the remaining $7.0 million was drawn on the 2007 – 2010 Budget Facility. The $30.0 million in 2010 – 2011 borrowings was converted to a term loan in February 2011 with monthly principal and interest payments payable from February 2011 through December 2013. At December 31, 2012, the interest rate on $5.0 million was fixed at 5.765% and the remaining $4.8 million was at 0.860%. At December 31, 2011, the interest rate on $10.0 million was fixed at 5.765% and the remaining $10.6 million was at 0.920%.

(ii) On July 21, 2010, NYISO entered into an unsecured $75.0 million line of credit facility (2011 – 2013 Budget Facility), the proceeds of which may be drawn between January 1, 2011 through December 31, 2013 to fund capital purchases and the development of significant projects during 2011 – 2013. NYISO must convert each year's annual borrowings to term loans, with principal and interest payments payable over three years. Interest on borrowings under this facility is based on NYISO's option of varying rates of interest tied to LIBOR plus 175 basis points for borrowings, or the prime rate. Interest payments on borrowings are due monthly. During 2011, $25.0 million was drawn on the 2011 – 2013 Budget Facility, which was converted to a term loan in January 2012 with monthly principal and interest payments payable from January 2012 through December 2014. At December 31, 2012, the interest rate on $13.3 million was fixed at 3.280% and the remaining $3.4 million was at 1.960%. At December 31, 2011, the interest rate on $20.0 million was fixed at 3.280% and the remaining $5.0 million was at 2.043%. During 2012, an additional $25.8 million was drawn on the 2011 – 2013 Budget Facility, which was converted to a term loan in January 2013 with monthly principal and interest payments payable from January 2013 through December 2015. At December 31, 2012 the interest rate on $20.0 million was fixed at 4.080% and the remaining $5.8 million was at 1.960%.

On July 23, 2010, NYISO entered into three interest rate swap agreements to fix interest payments on $60.0 million of the $75.0 million available on the 2011 – 2013 Budget Facility. Under the swap agreements, NYISO will pay fixed interest rates ranging between 3.280% to 4.773%. See additional information in note 7.

(iii) On July 8, 2005, NYISO entered into two financing agreements to purchase and renovate a 140,000-square foot office building in Rensselaer, NY. The first agreement is a $14.7 million mortgage to finance the building purchase (Mortgage), and the second agreement represents a $10.0 million line of credit for renovations during an 18-month period, beginning in July 2005 (Renovations Loan). The Mortgage has principal and interest payments payable over 20 years, beginning September 2005. Principal and interest payments on borrowings made during the Renovations Loan draw period are payable over 20 years, beginning in January 2007. During 2005, $14.7 million was borrowed on the Mortgage, and during 2006, $10.0 million was drawn on the Renovations Loan. Both agreements are secured by liens on the building and subsequent capitalized renovations. Interest on borrowings under both facilities is due monthly and is based on varying rates of interest tied to LIBOR plus 100 basis points. On February 15, 2005, NYISO entered into an interest rate swap agreement on the Mortgage, which fixed the interest rate on this loan at 5.790%. On February 15, 2005, NYISO also entered into an interest rate swap agreement on the Renovations Loan, which fixed the interest rate on these borrowings at 5.960%, beginning on January 1, 2007.

(iv) On July 8, 2011, NYISO entered into a financing agreement (2011 Infrastructure Loan) to renovate its facility in Guilderland, NY and to perform construction at its facility in Rensselaer, NY. The agreement permits borrowings of up to $45.0 million through July 7, 2014. The NYISO is required to make interest only payments through July 7, 2014, followed by 17 years of principal and interest payments on borrowings made during the 2011 Infrastructure Loan draw period, beginning in July 2014. Interest on borrowings under the 2011 Infrastructure Loan is due monthly and is based on varying rates of interest tied to LIBOR plus 325 basis points. The 2011 Infrastructure Loan is secured by a limited mortgage lien of $8.0 million on the NYISO's Guilderland facility. At December 31, 2011, there was $3.2 million outstanding on the 2011 Infrastructure Loan. On July 18, 2012, the 2011 Infrastructure Loan was paid off, terminated and replaced with a new unsecured financing agreement (2012 Infrastructure Loan).

(v) On July 18, 2012, NYISO entered into the 2012 Infrastructure Loan to renovate its facilities in Guilderland, NY and to perform construction at its facility in Rensselaer, NY. The agreement permits borrowings of up to $45.0 million through July 18, 2014. The NYISO is required to make interest only payments for up to 24 months, followed by 17 years of principal and interest payments. Interest on borrowings under the 2012 Infrastructure Loan is due monthly and is based on varying rates of interest tied to LIBOR plus 225 basis points. At December 31, 2012, the interest rate on $16.4 million was fixed at 4.149% and the remaining $1.2 million was at 2.460%.

On July 18, 2012, NYISO entered into an interest rate swap agreement to fix interest on $40.0 million of the $45.0 million available under the 2012 Infrastructure Loan. Under this swap agreement, NYISO will pay a fixed interest rate of 4.149%. See additional information in note 7.

At December 31, 2012, scheduled maturities of NYISO's long-term debt were as follows:

| | 2012 Infrastructure loan | 2011 – 2013 Budget facility loan | 2007 – 2010 Budget facility loan | Mortgage | Renovations | Total |
|---|---|---|---|---|---|---|
| 2013 | $ — | 16,933,333 | 9,785,714 | 575,537 | 379,757 | 27,674,341 |
| 2014 | 517,140 | 16,933,334 | — | 610,246 | 403,352 | 18,464,072 |
| 2015 | 1,034,280 | 8,600,000 | — | 647,050 | 428,412 | 10,709,742 |
| 2016 | 1,034,280 | — | — | 684,637 | 453,836 | 2,172,753 |
| 2017 | 1,034,280 | — | — | 727,364 | 483,225 | 2,244,869 |
| Thereafter | 13,962,735 | — | — | 7,245,497 | 6,017,805 | 27,226,037 |
| Total | $ 17,582,715 | 42,466,667 | 9,785,714 | 10,490,331 | 8,166,387 | 88,491,814 |

## (7) Derivatives and Hedging Activities

NYISO's derivative instruments are cash flow hedges used to hedge interest rate costs. The changes in the fair value of these derivatives are recorded in the Statements of Activities as a change in fair value of interest rate swaps. Due to NYISO's regulated rates, the offset to the changes in fair value of these derivatives is offset to Other Noncurrent Assets and Other Noncurrent Liabilities.

In February 2005, NYISO entered into two interest rate swap agreements with a commercial bank to fix interest rate payments on the financing of a new office building purchase. The notional amount of debt on the swap agreement for the Mortgage was $14,708,750, and NYISO pays a fixed interest rate of 5.79% on the outstanding principal amount of this financing on payments from August 2005 through August 2025. The notional amount of debt on the swap agreement for the Renovations Loan was $10,000,000, and NYISO pays a fixed interest rate of 5.96% on payments from January 2007 through January 2027. As of December 31, 2012 and 2011, the fair value of these interest rate swap agreements was ($2,364,720) and ($2,390,695), respectively, for the Mortgage and ($2,066,010) and ($2,088,765), respectively, for the Renovations Loan, recorded in Other Noncurrent Liabilities. For the years ended December 31, 2012 and 2011, NYISO recorded interest income of $48,730 and interest expense of $1,823,418, respectively, related to these two swap agreements.



In January 2007, NYISO entered into four interest rate swap agreements with a commercial bank to fix interest rate payments on the 2007 – 2010 Budget Facility. The notional amount of debt on the swap agreements was $60,000,000. NYISO pays fixed interest rates ranging between 5.392% to 5.515% during the annual borrowing periods and 5.642% to 5.765% on the four annual term loan conversions from January 2008 through December 2013. As of December 31, 2012 and 2011, the fair value of these interest rate swap agreements was ($112,925) and ($555,030), respectively, recorded in Other Noncurrent Liabilities. For the years ended December 31, 2012 and 2011, NYISO recorded interest income of $442,105 and $957,745, respectively, related to these four swap agreements.

In July 2010, NYISO entered into three interest rate swap agreements with a commercial bank to fix interest rate payments on the 2011 – 2013 Budget Facility. The notional amount of debt on the swap agreements was $60,000,000. NYISO pays fixed interest rates ranging between 3.280% to 4.7725% through December 2016. As of December 31, 2012 and 2011, the fair value of these interest rate swap agreements was ($1,709,487) and ($1,471,527), respectively, recorded in Other Noncurrent Liabilities. For the years ended December 31, 2012 and 2011, NYISO recorded interest expense of $237,960 and of $1,517,626, respectively, related to these three swap agreements.

In July 2012, NYISO entered into a interest rate swap agreement with a commercial bank to fix interest rate payments on the 2012 Infrastructure Loan. The notional amount of debt on the swap agreements was $40,000,000. NYISO pays a fixed interest rate of 4.149% through July 2031. As of December 31, 2012, the fair value of this interest rate swap agreement was $169,429, recorded in Other Noncurrent Assets. For the year ended December 31, 2012, NYISO recorded interest income of $169,429, related to this swap agreement.

| | Notional amount at inception | Notional amount at December 31, 2012 | Fair value at December 31, 2011 | Fair value at December 31, 2012 | 2012 Gain (loss) on market value |
|---|---|---|---|---|---|
| Loan: | | | | | |
| 2007 – 2010 Budget Facility | $ 60,000,000 | 5,000,000 | (555,030) | (112,925) | 442,105 |
| 2011 – 2013 Budget Facility | 60,000,000 | 37,333,328 | (1,471,527) | (1,709,487) | (237,960) |
| 2012 Infrastructure Loan | 40,000,000 | 16,359,277 | — | 169,429 | 169,429 |
| Mortgage | 14,708,750 | 10,490,331 | (2,390,695) | (2,364,720) | 25,975 |
| Renovations | 10,000,000 | 8,166,387 | (2,088,765) | (2,066,010) | 22,755 |

The fair value of NYISO's interest rate swaps are determined using pricing models developed based on the LIBOR swap rate and other observable market data (Level 2 inputs).

Interest rate swaps are included in Other Noncurrent Assets and Other Noncurrent Liabilities. The following table presents the carrying amounts and estimated fair values of NYISO's financial instruments at December 31, 2012 and 2011:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Financial assets: | | | | |
| Interest rate swaps | $ 169,429 | 169,429 | — | — |
| Financial liabilities: | | | | |
| Interest rate swaps | $ 6,253,142 | 6,253,142 | 6,506,017 | 6,506,017 |

## (8) Employee Benefit Plans

### (a) Defined Benefit Pension and Postretirement Plans

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 NYPP member companies. Employees become vested in pension benefits after three years of credited service. NYISO expects to contribute $0.8 million to the pension plan in 2013. Effective December 1, 2009, NYISO adopted changes to its pension plan to end the accrual of future benefits for most employees. Certain grandfathered employees will continue to accrue benefits until attaining age 55. NYISO replaced the defined benefit accruals with equivalent contributions to employee 401(k) plan accounts after December 1, 2009.

NYISO sponsors a defined benefit postretirement plan to provide medical and life insurance benefits for eligible retirees and their dependents. Substantially all employees who retire from NYISO become eligible for these benefits provided they have been credited with at least ten years of NYISO service (5 years of NYISO service for those employees hired before January 1, 2005). The benefits are contributory based upon years of service, with NYISO paying up to 50% of costs for retired employees and up to 25% for their dependents (subject to specified dollar limits). Medical coverage becomes secondary upon Medicare eligibility and life insurance coverage is reduced upon reaching age 65. Effective January 1, 2012, NYISO terminated the life insurance benefit of the postretirement plan.

Pursuant to resolutions adopted by NYISO's Board of Directors, NYISO's Retirement Board has been granted the authority to control and manage the operation and administration of NYISO's pension and postretirement plans, including responsibility for the investment of plan assets and the ability to appoint investment managers. The Retirement Board currently consists of NYISO's Chief Financial Officer, General Counsel, Vice President of Human Resources, and Controller. The Retirement Board provides reports to the Commerce and Compensation Committee of the Board of Directors on at least an annual basis.

The Company records the over-funded or under-funded position of a defined benefit pension and postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations, or gains/losses reported as recoverable under ASC Topic 980 and recorded as a regulatory asset.

For payment of benefits under the postretirement plan, as noted above, the NYISO established a Voluntary Employee Benefit Association (VEBA) trust in January 2010. The assets held in the VEBA trust reduce the accumulated postretirement benefit obligation as reported on the NYISO's Statements of Financial Position. The VEBA trust held assets of $4,248,809 and $3,921,198 as of December 31, 2012 and 2011, respectively. As noted in the table below, current obligations are assumed to be paid out of the trust assets, with the remaining unfunded obligation to be reflected as a noncurrent liability.

The schedules that follow show the benefit obligations, the plan assets, and the funded status as of December 31, 2012 and 2011, and the change in benefit obligations for NYlSO's pension and postretirement plans for the years ended December 31, 2012 and 2011.

| | Pension plan | | Postretirement plan | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Change in benefit obligation: | | | | |
| Benefit obligation – beginning of year | $ 30,869,721 | 28,300,166 | 8,401,151 | 7,092,538 |
| Service cost | 320,341 | 315,517 | 695,893 | 625,915 |
| Interest cost | 1,269,658 | 1,362,761 | 335,081 | 375,039 |
| Actuarial loss | 2,593,371 | 2,006,643 | (72,423) | 610,434 |
| Participant contributions | — | — | 121,315 | 133,998 |
| Benefits paid | (987,626) | (1,115,366) | (204,224) | (222,354) |
| Retiree life insurance elimination | — | — | — | (214,419) |
| Benefit obligation – end of year | 34,065,465 | 30,869,721 | 9,276,793 | 8,401,151 |
| Change in plan assets: | | | | |
| Fair value of plan assets – beginning of year | 26,167,287 | 25,362,899 | 3,921,198 | 4,048,651 |
| Actual return on plan assets | 2,978,390 | 462,895 | 451,696 | 1,143 |
| Employer contributions | 1,000,000 | 1,623,996 | — | — |
| Participant contributions | — | — | 121,315 | 133,998 |
| Benefits paid | (987,626) | (1,115,366) | (204,224) | (222,354) |
| Expenses paid | (124,514) | (167,137) | (41,176) | (40,240) |
| Fair value of plan assets – end of year | 29,033,537 | 26,167,287 | 4,248,809 | 3,921,198 |
| Funded status | $ (5,031,928) | (4,702,434) | (5,027,984) | (4,479,953) |

Amounts recognized in the 2012 and 2011 Statements of Financial Position consist of:

| | Pension plan | | Postretirement plan | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net actuarial loss/(gain) recognized in regulatory assets/(liabilities) | $ 11,773,587 | 11,100,923 | 1,527,759 | 1,771,465 |
| Projected benefit obligation | $ (34,065,465) | (30,869,721) | (9,276,793) | (8,401,151) |
| Fair value of assets | 29,033,537 | 26,167,287 | 4,248,809 | 3,921,198 |
| Unfunded projected benefit obligation | $ (5,031,928) | (4,702,434) | (5,027,984) | (4,479,953) |

Net periodic pension expense and other postretirement benefit costs include the following components:

| | Pension plan | | Postretirement plan | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Service cost | $ 320,341 | 315,517 | 695,893 | 625,915 |
| Interest cost | 1,269,658 | 1,362,761 | 335,081 | 375,039 |
| Expected return on plan assets | (1,639,307) | (1,888,833) | (245,081) | (304,838) |
| Amortization of unrecognized prior service cost | 32,460 | 51,424 | — | — |
| Amortization of unrecognized (gain)/loss | 673,678 | 399,036 | 5,844 | (71,868) |
| One-time credit for life insurance plan termination | — | — | — | (1,177,874) |
| Total | $ 656,830 | 239,905 | 791,737 | (553,626) |

NYISO uses a December 31 measurement date for its pension and postretirement benefit plans. NYISO's accumulated benefit obligation for the defined benefit pension plan is $33,695,371 and $30,372,218 at December 31, 2012 and 2011, respectively.

The following table as of December 31, 2012 and 2011, shows the assumptions used to calculate the pension and postretirement benefit obligations and net periodic costs:

| | Pension plan | | Postretirement plan | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Benefit obligations: | | | | |
| Discount rate | 3.60% | 4.30% | 4.00% | 4.55% |
| Rate of compensation increases | 3.00 | 3.00 | N/A | N/A |
| Net cost or credit: | | | | |
| Discount rate | 4.30% | 5.20% | 4.55% | 5.50% |
| Rate of compensation increases | 3.00 | 3.00 | N/A | 3.00 |
| Expected return on plan assets | 6.40 | 7.75 | N/A | N/A |

Effective January 1, 2012, the retiree life insurance benefit was eliminated, and therefore, the rate of compensation assumption was not applicable for benefit obligations.

NYISO's expected rate of return on plan assets reflects anticipated returns on the pension plan's current and future assets. To determine this rate, NYISO considers historical returns for equity and debt securities, as well as current capital market conditions and projected future conditions. The long-term investment objective for NYISO's pension plan is to maximize the total return on plan assets while limiting risk, reflected in volatility of returns, to prudent levels. To that end, NYISO's Retirement Board has appointed and regularly meets with an investment advisor to review asset performance, compliance with target asset allocation guidelines, and appropriate levels of asset diversification. NYISO's investment advisor operates under written guidelines provided by NYISO, which cover such areas as investment objectives, performance measurement, permissible investments, investment restrictions, and communication and reporting requirements. During 2011, the NYISO Retirement Board began a transition towards a revised investment strategy for pension plan investments to minimize the volatility in plan investments while balancing the long-term plan returns. The transition to the revised investment strategy was completed during 2012.

NYISO's pension and postretirement plan investments are composed of common stocks, mutual funds and commingled trust funds that are redeemable at net asset value (NAV) on a daily basis. Redemption of such investments generally requires 1 to 2 days written prior notice prior to the redemption date.

The targeted allocation and actual investment mix of the pension plan's assets are as follows December 31:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| **Asset category** | **Target** | **Actual** | **Target** | **Actual** |
| Fixed income | 70% | 70% | 49% | 47% |
| International and emerging equities | 15 | 16 | 21 | 21 |
| Large cap equities | 8 | 8 | 17 | 18 |
| Mid cap equities | 5 | 4 | 8 | 9 |
| Small cap equities | 2 | 2 | 5 | 5 |
| Total | 100% | 100% | 100% | 100% |



The targeted allocation and actual investment mix of the VEBA Trust (postretirement) plan's assets are as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| **Asset category** | **Target** | **Actual** | **Target** | **Actual** |
| Domestic equities | 50% | 52% | 50% | 52% |
| Fixed income | 35 | 33 | 35 | 35 |
| International and emerging equities | 15% | 15 | 15 | 13 |
| Total | 100% | 100% | 100% | 100% |

The actual rate of return for the pension plan's assets as of December 31, 2012 and 2011 as:

| Asset category | Annual returns December 31 2012 | 2011 |
|---|---|---|
| International and emerging equities | 18.4% | (3.5)% |
| Large cap equities | 16.0 | 0.6 |
| Small cap equities | 12.9 | 2.8 |
| Mid cap equities | 12.7 | 0.1 |
| Fixed income | 6.5 | 6.3 |
| Total portfolio weighted average | 11.4% | 2.3% |

The actual rate of return for the VEBA Trust (postretirement) plan's assets as of December 31, 2012 and 2011 as:

| Asset category | Annual returns December 31 2012 | 2011 |
|---|---|---|
| International and emerging equities | 21.7% | (14.2)% |
| Domestic equities | 11.6 | (2.0) |
| Fixed income | 4.3 | 6.9 |
| Total portfolio weighted average | 10.5% | (1.0)% |

The fair values of the pension plan assets at December 31, 2012 and 2011 are presented below:

| | 2012 Fair value | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Domestic investments: | | | | |
| Equities: | | | | |
| Small cap | $ — | 724,253 | — | 724,253 |
| Mid cap | — | 1,285,626 | — | 1,285,626 |
| Large cap | — | 2,268,268 | — | 2,268,268 |
| Total | — | 4,278,147 | — | 4,278,147 |
| Fixed income | 5,908,661 | 14,269,300 | — | 20,177,961 |
| Total | 5,908,661 | 14,269,300 | — | 20,177,961 |
| International and emerging equities | 4,484,788 | — | — | 4,484,788 |
| Total | 4,484,788 | — | — | 4,484,788 |
| Cash and cash equivalents | 92,641 | — | — | 92,641 |
| | $ 10,486,090 | 18,547,447 | — | 29,033,537 |

| | 2011 | | | |
|---|---|---|---|---|
| | Fair value | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Domestic investments: | | | | |
| Equities: | | | | |
| Small cap | $ — | 1,443,198 | — | 1,443,198 |
| Mid cap | — | 2,226,309 | — | 2,226,309 |
| Large cap | — | 4,802,763 | — | 4,802,763 |
| Total | — | 8,472,270 | — | 8,472,270 |
| Fixed income | 1,439,894 | 10,726,717 | — | 12,166,611 |
| Total | 1,439,894 | 10,726,717 | — | 12,166,611 |
| International and emerging equities | 5,396,052 | — | — | 5,396,052 |
| Total | 5,396,052 | — | — | 5,396,052 |
| Cash and cash equivalents | 132,354 | — | — | 132,354 |
| | $ 6,968,300 | 19,198,987 | — | 26,167,287 |

The fair values of the postretirement plan assets at December 31, 2012 and 2011 are presented below:

| | 2012 | | | |
|---|---|---|---|---|
| | Fair value | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Domestic equities | $ 2,060,126 | — | — | 2,060,126 |
| Total | 2,060,126 | — | — | 2,060,126 |
| Fixed income: | | | | |
| Fixed income securities | 587,995 | — | — | 587,995 |
| U.S. government obligations | 447,251 | — | — | 447,251 |
| Mortgage backed securities | — | 222,227 | — | 222,227 |
| Corporate debt securities | — | 95,221 | — | 95,221 |
| Total | 1,035,246 | 317,448 | — | 1,352,694 |
| International and emerging equities | 725,035 | — | — | 725,035 |
| Total | 725,035 | — | — | 725,035 |
| Cash and cash equivalents | 110,954 | — | — | 110,954 |
| | $ 3,931,361 | 317,448 | — | 4,248,809 |

| | | 2011 | | | |
|---|---|---|---|---|---|
| | | Fair value | | | |
| | | Level 1 | Level 2 | Level 3 | Total |
| Domestic equities | $ | 1,929,972 | — | — | 1,929,972 |
| Total | | 1,929,972 | — | — | 1,929,972 |
| Fixed income: | | | | | |
| Fixed income securities | | 536,946 | — | — | 536,946 |
| U.S. government obligations | | 286,935 | — | — | 286,935 |
| Mortgage backed securities | | — | 328,154 | — | 328,154 |
| Corporate debt securities | | — | 93,605 | — | 93,605 |
| Total | | 823,881 | 421,759 | — | 1,245,640 |
| International and emerging equities | | 558,375 | — | — | 558,375 |
| Total | | 558,375 | — | — | 558,375 |
| Cash and cash equivalents | | 187,211 | — | — | 187,211 |
| | $ | 3,499,439 | 421,759 | — | 3,921,198 |

The assumed health care cost trend rates for the postretirement plan are 8.75% for 2013 decreasing to 5.0% in 2021, and 8.0% for 2011 decreasing to 4.75% in 2019. A one-percentage point change in the assumed health care cost trend rate would change the 2012 postretirement benefit obligation as follows:

| | | 1% increase | 1% decrease |
|---|---|---|---|
| Effect on postretirement benefit obligation | $ | 645,300 | (566,200) |
| Effect on total of service and interest cost components | | 100,900 | (86,200) |

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

| | | Pension plan | Postretirement plan |
|---|---|---|---|
| 2013 | $ | 2,729,923 | 249,499 |
| 2014 | | 2,700,839 | 312,223 |
| 2015 | | 2,911,494 | 367,832 |
| 2016 | | 2,717,949 | 420,984 |
| 2017 | | 2,371,078 | 497,453 |
| 2018 – 2022 | | 10,530,074 | 3,468,188 |

**(b) 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. Beginning December 1, 2009, NYISO also contributes funds to employee 401(k) plan accounts equivalent to defined benefit accruals formerly earned in the pension plan.

Employees are immediately vested in NYISO's matching contributions and become vested in other employer contributions after three years of credited service. The total NYISO contributions to the 401(k) plan were $4,729,255 and $4,306,383 for 2012 and 2011, respectively.

**(c) Long-Term Incentive Plan**

NYISO's Long-Term Incentive Plan provides certain members of senior management with deferred compensation benefits. Benefits are based upon the achievement of three-year performance goals established by the Board of Directors, with participants becoming fully vested and distributions payable for these deferred amounts after the completion of the audited financial statements for the third year. Beginning with the long-term incentive cycle for the period January 1, 2010 through December 31, 2012, benefits will be paid in equal installments over three years following the completion of the three – year cycle. Accrued Long-Term Incentive Plan benefits included in Other Noncurrent Liabilities at December 31, 2012 and 2011, were $3,008,179 and $2,028,543, respectively. The short-term portion of such liability, included in Other Current Liabilities, at December 31, 2012 and 2011, was $1,692,871 and $0, respectively.

**(9) Lease and Other Commitments**

**(a) Operating Leases**

During 2008, NYISO entered into obligations under two operating lease agreements for the use of computer hardware. Expenses related to these leases totaled $0 and $2,946,450 in 2012 and 2011, respectively. The NYISO has no remaining obligation with respect to these leases.

**(b) Other Commitments**

On July 8, 2005, NYISO purchased an office building to relocate NYISO's alternate control center and to consolidate employees located in leased facilities. In connection with the purchase, management entered into a Payment in Lieu of Taxes (PILOT) Agreement with the Rensselaer County Industrial Development Agency (RCIDA) to achieve certain benefits. Per the terms of this agreement, NYISO is required to make annual payments of approximately $175,000 for the first 10 years. The agreement is cancelable at the discretion of NYISO.



**(10) Working Capital Reserve**

At December 31, 2012 and 2011, the working capital reserve consisted of:

| | | 2012 | 2011 |
|---|---|---|---|
| Market participant contributions through Rate Schedule 1 | $ | 33,000,000 | 33,000,000 |
| Interest on market participant contributions | | 14,603 | 25,562 |
| Total | $ | 33,014,603 | 33,025,562 |

## (11) Deferred Revenue

Deferred revenue at December 31, 2012 and 2011, consisted of the following:

| | | 2012 | 2011 |
|---|---|---|---|
| Advance payments received on planning studies | $ | 2,967,811 | 2,960,015 |
| Funds received for the enhancement of surveillance capabilities | | 966,914 | — |
| Governance participation fees | | 423,400 | 413,000 |
| Total | $ | 4,358,125 | 3,373,015 |

During 2012, NYISO received funds of $1.0 million from FERC for the purpose of enhancing NYISO's surveillance capabilities. As of December 31, 2012, $966,914 is recorded as deferred revenue.

## (12) Regulatory Liabilities

At December 31, 2012 and 2011, NYISO recorded the following amounts as regulatory liabilities:

| | | 2012 | 2011 |
|---|---|---|---|
| Funding for deferred charges | $ | 6,578,991 | 6,235,818 |
| Rate Schedule 1 underspending | | 681,649 | 1,761,641 |
| Voltage support service (reactive power) market | | 571,708 | 817,419 |
| Total | | 7,832,348 | 8,814,878 |
| Less current portion | | (1,253,357) | (2,579,060) |
| Long-term portion | $ | 6,578,991 | 6,235,818 |

NYISO recovers its revenues through a surcharge assessed to market participants via Rate Schedule 1 of the OATT and Services Tariff. To the extent that transactional volumes billed under Rate Schedule 1 exceed the amount expected when the Rate Schedule 1 surcharge is established, NYISO reflects a regulatory liability for the overcollection amounts. Additionally, to the extent that NYlSO's spending does not exceed the annual Rate Schedule 1 revenue requirement, a regulatory liability is also established for the underspending amounts.

In order to maintain acceptable transmission voltages on the New York State transmission system, certain market participants within the New York Control Area produce or absorb voltage support service (reactive power). Payments to market participants supplying voltage support service and recoveries from other market participants are assessed via Rate Schedule 2 of the OATT and Services Tariff. Differences between the timing of recoveries and payments for voltage support service that result in undercollections are reflected as regulatory assets or liabilities. At December 31, 2012 and 2011, respectively, NYISO recognized a regulatory liability of $571,708 and $817,419, related to such timing differences.

## (13) 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.

**(14) Smart Grid Investment Grant**

On October 27, 2009, the U.S. Department of Energy (DOE) announced that New York State will receive $37.8 million (the SGIG Award) in federal stimulus funding to deploy advanced metering, new customer service enhancements and grid automation. As the prime recipient of New York's smart grid stimulus application, NYISO is responsible for administering the overall project on behalf of itself and the New York State transmission owners (NYTOs). NYISO is eligible to receive reimbursement of $15.0 million and the NYTOs are eligible to receive reimbursement of $22.8 million from DOE, which is 50% of the total project costs. The NYISO's agreement with DOE was executed on May 5, 2010 and the project commenced on July 1, 2010 and is scheduled to end on June 30, 2013. NYISO has a separate agreement with the NYTOs which specifies the portion of the total SGIG Award for which each party is eligible. Consistent with the requirements of the DOE agreement, in order to receive its respective portion of the SGIG Award, each party must expend a matching amount. Under the NYISO agreement with the NYTOs, NYISO's obligation to reimburse the NYTOs is only for the amount the NYISO receives from DOE in respect of the NYTOs request for reimbursement. NYISO and the NYTOs' are eligible to receive reimbursement for expenditures incurred from August 6, 2009.

As of December 31, 2012 and 2011, $15.3 million and $3.7 million, respectively, is recognized in NYISO's Statements of Activities in Grant revenue, which represents 50% reimbursement from DOE of NYISO's and the NYTO's incurred allowable cost during these respective years. Recorded in NYISO's Statements of Activities is the NYTO's 50% share of incurred allowable costs, as of December 31, 2012 and 2011, $10.1 million and $0.6 million, respectively, is classified as Grant expenses – New York Transmission Owners. As of December 31, 2012 and 2011, $1.3 million and $0.8 million, respectively, is recorded in NYISO's Statements of Financial Position included as Accounts receivable – net.

**(15) Eastern Interconnection Planning Collaborative Grant**

On December 18, 2009, the DOE announced that the Eastern Interconnection Planning Collaborative (EIPC) would receive $16.0 million (the EIPC Award) in federal stimulus funding to promote collaborative long-term analysis and planning for the Eastern electricity interconnection, which will help states, utilities, grid operators, and others prepare for future growth in energy demand, renewable energy sources, and Smart Grid technologies. As the prime recipient of the EIPC Award, PJM Interconnection, L.L.C. (PJM), is responsible for administering the overall project on behalf of itself and seven other "Participating Principal Investigators," including the NYISO. The agreement with DOE for the EIPC Award was executed on July 19, 2010 and the project obligations became effective on July 16, 2010. NYISO has a separate agreement with PJM and the other Participating Principal Investigators (the EIPC Agreement) which specifies the parties' obligations under the EIPC Award. Consistent with the requirements of the DOE agreement, NYISO is eligible to receive reimbursement of $0.9 million from DOE for expenditures incurred from March 1, 2010. Under the PJM agreement with the Participating Principal Investigators, PJM's obligation to reimburse the NYISO is only for the amount that PJM receives from DOE in respect of NYISO's request for reimbursement.

For both the years ended December 31, 2012 and 2011, NYISO recognized $0.2 million in NYISO's Statements of Activities as Grant revenue.

**(16) Subsequent Events**

NYISO considers events and transactions that occur after the balance sheet date, but before the financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These financial statements were available to be issued on March 15, 2013 and subsequent events have been evaluated through that date.