

A glowing lightbulb is centered in the frame against a dark background. The bulb is illuminated from above, creating a bright highlight on its top surface and a soft glow. On the side of the bulb, there is a circular stamp. The stamp contains the text "NEW YORK INDEPENDENT SYSTEM OPERATOR, INC." around the perimeter, "ANNUAL REPORT" in the center, and "2001" in a large font in the middle.

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC. • ANNUAL REPORT 2001

**New York Independent System Operator, Inc.  
2001 Annual Report**

**Electric industry deregulation is working in New York State.**





*Electric industry deregulation is working in New York State. In fact, the Independent Market Advisor reported that “the transition to competitive electric markets has been remarkably smooth given the unprecedented scope of this effort.”*

*We are proud of the NYISO’s accomplishments in 2001 as operator of one of the largest wholesale power markets in the country. We have succeeded in developing open, fair and competitive energy markets involving many participants – transmission operators, private and public power producers, power marketers, and retail energy companies.*

*For 2001 and beyond, our objectives include supporting development of critically needed electric generation capacity in New York State; implementation of additional demand reduction programs; improved interregional coordination and cooperation; and continued improvement in the NYISO’s operational efficiency.*

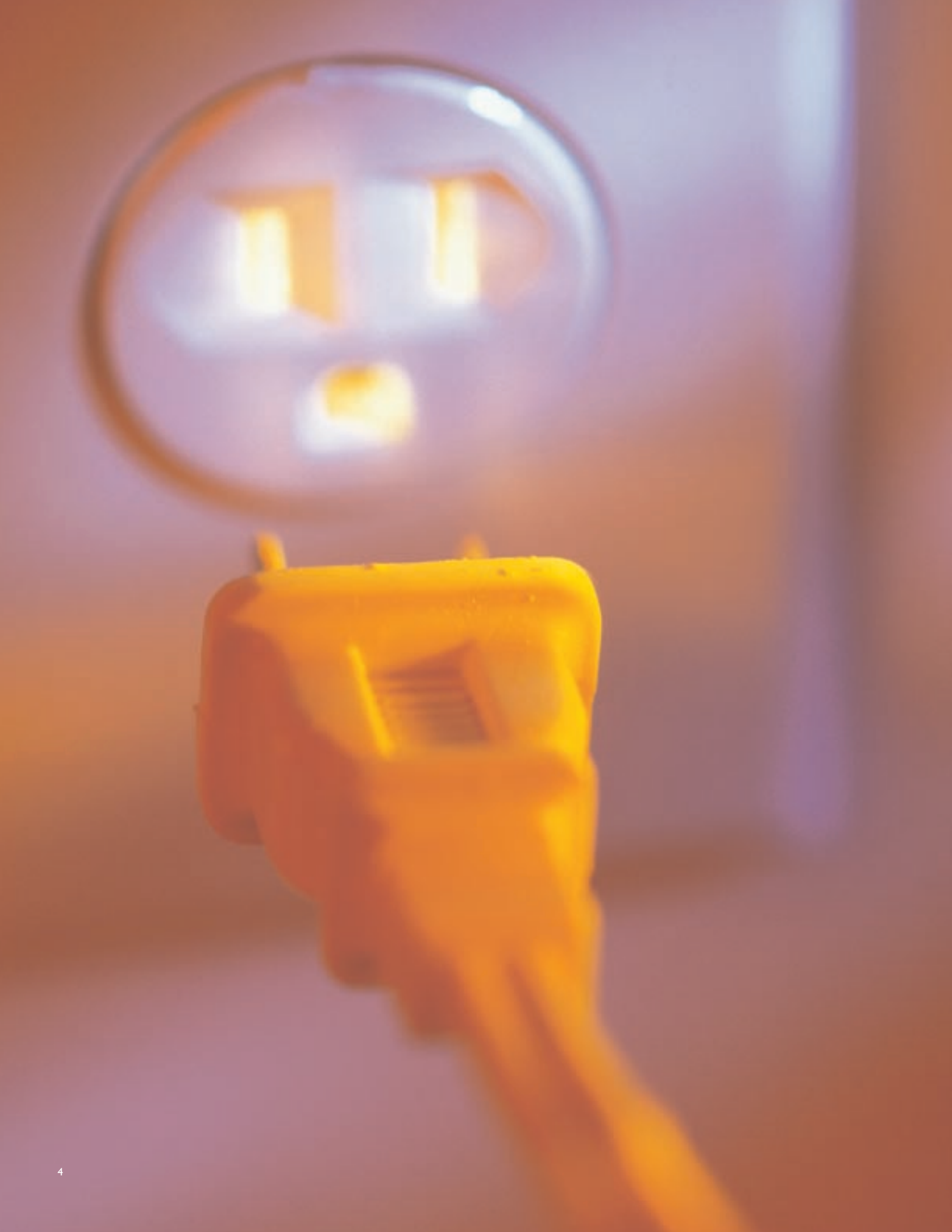
*We steadfastly believe that competitive market forces will achieve environmental objectives while providing adequate, affordable, and reliable supplies of electrical energy now and in the future.*

A handwritten signature in black ink, appearing to read "Richard J. Grossi".

*Richard J. Grossi,  
Chairman of the Board*

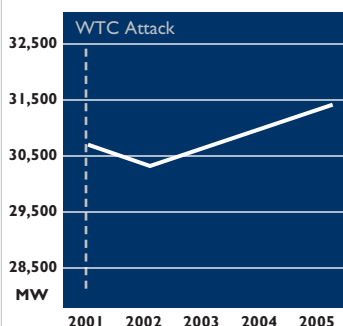
A handwritten signature in black ink, appearing to read "W. J. Museler".

*William J. Museler,  
President and CEO*



## The NYISO exists to ensure the reliable, safe, and efficient operation of New York's high voltage transmission system and to administer open, competitive, and nondiscriminatory wholesale electric markets in New York State

In April 1996, the Federal Energy Regulatory Commission (FERC) issued regulations to create competition in the nation's wholesale electricity markets. These regulations required investor owned utilities to allow open access to the electric transmission system. The need for an entity to facilitate such access brought forth the concept of an Independent System Operator (ISO). As envisioned, an ISO would manage the transmission network to allow open and equal access to electricity sellers and buyers. Federal regulations did not require an ISO, but there was general ac-



**Demand for electricity is projected to increase by 1,000 megawatts over the next three years**

ceptance of the need for some entity to be an independent, unbiased system coordinator. Now, regional ISOs manage a majority of the country's electric supplies.

The New York Independent System Operator, Inc. – a New York not-for-profit corporation (NYISO) – operates the transmission system formerly managed by a consortium of electric utilities (the New York Power Pool) and it balances electricity supply with demand. To do this, the NYISO created an open market, like a commodity or stock exchange, where suppliers and

distributors (who deliver electricity to end users) buy and sell the power needed by residents, businesses and industrial organizations.

The price paid by distributors is unregulated and determined either through long-term contracts (bilateral agreements) or through wholesale markets overseen by the NYISO. Distribution companies contract with suppliers for about half of the electricity they will distribute. The remainder is purchased through the NYISO's competitive markets, either

on a "Day-Ahead" or "Real-Time" basis.

In the Day Ahead Market, load-serving companies (for example, distribution companies) inform the NYISO of their anticipated electricity needs for the following day. Suppliers submit bids for energy they can supply. The NYISO accepts the lowest bid supplies to meet demand, setting a "market-clearing price."

In the Real Time Market, load-serving companies buy the electricity they need to

meet immediate demands. The NYISO provides the facilities and rules for trading, but does not set or regulate prices. Instead, the NYISO ensures the market functions efficiently by accepting bids that supply electricity for the lowest cost. All NYISO activities are funded by a charge on electrical transmission and wholesale market activities.

In New York, energy distributors have been able to enter into long-term contracts with generators, assuring a relatively stable price for power.

*As wholesale electricity markets evolve, they are increasingly afforded the type of attention previously reserved for financial and other commodities markets. Below, NYISO President William Museler is interviewed in the NASDAQ studios about the state of New York's electricity markets.*





*One of the major industry stories during 2001 was whether New York would experience the kind of crisis that was devastating California. After a summer during which New York set three consecutive electricity consumption records, while successfully keeping the lights on, the answer came back a resounding "No." New York's markets were functioning largely as they had been designed.*

In California, when prices on the open market doubled or tripled because of short supply and excess demand, the government stepped in – holding consumer prices steady on the theory that losses would be recouped over a long period of time. Unfortunately, by freezing prices, the government removed cost incentives for

consumers to reduce demand. The government's actions also decreased incentives for developers to build new sources of supply.

Although New York's electricity market differs from California's, where sharp price increases and major service disruptions made national headlines, the Califor-

nia experience nevertheless provides warning to New York. The disparity between electricity demand and supply in New York must be resolved. Failure to correct this imbalance will result in environmental and economic degradation, a decrease in the reliability of the State's electric infrastructure, and higher prices.

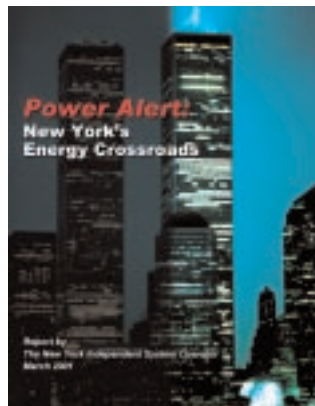




## More power plants promise to improve air quality, lower prices and ensure reliability

The NYISO prepared the report, *Power Alert: New York's Energy Crossroads*, in March 2001 to point out that New York faces a growing gap between demand for electricity and in-state supply. Between 1995 and 2000, demand for electricity rose by more than twice the rate of increased supply. Moreover, demand for electricity is expected to increase at an annual rate of 1.2 to 1.4 percent.

As demand increases, the cost of electric power on the open market increases sharply. In a market where demand is high, costs increase for many rea-



**One of NYISO's  
highest priorities  
is ensuring a  
sufficient level of  
electric capacity**

sons, including: the necessity to employ less cost-efficient generators to supply additional power; start-up costs associated with increased power production; and the opportunity for suppliers to earn wind-fall profits. Simply put, the most important determinant of the cost of a given kilowatt of electricity is the relationship between supply and demand. If available power supplies, including emergency reserves, meet market demands, the market functions effectively. Conversely, as demand approaches the total available supply, prices rise, sometimes significantly.

To address this situation, approximately 7,000 megawatts (MW) of new generating capacity must be developed during the next four-to-five years if New York is to avoid serious electricity shortages, improve air quality, stimulate economic growth, and avert strong upward pressure on prices. The NYISO's Independent Market Advisor, Dr. David Patton, predicted in his 2001 Annual Report on the

New York Electric Markets that "summer electricity prices are likely to rise by close to 50 percent over the next four years if new generation is not built." The impacts of not increasing New York State's generating resources are now clear: prices will rise, reliability will decline, and air quality will suffer.

The NYISO's Power Alert studies indicate that, if recom-

mended new generation programs are implemented, together with conservation measures and the development of markets for renewable energy, New Yorkers can be assured of reliable, affordable and environmentally responsible sources of power to fuel economic growth. Increased electricity production drives robust competition, essential for free markets to operate in the public interest. Scarcity of supply undermines free market principles upon which the deregulated electric industry system depends.

In fact, if recommended expansion and conservation measures are implemented, dramatic benefits can be achieved by 2005. These include:

- Wholesale prices could be reduced 20-25 percent.
- Savings could exceed \$1.4 billion annually.
- There would be 28 percent less sulfur dioxide and 43 percent less nitrogen oxides emitted in New York State, resulting in a reduction of 88,000 tons of sulfur dioxide and 45,000 tons of nitrogen oxides annually.

Modern natural gas-powered generation plants are much less detrimental to air and

*Once largely the domain of western states, alternative energy sources such as wind power are now playing an increasingly important role in helping New York meet its energy needs. The 20 General Electric wind turbines installed at CH2 Energy's Fenner Wind Project site (below) can generate enough electricity at peak to supply approximately 30,000 upstate New York homes. Because of the uncertainty of predicting when the wind will blow, the NYISO has developed special rules to accommodate scheduling "intermittent" resources such as wind power. With demand for renewable energy growing among consumers and businesses and better than adequate wind resources, the outlook for wind power in New York is excellent.*



water quality than older fossil fuel technologies now in use. In addition, new generating facilities will reduce the operation of older, uneconomic, less efficient generating stations that are more harmful to environmental conditions.

Before March 2001 no major electric power plant or expansion exceeding 80 MW was approved under the Article X permitting process. In the last year, the New York State Siting Board approved construction of six new power plants or repowerings, representing a combined 3,680 MW in added capacity. The New York Power Authority also added 440 MW of new combustion turbines in New York City and Long Island, and the Long Island Power Authority added 407 MW of new combustion turbines to Long Island. The approval figure is within the 4,000-5000 MW of additional capacity recommended by the NYISO. It should be noted, however, that Article X approvals do not automatically result in increased capacity. Unfortunately, only two projects of those recently approved (the Athens generating plant [shown on page 8], and Bethlehem steam station in Albany) are actually under construction. Other certified plants may not be built due to the changing investment

climate – due in large part to the “ripple effect” of the Enron collapse – which has made it difficult to finance new facilities.

The Torne Valley Station project in Rockland County was recently cancelled, and the Orion Astoria project in Queens, which had its application accepted and certification was pending, has been postponed because of conditions in the capital markets. Postponed and cancelled projects such as these are clear evidence of a growing and ominous trend throughout the Northeast. Lost momentum at a time when New York so critically needs new sources of electric supply could be devastating to the reliability of the State’s electric system and to the health of its economy.

The future of Article X is extremely important. Unless the State Legislature renews Article X by the end of 2002, the electric power plant siting law will sunset. This deadline raises several questions, including:

- Should Article X be renewed “as is” or revised?
- Should Article X be discarded in favor of the more basic State Environmental Quality Review Act process?

- Should a new regulatory scheme be developed to replace the Article X approach?

The NYISO believes that renewing Article X without radical changes is the short-term approach. Nevertheless, Article X can be improved:

- The timeframe for approval after applications have been determined to be complete should be shortened from 12 months to 6 months or less. Many states have adopted 6-month or shorter approval periods. New York must be competitive with surrounding states or it will suffer economically.
- The process for power plant developers building on acceptable “brownfields” (existing industrial use sites) should be further streamlined. In 2001, the State Legislature reduced the timeframe for power plant developers who demonstrated substantial reductions in emissions and water use. A similar timeframe should be provided for brownfield sites that are appropriate for power plants. Such a provision will provide greater incentive to redevelop “fallow” sites that have fallen from the tax rolls, and possibly expedite new development as well.

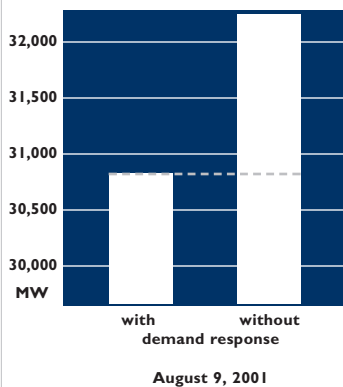


**Supply and demand must achieve a stable balance for the more than 7,000,000 residential and business customers who purchase electricity in New York State to enjoy reliable power at fair prices**

In addition to the need for increased electric supplies, reduced demand for power must be achieved. This is particularly important during times of peak use.

Demand response programs, which can reduce electric use for short periods of time, are important because they lessen the need to build costly generation facilities, help stabilize the price for electricity, improve the reliability of transmission systems, and increase public awareness of important energy policy issues.

To assure adequate power



**When demand was at its peak, the NYISO's demand response program saved 1,577 MW of electricity**

supplies and reasonable prices, the New York ISO established a wide-ranging demand response program. The impact of this program was dramatically illustrated in New York City in early August. During an unusually hot weather spell, the New York electricity grid set three new historical peak loads, culminating on August 9 with the highest electricity demand ever recorded – 30,983 MW.

The NYISO's demand response programs, combined with efforts by the Governor and the public, shaved over 1,500 megawatts off this peak

demand, helping New York avert a blackout.

The NYISO and New York's utilities implemented three demand response programs, each of which recognizes the necessity to compensate participating consumers, since costs to curtail energy consumption are real and without compensation major consumers are unlikely to respond to appeals for reduced consumption.

The Emergency Demand Re-

sponse Program (EDRP) provides incentives to consumers to cut power use when notified to do so during emergency conditions (an interruptible load). The Day-Ahead Demand Response Program (DADRP) allows certain customers to sell their reductions in consumption on the day-ahead market and be paid for actual reductions made on that day. The Special Case Resources Program (SCR) provides installed capacity payments to large consumers will-

ing to be curtailed during emergency conditions.

Under the Emergency Demand Response Program, when New York is faced with an impending power reserve deficiency, the NYISO contacts consumers who have been paid an agreed-to per-megawatt-hour (MWh) incentive to participate, directing them to curtail electric use. This program is open to large consumers which can function even if their service is interrupted, and to those

*Production Technicians Eddy Jeanty and Chuck Barone confer with Plant Manager Christian Lenci at Praxair's production facility in Niagara Falls. The facility's new computer control system was installed in May 2002 and funded in part by payments from the NYISO's Emergency Demand Response Program (EDRP). "During times of extremely high electricity demand, Praxair turns its plant off so other New Yorkers can keep their lights on," said Lenci. "The NYISO has developed one of the best demand-response programs in the country; Praxair is proud to help out when the NYISO needs it most."*



that have access to local emergency generation. As of August, there were nearly two dozen large consumers participating in this program, accounting for a total load reduction capability of 611 MW, of which 467 MW is interruptible.

The Day-Ahead Demand Response Program allows consumers or groups of consumers to bid what they would normally consume on a given day. If the offer is accepted on the open market, the consumer must reduce its electric use accordingly and be paid for whatever demand reduction was sold.

The Special Case Resources Program is directed at loads greater than 100 kW. These are loads capable of being interrupted upon demand. Participants may receive payments, but they are exempt from the bidding, scheduling and notification requirements. Contractually, participants must respond to NYISO day-ahead notification to interrupt power consumption. This notice is followed by an in-day, NYISO-issued two-hour notice when shortages exist.

The Emergency Demand Response Program is approved through October 2002 and



*As energy markets become more competitive, consumers are more aware of finite power resources, and the need to conserve. The Reuters Building, at 3 Times Square, is "smart, green, and ready," consuming 30 percent less energy than similar office buildings. Owner Rudin Management accomplished this by using more natural light, glazing external glass to deflect sunlight from entering the interior of the building, as well as state-of-the-art motors and fuel systems in the heating and ventilation network.*

the Day-Ahead Demand Response Program through October 2003. NYISO will continue to improve these demand reduction programs, as well as develop real-time pricing alternatives. With real-time pricing, consumers are able to monitor the cost of the electric power they are purchasing and using.

Consumers can then make immediate decisions to continue or curtail use based upon costs. To achieve real-time pricing involves development of a simple two-way meter for residences and small commercial facilities and price structures that reward consumers for using less electricity in times of highest demand.





## **New York has been a leader in ongoing regional coordination efforts**

ISO New England, Inc. (ISO-NE) and NYISO are part of the Northeast Power Coordinating Council (NPCC), the reliability organization for seven states in the northeast U.S. and parts of Canada. This area serves more than 33 million people and includes the cities of New York, Albany, Boston, Hartford, Providence, Buffalo, Syracuse, Rochester, Portland, Montpelier, Concord and Springfield.

As a culmination of extensive inter-regional coordination efforts throughout 2001, the NYISO and ISO-NE executed an agreement in January



**Electric demand  
in the Northeast  
totals 56,000  
megawatts**

2002 to develop a common electricity market for their combined regions. This agreement also includes the parties' agreement to jointly evaluate the feasibility of creating a Northeast Regional Transmission Organization (NERTO).

This agreement is an important milestone toward creating larger electricity markets that combine the best practices of current markets while providing increased benefits for energy consumers throughout the region.

This agreement also addresses the Federal Energy Regulatory



Commission's (FERC) objective of creating seamless inter-regional markets by reducing or eliminating barriers to scheduling energy transactions.

In September 2001, Administrative Law Judge H. Peter Young reported to the FERC on mediation efforts to form a Northeast regional transmission organization. Judge Young expressed particular support for the plan's emphasis on "Best Practices" and implementation of interim market improvements, both of which are elements strongly supported by the NYISO. Judge Young also declared support for the NYISO's recommendation for an independent technology assessment at the beginning of the integration process to determine the extent of software improvements needed to operate a larger system.

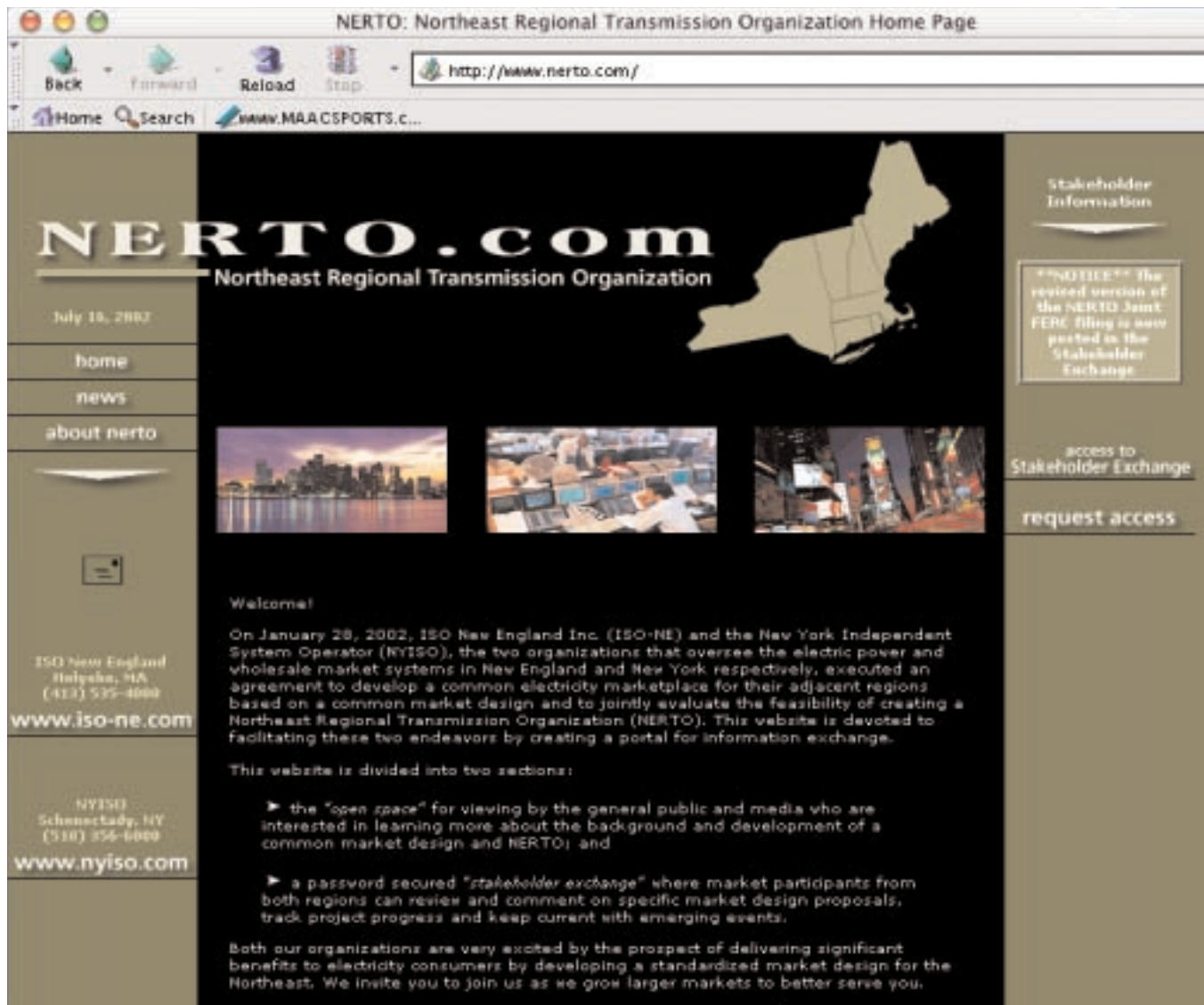
As part of its regional market integration strategy, NYISO entered into an Interregional Coordination and Issue Resolution Agreement with PJM Interconnection LLC, the ISO for Delaware, the District of Columbia, Maryland, New Jersey, Pennsylvania and northern Virginia, effective March 15, 2002. The goal of this agreement is to resolve seams issues, where a difference in rules between our respective

electric markets causes problems with interregional trading. Under this agreement, the NYISO and PJM will each designate an Interregional Coordination Officer who will be responsible for identifying market inefficiency issues and exploring opportunities

for improvements. Improved market efficiencies are among the most effective ways to deliver greater benefits to consumers.

In the months ahead, the NYISO will be working with its regional partners, state and

federal regulators, and market participants to develop regional objectives consistent with the NYISO's primary mission: providing safe, reliable and economic electricity through an efficient wholesale market for the people of New York State.



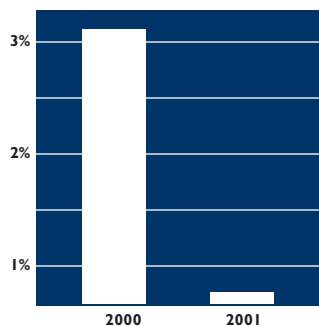
The Northeast Regional Transmission Organization represents a year's efforts to merge NYISO and ISO-NE operations into one seamless, efficient market in the Northeast. As the synthesis to one market proceeds, the NERTO Web site ([www.nerto.com](http://www.nerto.com)) serves as an important connection among market participants, government officials and the two ISOs. The site is a tangible starting point for knowledge and information-sharing as well as a symbol of the evolution of the nation's electric markets.



## The NYISO is committed to guaranteeing electric markets function efficiently and fairly for all New Yorkers

The complexities of electric industry deregulation mandate diligent management and administrative programs. Further improving operational efficiency is one of the NYISO's top priorities.

As reported by the Independent Market Advisor in his annual report (nyiso.com): "The New York electricity markets in 2001 were marked by considerable changes, including changes in market rules to correct certain flaws detected during the first year of operation, as well as substantial changes in external factors affecting the market...



**Real time price corrections in 2001 decreased approximately 90 percent from the previous year**

These changes led to lower overall energy prices and reduced congestion during 2001." The Advisor's report concluded that "the New York market has been workably competitive."

Among the management initiatives undertaken during the year was the completion in November of a cooperation agreement between the NYISO and Kansai Electric Power Company, Inc.

Kansai is Japan's second largest power provider. Its grid in western Japan serves a market equal to that of



*NYISO Board of Directors, standing: William J. Museler (CEO), Erland E. Kailbourne, Richard E. Schuler, John W. Boston, Alfred F. Boschulte. Seated: Karen Antion, Harold N. Scherer, Jr., Richard J. Grossi (Chairman), Thomas F. Ryan, Jr., Peter A. A. Berle.*

Sweden. In March, 2000, Japan's power industry began deregulating. Kansai responded by adopting what it calls "Total Solution Power," an effort to improve efficiency and expand into related fields including gas supply, cogeneration, telecommunications, security and the Internet.

The agreement between Kansai and the NYISO is designed to promote information sharing, including:

- Best practices learned in the transitioning to competitive environments.

- Determination of the root causes of electrical disturbances and other changes in electric grid dynamics.
- Identification of communication technologies and related customer interfaces best suited to competitive markets.
- Transmission options based on long-term supply and demand forecasts.

Both parties to this agreement believe that sharing best practices will facilitate the operation of safe and reliable electric systems and provide savings for all users.

Importantly, during the year, the NYISO put in place an Automated Mitigation Procedure (AMP) designed to protect consumers while balancing the economic needs of suppliers. This procedure is used when electricity markets experience very high loads, excessive generator outages or transmission constraints, and when prices rise above \$150/MWh. At such times, suppliers' bids in the Day-Ahead Market are automatically reviewed to determine if they exceed levels that would be expected in a competitive market (photo page 20). In instances when the AMP de-

termines that supply bids are noncompetitive, the bids are rejected and automatically adjusted to competitive Day-Ahead Market reference prices, in accordance with accepted formulations.

In June, the Federal Energy Regulatory Commission approved the NYISO's AMP software, the first of its kind in the nation. The success of New York's AMP system provides strong assurance that markets in the New York State are functioning efficiently and fairly.

In another effort to assure the electric markets are open and

fully competitive, the NYISO initiated "Virtual Trading" in November. Under Virtual Trading, credit-qualified companies may take positions in the Day-Ahead market by buying or selling "virtual" energy, then settle the positions by selling or buying covering amounts in the Real-Time market. The difference between the prices in the Day-Ahead and Real-Time markets dictates the gain or loss experienced by the company which is trading. Virtual bids are financial transactions only and have no effect on real-time energy consumption. Their purpose is to smooth price differences be-

tween markets as traders seek to arbitrage price differences. Virtual trading serves as a tool to hedge against risk, and as one mechanism among many to balance prices in the markets.

In September, the New York State Energy Research and Development Authority (NYSERDA) and the NYISO announced initiation of a study to examine the impact of increased demand for natural gas on the state's electric and natural gas infrastructure. Using a specially-designed modeling system, this study will assess the operation of the electric and



*NYISO senior staff, back row: Charles King, Andrew Ragona, John Adams, Carol Murphy, Robert Fernandez, Steven Sullivan. Front row: Robert Soeldner, Mary McGarvey, Michael Calimano, Ken Fell, Sandra Sanford, Belinda Thornton, William Museler.*





gas systems under a range of varying conditions.

Important factors to be considered in the study include:

- Whether adequate supplies of natural gas exist to meet current demands for heating and the growing demand for electricity.
- The impact on the petroleum supply if electric generating facilities use petroleum fuels.
- The capacity of the infrastructure to handle the increased flow of natural gas required by the proposed new power.
- The effect of increased natural gas consumption on the diversity of fuels used to generate power in a competitive electricity marketplace.

*The simple and moving Tribute of Lights cast twin beams into the night above the New York skyline in March, to commemorate the six-month anniversary of September 11. Consolidated Edison donated 700 kilowatts for the duration of the memorial, or about \$10,000 worth of electricity, to power the 7,000-watt searchlights at the site of the World Trade Center.*

## FINANCIAL STATEMENTS NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

### Contents

Statements of Financial Position, Assets  
Statements of Financial Position, Liabilities  
Statements of Activities  
Statements of Cash Flows  
Notes to Financial Statements

### 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
<b>ASSETS</b>		
<i>Current Assets:</i>		
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
<i>Noncurrent Assets:</i>		
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
<b>LIABILITIES</b>		
<i>Current Liabilities:</i>		
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
<i>Noncurrent Liabilities:</i>		
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
<b>Revenues:</b>		
Rate Schedule I 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
<b>Operating Expenses:</b>		
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.

## NOTES TO FINANCIAL STATEMENTS NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Years Ended December 31, 2001 and 2000

### I. 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 I, 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
	<b>54,942,444</b>	54,942,444
Accumulated amortization	<b>(21,976,978)</b>	(10,988,488)
Transition asset, net	<b>\$ 32,965,466</b>	\$ 43,953,956



## NOTES TO FINANCIAL STATEMENTS NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Years Ended December 31, 2001 and 2000

### 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
	<b>21,391,903</b>	10,831,038
Accumulated depreciation and amortization	<b>(7,367,941)</b>	(2,586,914)
Property and equipment, net	<b>\$ 14,023,962</b>	\$ 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 De-

cember 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:

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

## NOTES TO FINANCIAL STATEMENTS NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Years Ended December 31, 2001 and 2000

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 I 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

## **SENIOR STAFF**

William J. Museler  
President and Chief Executive Officer

Robert E. Fernandez  
General Counsel

Mary McGarvey  
Controller

Michael C. Calimano  
Vice President, Operations and Reliability

S. Kennedy Fell  
Vice President and Chief Information Officer

Charles A. King  
Vice President, Market Services

Carol E. Murphy  
Vice President, Government Affairs and Communications

Andrew R. Ragogna  
Vice President and Chief Finance and Compliance Officer

Robert M. Soeldner  
Vice President, Strategic Initiatives

John M. Adams  
Director, Analysis and Planning

Sandra L. Sanford  
Director, Human Resources

Steven C. Sullivan  
Director, Communications

Belinda Thornton  
Director, Regulatory Affairs

Diane L. Egan  
Executive Assistant to the Chief Executive Officer

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