

New York Independent System Operator



F u l f i l l i n g O u r M i s s i o n



2 0 0 3 A n n u a l R e p o r t



NYISO

Fulfilling Our Mission



Dear Market Participants:

The year 2003 was one of trial and triumph, as the NYISO continued to fulfill its mission to:

- Maintain and enhance the reliability of New York's electric system,
- Operate and promote fair, open and competitive markets, and
- Provide cost-effective, first-class customer service with our exceptional workforce.


The NYISO was put to the test during the August 14th blackout, which was caused by events well beyond the boundaries and control of anyone in New York. The protective systems of New York's Transmission Owners and those of New York's Independent Power Producers functioned properly to prevent damage to the State's generation and transmission equipment, thereby ensuring that it could be used to assist in a rapid recovery from the blackout. In addition, the NYISO's well-designed and thoroughly tested restoration plan allowed the NYISO, the Transmission Owners, and the Independent Power Producers, working in close cooperation with New York State and New York City officials and agencies, especially the New York Department of Public Service, to restore electric service quickly. As a result, a blackout that might otherwise have lasted several days lasted less than 30 hours.

The NYISO markets functioned efficiently in 2003, handling nearly \$7 billion of transactions smoothly and providing New Yorkers with reliable, competitive electric supplies. We continued to work effectively with our neighboring systems on important Seams issues, striving to develop a virtual Regional Transmission Organization (RTO) in the Northeast to further improve the market's effectiveness.


In 2004 the NYISO will implement the state-of-the-art market design known as SMD2, which will enable the NYISO to refine many vital market functions and resolve issues that act as barriers to the trading of energy across northeast markets. Also in 2004, we will complete the initial steps leading to a comprehensive planning process for New York State that will establish necessary infrastructure improvements as a top priority.

The NYISO remains determined to be the industry leader in customer service by collaborating with all of our stakeholders to improve the efficiency and effectiveness of the NYISO markets. In 2003 we began a number of customer focused initiatives to simplify and streamline the billing and settlement process as well as a concerted effort to make the physical operation of the power system more visible to the marketplace.

The future is bright for New York's competitive electric market. We are committed to improving the NYISO's national leadership role as we continue to develop and manage an efficient and competitive electricity trading market, while planning for and operating a reliable transmission system for the benefit of New York State and regional consumers.



John W. Boston
Chairman of the Board



William J. Museler,
President and CEO

NYISO

Enhancing Reliability



On August 14th, a series of events began in northern Ohio, which resulted in the New York power grid shutting down as its automatic systems operated to protect valuable generation and transmission resources from major damage due to mammoth power surges.

NYISO received no notice or advisory from other control areas of any problems. At 4:06 in the afternoon, there were relatively small but noticeable and increasing power shifts out to Ontario. Just three minutes later, a power swing of approximately 700 megawatts (MW) went out to Ontario and a coincident swing of similar proportion entered New York from the Pennsylvania-New Jersey-Maryland (PJM) control area. Shortly thereafter, at 4:10:39, a sudden surge in excess of 3,500 MW flowed into Ontario and then Michigan and Ohio from the New York system and PJM.

Within six seconds, the ties in the grid between New York and PJM tripped and, two seconds later, the upstate ties with ISO New England opened, followed immediately by the separation of the New York system into two electrical “islands.”

In the western part of the state, the surges caused some large generation plants to automatically trip and in some cases, operators took units off-line because they were unstable. In Western New York, load shedding relays operated to maintain a balance of available supply to the load and the upstate transmission system stabilized.

In the Hudson Valley, Long Island and New York City, however, there was a 6,000 MW mismatch between demand and supply and the downstate system collapsed completely resulting in a total blackout. In total, almost 23,000 megawatts of electric load was lost in New York and the blackout began.

Immediately following the loss of the downstate system, restoration of the system was begun. Following the NYISO’s existing Emergency Operating Manual, control room operators, who are regularly trained in restoration procedures, worked with owners of the transmission grid and New York’s independent power producers to restore the grid.

Priorities in the plan were followed rigorously and no significant impediments were encountered. The return of electric power began Thursday evening. Customers on Long Island were gradually brought on line also on Thursday evening using local generation sources, and the first restoration of power to New York City began at approximately 7:56 p.m. on August 14. Power was totally restored to all New York customers by 10:45 p.m. on Friday, August 15.

The NYISO maintained close communication with city, state and federal officials and agencies throughout the restoration process, particularly the New York State Department of Public Service, which assisted the NYISO at several critical junctures.



James Cacciotti (left) an electrician for PSEG Power, LLC discusses construction of the new Bethlehem Energy Center with Dave Evanoski, NYISO Supervisor of Customer Relations.

During the restoration process, the NYISO made innovative use of its demand response program to assist in balancing load and generation. The use of NYISO's demand response programs during system restoration has been recognized as an industry first.

As long and unfortunate as that outage was, had system protections not worked as designed and major facilities were consequently significantly damaged, restoration of power could have taken many days, not hours, to accomplish.

The blackout demonstrated that NYISO's essential protection systems functioned, but it also revealed areas where improvements should be made to protect New York from events not under its control. These include:

- Making current voluntary reliability standards for all ISOs and Control Areas mandatory,
- Incorporating all power systems into ISOs or Regional Transmission Operators,
- Improving communications between ISOs to prevent the spread of a problem in one control area from affecting an adjoining one, and
- Strengthening the transmission grid by providing incentives for new facilities.

Defense in Depth—While the NYISO is responsible for coordinating and scheduling the operation of the power grid in New York State, in the event of a disaster at the NYISO's control center, control of the New York power grid reverts to the control centers maintained by each of the state's major transmission owners. This defense in depth concept assumes that the New York State power grid is capable of operating independent of the NYISO control center during emergency situations.

The NYISO's defense in depth concept also provides redundant capability to continue operation of the NYISO's markets for electricity in the event of damage to its computer systems. Fully redundant computer systems are synchronously connected but geographically separated, so that a disaster at one location will not result in loss of the NYISO's electricity markets.

Supply and Demand—In addition to the need for critically important system improvements, new generation facilities must be developed in an environment conducive to investment. It is essential that the New York State Legislature re-enact the State power plant siting law (Article X) that was

allowed to lapse last year. As of spring 2004 it is extremely difficult, if not impossible, to license new power plants in New York, clearly an unacceptable situation. By 2008, if no new generation facilities are constructed in New York State, energy supplies will just meet the minimum demand requirement under extreme summer weather conditions. To enhance reliability, increase competition and deliver environmental benefits, a minimum of 2,000 MW must be brought online over the next four years. Thereafter, additional new resources of 300-600 MW per year should be brought online to account for load growth and the retirement of older generators.

In addition to increasing generated supplies, actions must continue to assure that emergency supplies are available through an effective program of reducing demand when needed. Fortunately, NYISO's demand response programs have been growing dramatically. Between April 2002 and September 2002, the number of demand side resources rose fourfold—from 400 to almost 1,600. During the same time period, power registered for emergency curtailment almost doubled—from about 900 MW to more than 1,600 MW.

In May, the NYISO received confirmation by outside entities that its demand-reduction programs,



NYISO grid operators annually receive four times the amount of training recommended by the North American Electric Reliability Council. Pictured are Control Center Shift Supervisor Mike Egan, standing, and Robert Shellhouse, dispatcher.

a vital element of New York State’s electricity market, continue on a successful track. Researchers from Neenan Associates and the Consortium for Electric Reliability Solutions in Berkeley, California, evaluated the Price Responsive Load Programs and concluded that the demand-reduction measures taken in the program have significantly reduced energy use in emergency peak situations. Last year, the NYISO saved 668 megawatts—the equivalent of 70 large shopping malls—during the two hot summer days on which it asked customers to curtail loads. NYISO customers also received benefits in the range of \$3 million to \$16.9 mil-

lion over the course of the year for participating in demand reduction programs.

As the demand and supply of electricity must be addressed, so must transmission facilities to ensure that electricity can be delivered to the customer. Current “bottlenecks” cost customers more than in adjoining ISOs—more than \$1 billion a year by one measure. These bottlenecks inhibit the transmission of electricity as the system becomes loaded to its limits, and represent a significant inefficiency in New York’s electric markets.



Wind photos above, right and front cover by Jennifer Harvey, NYSERDA



NEGT's Madison Windpower Project in Madison County is an example of the important role renewable energy sources play today and for the future. Madison's 7 wind turbines contain a total installed capacity of 9 megawatts.

NYISO

Fair, Open, Competitive Markets

The screenshot shows a Microsoft Internet Explorer browser window displaying the NYISO Market Data Exchange (MDEX) website. The browser's address bar shows the URL <http://mdex.nyiso.com/Scheduled+Data>. The website features a blue and white color scheme with the MDEX logo and the tagline "Building the Energy Markets of NY". A navigation menu includes links for "Company", "The Markets", "The Power Grid", "Services", and "Documents". The main content area is titled "Home > The Power Grid > Scheduled Data" and contains several sections:

- NY Control Area Information:** Includes links for "Real-Time Data" and "Scheduled Data".
- MDEX Login:** A form with fields for "Username" and "Password", a "Login" button, and links for "Sign Up Now!" and "Forgot Password?".
- Search:** A search bar with a "Go" button and the text "Powered by Google".
- ISD Load Forecast:** A table listing dates from 03-26-2004 to 03-30-2004 with associated icons.
- Zonal Bid Load:** A table listing dates from 03-26-2004 to 03-30-2004 with associated icons.
- DAM Limiting Constraints:** A table listing dates from 03-25-2004 to 03-30-2004 with associated icons.
- Par Schedules:** A table listing dates from 03-29-2004 to 03-30-2004.

The browser's taskbar at the top shows several open applications: Start, Carol Murphy - Sent - L..., Microsoft Word, and Adobe Reader. The status bar at the bottom of the browser window displays "Done".

To ensure competitive electricity prices, the NYISO operates open markets, much like commodity and stock markets. Power is bought and sold on a Day-Ahead or Real-Time basis. The NYISO also schedules all bilateral (or party-to-party) transactions. In 2003, the NYISO handled nearly \$7 billion worth of transactions. Since establishing the markets, the value of the NYISO's spot market transactions has increased 32 percent from \$5.3 billion in the first year. The number of market participants increased to over 200 by the end of 2003.

Of the many market improvements already achieved to date, the introduction of true "scarcity pricing" for the summer of 2003 and the implementation of the Demand Curve for installed capacity are particularly significant. Scarcity pricing solves both a seams issue with neighboring markets and enhances overall market efficiency by sending the right price signal to encourage both short- and long-term supply. The Demand Curve allows the NYISO to recognize the reliability benefits of capacity that exists over and above the minimum for system security and reduces the volatility in the price signals.

Enhancing Regional Competition—"Seams issues" relate to barriers that prevent the free flow of energy commerce between New York and its adjoining energy markets. Seams problems are among the most important concerns facing the

NYISO and significant progress was made in 2003 toward creating a seamless interface among and between neighboring electricity markets.

Seams coordination agreements are now in place with all neighboring market operators, and New York chairs the ISO/RTO Council established to further coordinate markets across North America. Resolution of Seams issues will deliver many specific market improvements including:

- Improved efficiency of the real-time and day-ahead energy markets,
- Reduction or elimination of uneconomic barriers to trade,
- A common data exchange protocol for energy markets,
- Improved ability of market participants to hedge congestion across boundaries,
- Faster and more accurate settlements across markets,
- Reductions in ancillary services costs, and
- Support for robust energy forward and futures markets.

The elimination of export charges between markets, also known as "rate pancaking" or "through-and-out charges" is recognized as one of the largest barriers to trade in the northeast. The NYISO recognizes the complexity of this issue and worked diligently in 2003 to bring transmission owners, state regulators and other inter-

In September, the NYISO launched its state-of-the-art Market Data Exchange or MDEX, giving Market Participants the capability to generate their own customized, individual Web pages. The MDEX portal or gateway lets users choose from a menu of data modules which contain information of most interest to them.

ested parties together to begin crafting an equitable resolution of this key market issue. Discussions in 2003 focused on the export charges between New York and New England. Objectives for 2004 and beyond look to establishment of a “virtual Northeast RTO,” a truly seamless regional market.

During 2003, the NYISO initiated its most ambitious project since the original market startup in 1999. The Standard Market Design (SMD2) project represents a wholesale replacement and upgrade of NYISO’s real-time market and operations software and infrastructure. These major market improvements are slated for implementation in fall 2004.

Significant development work on products to enhance control area coordination and efficiency, such as Facilitated Checkout and E-Tagging also occurred in 2003. Products such as these will continue to make doing business with NYISO easier and more efficient.

To enable participants and other interested parties more efficient access to information crucial to trading in the markets, the NYISO implemented the first phase of the Market Data Exchange (MDEX) in 2003. This Web “hub” provides easier access to information, much like Yahoo or MSN search engines. From the MDEX portal, users can locate a portion of the NYISO Web content they frequently access and create their own customized Web pages encompassing the information they most frequently

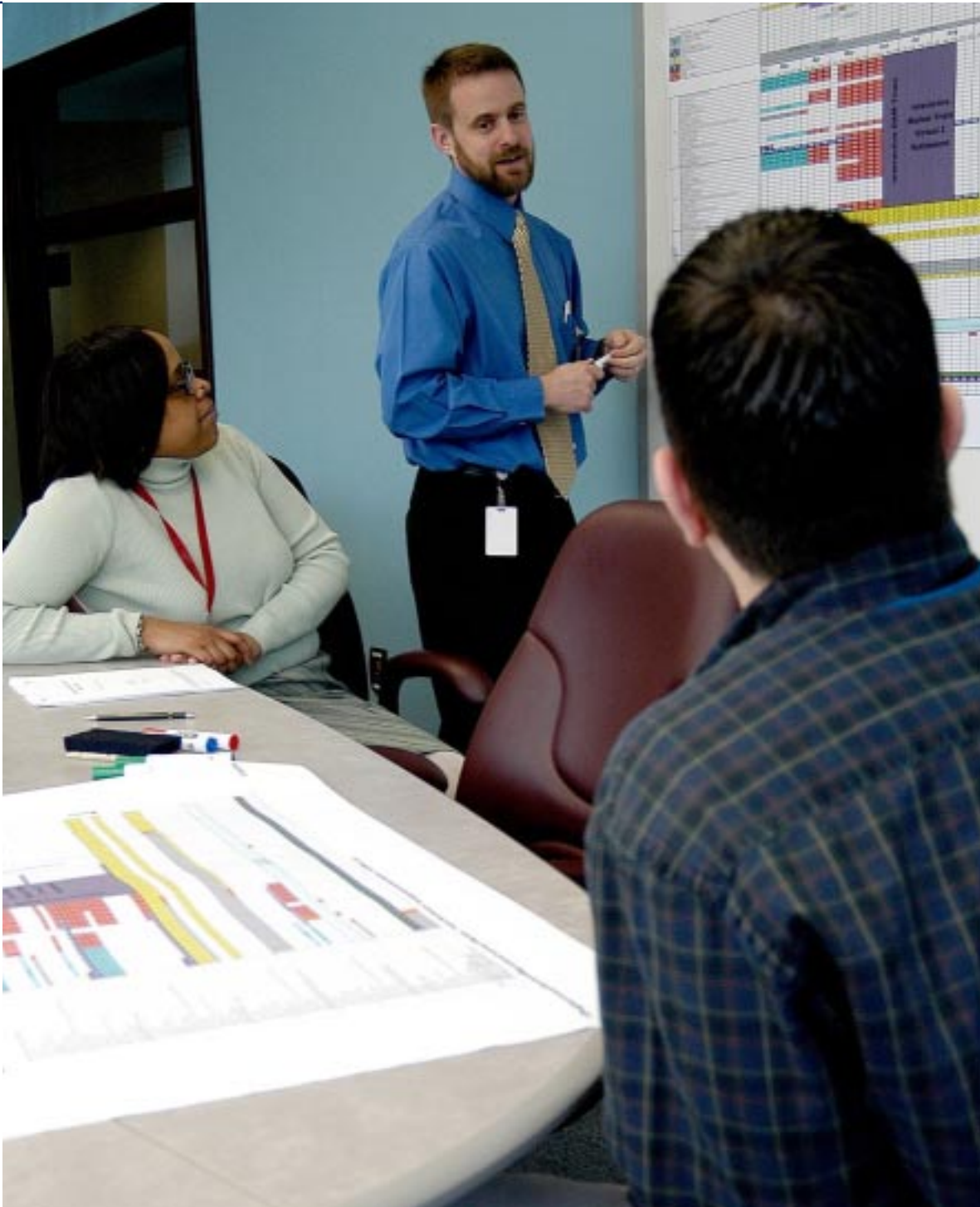
seek. Future phases of MDEX will bring additional features and functionality to further enhance customers’ Web experience and facilitate their interaction with the NYISO markets.

Features of MDEX include:

- An enhanced live Data Map displaying real-time, hour-ahead, and day-ahead pricing,
- Individual user customization capability,
- Integration of Google search technology,
- Improved Committee pages and meeting calendar with links to all meeting materials, and
- Secure information area for registered Market Participants.

2003 also saw the successful launch of the “Data Warehouse” that serves as an enterprise-wide centralized information repository for reporting and analysis. The first set of data provided enables Market Participants to access information and use advanced tools to reconcile and analyze their settlements efficiently and effectively.

By improving the efficiency, predictability and consistency of energy markets, and information about those markets, NYISO believes that appropriate incentives will be created to support much needed long-term investment in generation and transmission facilities, as well as in demand response technologies.



A state-of-the-art Standard Market Design (SMD2) will integrate the NYISO's day-ahead and real-time energy markets in 2004. Robert Pike, Supervisor for SMD2 Development, leads a market trial planning session with Associate Analyst Crystal Perkins and Analyst David Donofrio.

The overall operations of NYISO in 2003—billing and reconciliation processes, market and systems operations, customer interface systems—showed continuous improvement.

Underlining the effective nature of operations was the finding by KPMG, one of the nation’s ‘big four’ audit firms, that NYISO’s operations—from a market participant submitting a bid for electric power to the invoicing for that bid when the transaction was complete—were efficient and reliable. Their audit, generally referred to as SAS 70, evaluated NYISO’s controls on the entire Bid-to-Bill process, including information technology practices, as well as IT and facility security. New York was the first ISO to achieve an unqualified opinion for this “Type 2” audit on its first attempt at the audit, completed in accordance with standards established by the American Institute of Certified Public Accountants. More good news followed, as KPMG issued a second positive audit for the period ending December 31, indicating that the NYISO’s Bid-to-Bill controls again were accurate and complete.

On December 21, new customer creditworthiness requirements approved by the FERC became effective. The new requirements are the result of a substantial undertaking by NYISO staff and stakeholders to develop customer credit standards that are carefully tailored to protect against credit losses without creating barriers to entry or unduly burdening customers in the New York markets. In keeping with these principles, the NYISO is continuing to work with its stakeholders to explore further refinements to its settlement mechanisms and credit requirements to effectively and equitably address customer credit risk.

That is not to say that there is not more to accomplish. First class customer service is an essential aspect of NYISO’s objective to remain the acknowledged leader in electricity markets. The NYISO’s annual Customer Opinion Survey showed a six percent increase in performance over 2002’s results and represents a 24 percent increase since 2000. The NYISO used the opportunity of the 65 visits with customers at their sites to identify areas that will improve service to customers in 2004 and beyond. Initiatives are underway to improve the operational information provided to the marketplace as a result of feedback received in 2003.

Comprehensive and Strategic Planning—In summary, most strategic plan goals established in 1999-2000 were accomplished by the end of 2003. Accomplishments include:

- Commencement of the Standard Market Design (SMD2) project,
- Market design improvements such as the ICAP Demand Curve and “scarcity pricing,”
- Introduction of the Market Data Exchange (MDEX), a customizable web portal,
- Implementation of the Data Warehouse to provide an enterprise-wide storage repository for reporting and analysis,
- Implementation of financial incentives to optimize transmission maintenance,
- Implementation of a new comprehensive planning process,
- Completion of Seams projects noted above,
- Continued development of demand reduction programs, shown to have a significant impact on reducing energy use in peak situations, and
- Customer acknowledged service improvements at the highest level since NYISO creation.



Customer relations representatives, including Cheryl-Ann De La Rosa, made 65 customer visits in 2003 as part of the NYISO's focus on improved customer service.

In 2003, NYISO undertook a revised strategic planning process. NYISO's strategic plan follows from its mission to maintain and enhance regional reliability; promote and operate fair and competitive markets; provide first class customer service; attract and retain exceptional employees; and operate in a cost effective manner. The new strategic plan identifies four strategic objectives to be achieved over the next five years. These objectives are:

- To be the national leader in reliability,
- To develop and manage the premier electricity market as part of a seamless regional market,
- To provide first class customer service, and
- To achieve excellence in execution of the NYISO's business model.

On September 10, 2003, the NYISO Operating Committee voted unanimously to implement the first phase of the electric system comprehensive planning process. This initial planning process has three major benefits; it:

- Moves New York closer to meeting FERC RTO planning requirements,
- Combines past congestion reports with current data from various NYISO reports and market participants' supplemental information, and
- Extends reliability assessments beyond five years to 10 years. Also, the process conducts additional sensitivity analyses that will help the NYISO determine how robust the power system is in meeting system reliability standards.

Governance—The NYISO has a shared governance structure comprised of an independent 10-member Board of Directors and Market Participants that oversees the New York ISO's markets.

Directors are selected from a variety of backgrounds. Board members are not affiliated with electric power market participants, their subsidiaries or parent companies. Policy decisions that require involvement of the Federal Energy Regulatory Commission (FERC) result from Board-collaboration with market participants who forward recommendations for market improvements to the Board of Directors. The Board is empowered to affirm recommendations, reject them or send them back to committees for further refinement. This collaborative decision-making process ensures that market participants are actively engaged and well represented in all important policy matters. Only under extraordinary or "exigent" circumstances will the NYISO Board render policy decisions that involve FERC without committee input.

A superior workforce possessing the skills, knowledge, training and perspective required to support NYISO's important objectives carries out day-to-day management of NYISO operations. NYISO strives to implement human resources policies that support strategic business goals and fulfill organizational workforce needs. Maintaining standards of workforce excellence requires ongoing training programs, opportunities for employee participation in goal setting and personnel policies through established personnel practices, along with new and innovative recognition programs and benefits for employees. Workforce excellence also requires staff involvement in planning at all levels. NYISO believes that to achieve its strategic goals, attending to workforce needs (including recruitment, compensation, training, retention and development) is of the highest priority.



Board of Directors (left to right)

Alfred F. Boschulte

President of AFB Consulting, specializing in strategic planning for telecommunications firms.

William J. Museler, President and CEO

Formerly Executive Vice President of the Transmission/Power Supply Group of the Tennessee Valley Authority.

Karen Antion, Vice Chairman

President of Karen Antion Consulting, LLC and former Vice President of Oracle Corporation.

Peter A.A. Berle, Vice Chairman

Former Commissioner of the NYS Department of Environmental Conservation and CEO of the National Audubon Society.

John W. Boston, Chairman

Past President and COO of the Wisconsin Electric Power Company.

Thomas F. Ryan, Jr.

Former President and COO of the American Stock Exchange.

Harold N. Scherer, Jr.

Former President and COO of the Commonwealth Electric Company of Massachusetts.

Richard E. Schuler

Professor of Economics and Civil/Environmental Engineering at Cornell University and former Commissioner of the NYS Public Service Commission.

Erland E. Kailbourne

Former Chairman and CEO of Fleet National Bank, New York region.

Richard J. Grossi

Former Chairman and CEO of United Illuminating, a Connecticut utility, and past Chairman of the North American Reliability Council.

Senior Staff



William J. Museler
President and Chief Executive Officer
Responsible for the overall operations of the NYISO and for establishing the strategic direction of the company.



Garry A. Brown
Vice President, Strategic Development
Responsible for developing and implementing the strategic and annual business plans as well as state and regional system planning and load forecasting.



Robert E. Fernandez
General Counsel
Responsible for managing legal and regulatory affairs for the NYISO.



Michael C. Calimano
Vice President, Operations and Reliability
Responsible for ensuring the reliable operation of the transmission system, operating the Day-Ahead and Real-Time wholesale markets.



Mary K. McGarvey
Controller
Responsible for financial and tax reporting, budget preparation and monitoring, treasury and debt management, and oversight of accounts payable, receivable and purchasing.



S. Kennedy Fell
Vice President and Chief Information Officer
Responsible for technical design, development, deployment, support and maintenance of all NYISO software, support of NYISO's communications and computing infrastructure.



Frank Frankowski
Vice President and Chief Financial Officer
Responsible for accounting, budgeting, credit, treasury, and customer settlements.



Charles A. King
Vice President, Market Services
Responsible for overall market design, research and development, congestion hedging and capacity auctions, and primary liaison with Market Participants.



Vincent J. Budd
Director, Corporate and Market Risk Management
Responsible for monitoring market performance and market power mitigation, Enterprise Risk Management process, and coordination of NYISO participation in Industry Affairs.



Carol E. Murphy
Vice President, Government Affairs and Communications
Responsible for communications with the media, external groups and government entities, and for internal communications.



Sandra L. Sanford
Director, Human Resources
Responsible for recruitment, benefits, and compensation administration, performance management, employee and Market Participant training, employee and labor relations, and records retention.



Andrew R. Ragona
Vice President and Chief Administrative Officer
Responsible for securing and maintaining the NYISO's assets and systems, contract administration and project management.



Belinda Thornton
Director, Regulatory Affairs
Responsible for management of the federal and state regulatory processes and serves as principal liaison to the Federal Energy Regulatory Commission.



John M. Adams
Director, System and Resource Planning
Responsible for overall management of system planning processes which ensure the bulk power system is planned consistent with good utility practice and meets all reliability criteria.

Market Participants

1st Rochdale Cooperative Group, Ltd.
3M Purchasing and Packaging
ACN Power, Inc.
Advantage Energy, Inc.
AES Creative Resources, L.P.
AES Eastern Energy, L.P.
Agway Energy Services
AIG Energy, Inc.
Aleph One, Inc.
Allegheny Energy Supply Company, LLC.
Allegheny Power
Allied Utility Network
Amerada Hess Corporation
American Electric Power Service Corp.
American Ref-Fuel Company
Amherst Utility Cooperative
Aquila Energy Power Marketing
Astoria Generating Company, L.P.
Athens Generating Company
Automated Energy, Inc.
Bank of America, NA
Bethlehem Steel
Black Oak Capital, LLC
Black Oak Energy
Boralex Chateaugay
BP Energy Company
Brascan Energy Marketing, Inc.
Calpine Energy Service, L.P.
CAM Energy Products
Canastota Wind Power, LLC
Cargill Power Markets, LLC
Carr Street Generating Station
Central Hudson Enterprises Corp.
Central Hudson Gas & Electric Corp.
Cinergy Capital and Trading, Inc.
Cinergy Services, Inc.
Citadel Energy Products
Conectiv Energy Supply, Inc.
Consolidated Edison Company of New York
Consolidated Edison Energy, Inc.
Con Edison Solutions, Inc.
Constellation NewEnergy, Inc.
Constellation Power Source, Inc.
Consumerpowerline.org
Coral Canada US, Inc.
Coral Power, LLC
Core Equities, Inc.
County of Niagara
Crucible Specialty Metals
Cummings, Inc.
D C Energy, LLC
DE Shaw Plasma Power
Delphi Automotive Systems
Direct Commodities Trading
Dominion Energy Marketing
DTE Energy Trading, Inc.
Duke Energy Trading and Marketing
Dynegy Energy Services
Dynegy Power Marketing, Inc.
East Coast Power, LLC
ebidenergy, Inc.
ECONergy Energy Company, Inc.
Edison Mission Marketing & Trading
Electrotek Concepts
El Paso Merchant Energy, L.P.
Empire Natural Gas
Energetix
Energy Aggregation Services, LLC
Energy Analytics, Inc.
Energy Conservation & Supply, Inc.
Energy Cooperative of New York, Inc.
Energy Curtailment Specialists
Energy Enterprises, Inc.
Energy New England
Energy Procurement Services Alliance
Energy Services Provider
Energy Solutions USA
Energy Systems North East, LLC
Engage Energy America, LLC
Engage Networks, Inc.
Enron Power Marketing, Inc.
Entegra Capital Management
Entergy Koch Trading, L.P.
Entergy Nuclear Fitzpatrick
Entergy Nuclear IP2
Entergy Nuclear IP3
EPCOR Merchant & Capital (US) Inc.
Eric, County of
Exelon Generation (Formerly PECO Energy Company)
Finger Lake Utilities
FirstEnergy Solutions Corp.
Florida Power & Light Company
Fortis Ontario Inc.
Fortis US Energy Corp.
FPL Energy, LLC
Freeport, Inc., Village of
General Electric Plastics
Glens Falls Lehigh Cement Company
Great Bay Power Corp.
Hess Energy Power and Gas Company, LLC
Horizon Power, Inc.
HQ Energy Services US
HSBC Bank USA
Hudson Energy Systems, LLC
Indeck – Corinth, L.P.
Indeck – Ilion, L.P.
Indeck – Olean, L.P.
Indeck – Oswego, L.P.
Indeck – Silver Springs, L.P.
Indeck – Yerkes, L.P.
Innovative Energy Systems
International Paper
J Aron and Company
Jamestown, Board of Public Utilities
Kaleida Health
Keyspan Energy Services
Keyspan Ravenswood
Lafarge Building Materials, Inc.
Legacy Energy Group
Liberty Power Corporation
Lockport Energy Associates
Long Island Power Authority
Lyonsdale Biomass, LLC
Madison Windpower, LLC
Merrill Lynch Capital Services, Inc.
MetroGen Enterprises, LLC.
MG Industries
Mirabito Gas & Electric, Inc.
Mirant Americas Energy Marketing, L.P.
Model City Energy, LLC
Monroe County
Morgan Stanley Capital Group, Inc.
National Fuel Resources, Inc.
New York Municipal Power Agency (NYMPA)
New York Power Authority
New York State Electric & Gas Corp.
Niagara Mohawk Power Corporation
Nine Mile Point Nuclear Station, LLC
Nissequogue Cogen Partners
Norbord Industries
Northbrook New York, LLC.
Northeast Expense Reduction Services, Inc.
Northeast Utilities
Northern States Power Company
NRG Power Marketing, Inc.
NYSEG Solutions, Inc.
Occidental Chemical Corp.
Onondaga Cogeneration, L.P.
Ontario Power Generation, Inc.
Orange & Rockland Utilities, Inc.
Pepeco Energy Services
PG&E Energy Trading - Power
Powerex Corporation
PPL EnergyPlus, LLC
Praxair, Inc.
Preferred Utilities Energy Services Corp.
Primary Power Marketing, LLC
Pro-Energy Development, LLC
Pro-Energy Marketing, LLC
Project Orange Associates, L.P.
PSEG Energy Resources & Trade, LLC
PSEG Energy Technologies, Inc.
Public Service Company of Colorado
Public Service Electric & Gas Co.
Quark Power
Rainbow Energy Marketing Corp.
RAM Energy Products, LLC
Reliant Energy Services
Rochester Gas & Electric Corp.
Rockville Center, Village of
RS Environmental Solutions, Inc.
RWE Americas, Inc.
Schools & Municipal Energy Co-Op of Western NY
Service Resources, Inc.
Select Energy, Inc.
Select Energy New York, Inc.
Selkirk Cogen Partners, L.P.
Sempra Energy Solutions
Sempra Energy Trading Corp.
Seneca Energy II
Sesco Enterprises
Singer Holding Co. (DBA Robinson Oil)
Sithe/Independence Power Partners, L.P.
Sithe Energy Marketing
Sithe Power Marketing, L.P.
SourceOne
Special Metals Corporation
Split Rock Energy, LLC
State University of NY
State University of NY at Buffalo
Statoil/Hess Energy (SESI)
Strategic Energy LLC.
Strategic Power Management
Susquehanna Energy Products, LLC
Tarachand Consulting
The May Department Stores Company
Tonawanda Coke Corporation
Tops Markets, Inc.
Total Gas & Electric, Inc.
Tractebel Energy Marketing
Tractebel Energy Services
TransAlta Energy Marketing (U.S.) Inc.
TransCanada Power Marketing, Ltd.
Trigen Syracuse Energy Corp.
TXU Energy Trading
UBS AG, London Branch
UniGridEnergy, LLC
University of Rochester
US Energy Partners, LLC
Virginia Electric and Power Company
Webgen Systems
Wegmans Food Markets, Inc.
Western New York Wind Corp.
Wheelabrator Westchester, L.P.
Williams Energy Marketing & Trading Co.
WPS Energy Services, Inc.

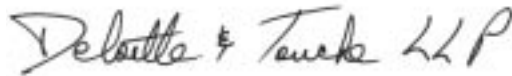
Independent Auditors' Report

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, 2003 and 2002, 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, 2003 and 2002, 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.



March 26, 2004

STATEMENTS OF FINANCIAL POSITION

	December 31,	
	2003	2002
ASSETS		
<i>Current Assets:</i>		
Cash and cash equivalents	\$ 48,930,462	\$ 33,552,160
Accounts receivable, net (Note 2)	13,810,170	31,678,822
Prepaid expenses	6,417,675	5,289,445
Restricted cash	210,467,802	107,301,025
Regulatory assets - current portion (Note 3)	13,241,667	3,500,000
Other assets - current portion	257,405	-
Total current assets	293,125,181	181,321,452
<i>Noncurrent Assets:</i>		
Regulatory transition asset, net (Note 3)	10,988,489	21,976,978
Regulatory assets (Note 3)	39,591,666	5,833,333
Property and equipment, net (Note 4)	69,593,658	29,549,070
Other noncurrent assets	2,428,310	3,782,363
Total noncurrent assets	122,602,123	61,141,744
Total Assets	\$415,727,304	\$ 242,463,196
LIABILITIES		
<i>Current Liabilities:</i>		
Accounts payable and accrued expenses	\$ 16,811,758	\$ 14,966,567
Market participant security deposits	187,353,080	82,303,164
Long-term debt - current portion (Note 6)	25,898,628	15,299,241
Capital lease obligations - current portion (Note 9)	-	116,602
Working capital reserve (Note 10)	48,785,895	48,422,459
Deferred revenue - current portion (Note 11)	39,783,261	29,008,566
Regulatory liabilities - current portion (Note 12)	3,289,497	8,167,476
Other current liabilities	1,436,425	2,088,223
Total current liabilities	323,358,544	200,372,298
<i>Noncurrent Liabilities:</i>		
Accrued pension liability (Note 8)	662,246	1,260,094
Accrued postretirement liability (Note 8)	2,161,503	-
Deferred revenue (Note 11)	46,830,327	18,110,758
Regulatory liabilities (Note 12)	2,730,107	3,634,685
Other noncurrent liabilities (Note 8)	392,910	595,067
Long-term debt (Note 6)	39,591,667	18,490,294
Total noncurrent liabilities	92,368,760	42,090,898
Commitments and Contingencies (Note 13)		
Total Liabilities	\$415,727,304	\$ 242,463,196

See notes to financial statements.

STATEMENTS OF ACTIVITIES

	Years Ended December 31,	
	2003	2002
Revenues:		
Rate Schedule 1 tariff charge	\$ 116,822,858	\$ 98,379,114
Fees and services	755,936	839,089
Interest income	240,475	192,729
Total revenues	117,819,269	99,410,932
Operating Expenses:		
Compensation and related benefits (Note 8)	32,742,038	30,580,920
Professional fees and consultants	24,972,472	21,987,327
Depreciation and amortization	17,570,115	8,420,385
Amortization of regulatory transition asset (Note 3)	10,988,489	10,988,489
Rent, equipment leases and other facility costs	10,627,028	10,134,706
Federal Energy Regulatory Commission fees	7,862,930	6,234,908
Administrative and other expenses	4,137,937	2,901,535
Telecommunications	3,110,895	2,236,580
Training, travel and meeting expenses	2,986,814	2,574,766
Northeast Power Coordinating Council fees	1,496,308	1,374,043
Total operating expenses	116,495,026	97,433,659
Interest Expense	\$ 1,324,243	\$ 1,977,273
Net Results of Activities	\$ -	\$ -

See notes to financial statements.

STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2003	2002
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	17,570,115	8,420,385
Amortization of regulatory transition asset	10,988,489	10,988,489
Change in operating assets and liabilities:		
Decrease (increase) in accounts receivable and prepaid expenses	16,740,422	(17,832,906)
Increase (decrease) in accounts payable and accrued expenses	1,845,193	(577,179)
(Increase) in restricted cash	(103,166,777)	(58,858,738)
(Increase) in regulatory assets	(43,500,000)	(7,583,333)
Decrease (increase) in other assets	1,096,650	(881,081)
Increase in working capital reserve	363,436	754,076
Increase in market participant security deposits	105,049,916	47,176,198
Increase in deferred revenue and other liabilities	34,421,404	27,857,215
Net cash provided by operating activities	41,408,848	9,463,126
Cash Flows from Investing Activities:		
Acquisition of property and equipment (including capitalized interest)	(57,614,703)	(23,945,493)
Net cash used in investing activities	(57,614,703)	(23,945,493)
Cash Flows from Financing Activities:		
Repayment of term credit loan	(11,799,241)	(11,018,351)
Proceeds from 2003 budget facility loan	47,000,000	-
Proceeds from equipment term loan	-	8,700,000
Repayment of equipment term notes	(3,500,000)	(1,116,667)
Decrease in capital lease obligations	(116,602)	(275,122)
Net cash provided by (used in) financing activities	31,584,157	(3,710,140)
Net (Decrease) Increase in Cash and Cash Equivalents	15,378,302	(18,192,507)
Cash and Cash Equivalents, Beginning of Year	33,552,160	51,744,667
Cash and Cash Equivalents, End of Year	\$ 48,930,462	\$ 33,552,160
Supplemental Disclosure of Cash Flow Information –		
Cash paid during the year for interest	\$ 2,316,991	\$ 2,266,334

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Description - The New York Independent System Operator, Inc. (“NYISO”) was formed in April 1997 and commenced operations on December 1, 1999. NYISO is incorporated in the State of New York as a not-for-profit organization. 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 10,612 miles of high-voltage transmission lines and serves approximately 230 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 facilitates fair and open competition in the wholesale power market and creates an electricity commodity market in which power is purchased and sold on the basis of competitive bidding. NYISO utilizes a bid process for electricity and transmission usage, which enables New York State’s utilities and other market participants, to offer electricity at competitive prices, rather than regulated rates. Billing invoices are issued to each market participant by NYISO each month to settle transactions occurring in the previous month.

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.

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

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.

Revenue Recognition - Monthly settlements of market participants’ energy transactions are not reflected in NYISO’s Statement 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 in the month following the month transactions occurred. See Note 15 for a summary of transactional volumes occurring in 2003 and 2002.

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 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, 2003 and 2002 were held in short-term United States government obligations. NYISO’s cash and cash equivalents consist primarily of funds accumulated for the working capital reserve and for general operating purposes.

Restricted Cash - Restricted cash consists primarily of market participant security deposits held in escrow accounts, amounts prepaid by market participants in advance of settlements billing dates, amounts retained by NYISO pursuant to setoff, amounts due to market participants for overcollections on the voltage market, and amounts reserved for funding employee benefit plans.

Other Assets - Other assets consist primarily of the intangible asset on NYISO’s pension plan, the fair value of securities held by the Trust Share Option Agreement, the fair value of an interest rate cap agreement, and other deferred charges.

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. Building

improvements are depreciated on a straight-line basis over forty 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.

In accordance with Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*, 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.

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.

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 ending December 31, 2003 or 2002.

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 Rate Schedule 1. Any additional working capital needs would be billed to market participants in future Rate Schedule 1 charges.

Deferred Revenue - Amounts collected from market participants through Rate Schedule 1 for capital expenditures are deferred and recognized over the depreciable period of the assets' lives. Such amounts are included in deferred revenue - long term.

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, and amounts retained by NYISO pursuant to setoff are recorded 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.

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. See additional details in Note 7.

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 either maintain 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 also mitigates credit risk by procuring credit insurance on receivables for certain market participants.

NYISO's tariffs establish specific periods for the adjustment of settlement invoices as originally billed and for challenges to amounts billed for a particular service month. 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 month. If NYISO agrees with the provisions of the challenge, a final invoice is issued for that service month. As a result, NYISO is exposed to credit risk until all settlement adjustment and final invoices for each service month are finalized and liquidated. However, Rate Schedule 1 of the OATT allows NYISO to recover bad debt losses from remaining market participants in future billings.

For original invoices issued prior to October 2002, settlement invoices may be adjusted up to two years after the date of original issuance, and these invoices may be challenged for an additional one year after the issuance of all settlement adjustment invoices. Effective with the October 2002 settlement invoice, these periods were shortened to one year for adjustments and four months for invoice challenges.

Use of Estimates - Accounting principles generally accepted in the United States of America 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.

Reclassifications - Certain reclassifications of prior period data have been made to conform with the current year presentation.

Derivative Financial Instruments - NYISO records derivative financial instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS No. 133"). SFAS No. 133 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 an external source. The changes in the fair value of these derivatives qualify as cash flow hedges and are recorded as interest expense. Due to NYISO's regulated rates, the offset to the changes in fair value of these derivatives is recorded as other assets. See additional details in Note 7.

Recently Issued Accounting Pronouncements - Effective January 1, 2003, NYISO adopted SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS No. 146"), which requires that a liability for costs associated with an exit or disposal activity

be recognized when the liability is incurred, rather than at the date of a commitment to an exit or disposal plan. The adoption of SFAS No. 146 had no effect on NYISO's statement of position or results of operations.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities* ("SFAS No. 149"), which amends and clarifies accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. The adoption of SFAS No. 149 had no effect on NYISO's statement of position or results of operations.

In December 2003, the FASB revised SFAS No. 132, *Employers' Disclosures About Pensions and Other Postretirement Benefits*, by requiring additional plan disclosures, such as listing plan assets by category, investment strategies and assumptions, estimated future contributions, cash flows, and measurement dates. Nonpublic companies are required to provide such additional disclosures for fiscal years ending after June 15, 2004. NYISO will adopt this pronouncement effective January 1, 2004. The adoption of the revisions to SFAS 132 is not expected to have any effect on NYISO's statement of position or results of operations.

In January 2004, the FASB issued FSP 106-1, which allows a one-time deferral of the recognition of the effects of the Medicare Prescription Drug Act in regard to benefit plan accounting and disclosures. NYISO has elected the one-time deferral, which will remain in effect until authoritative guidance is issued on accounting for the federal subsidy.

2. ACCOUNTS RECEIVABLE

NYISO's accounts receivable at December 31, 2003 and 2002 consisted of the following:

	2003	2002
Billed:		
Past due settlement invoices	\$ 11,378,143	\$ 11,390,024
Miscellaneous billings	152,821	401,380
Reserve for doubtful accounts - past due settlement invoices	(11,377,080)	(11,305,465)
	\$ 153,884	\$ 485,939
Unbilled:		
Operating expenses for December	\$ 10,414,258	\$ 9,212,091
Other unbilled receivables	3,232,339	10,675,327
Bad debt loss recoverable from market participants	9,689	11,305,465
	\$ 13,656,286	\$ 31,192,883
Total	\$ 13,810,170	\$ 31,678,822

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. NYISO's reserve for doubtful accounts at December 31, 2003 and 2002, respectively, results primarily from past due settlement invoices related to two subsidiaries of Enron Corporation. As of December 31, 2003, NYISO recorded an unbilled receivable of \$9,689 to reflect the residual amount recoverable from remaining market participants in connection with such bad debt losses.

Other unbilled receivables relate to payments made by NYISO out of the working capital reserve primarily for timing differences on the recovery of certain transmission service agreements. These unbilled receivables are recoverable from market participants via future Rate Schedule 1 charges.

NYISO recovers its operating expenses via Rate Schedule 1 in the month following the month of service. Therefore, the unbilled operating expenses for December are billed and recovered in January of the subsequent year.

3. REGULATORY TRANSITION ASSETS AND REGULATORY ASSETS

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

a five-year period, and are amortized over such same period, beginning in January 2000.

At December 31, 2003 and 2002, the regulatory transition asset was comprised of:

	2003	2002
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
	<u>54,942,444</u>	<u>54,942,444</u>
Accumulated amortization	(43,953,955)	(32,965,466)
Regulatory transition asset, net	<u>\$ 10,988,489</u>	<u>\$ 21,976,978</u>

Certain amounts recovered under NYISO's ratemaking mechanisms are based on estimates. The difference between actual results and estimates that result in under collections are reflected as regulatory assets due from

market participants. NYISO's regulatory assets represent amounts to be recovered in future periods for repayment of debt incurred to fund budgetary needs through December 31, 2003 and 2002, respectively.

4. PROPERTY AND EQUIPMENT

Property and equipment, which includes capitalized interest of \$211,351, at December 31, 2003 and 2002 consisted of the following:

	2003	2002
Computer hardware, software and accessories	\$ 55,554,092	\$ 24,477,631
Software developed for internal use	20,905,911	7,357,655
Assets under capital leases	-	3,636,205
Building and leasehold improvements	2,966,071	1,187,065
Furniture and fixtures	2,165,383	1,521,742
Machinery and equipment	1,479,052	1,271,117
Work in progress	19,878,914	5,885,981
	<u>102,949,423</u>	<u>45,337,396</u>
Accumulated depreciation and amortization	(33,355,765)	(15,788,326)
Property and equipment, net	<u>\$ 69,593,658</u>	<u>\$ 29,549,070</u>

5. 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, 2003 and 2002, respectively, there were no amounts outstanding on the Revolving Credit Facility.

6. LONG-TERM DEBT

On September 8, 2000, NYISO borrowed \$48,460,444 under a Term Credit Loan to reimburse NYPP member companies for their investment in the transition of the NYPP to the NYISO, and for the purchase of certain NYPP assets. Principal and interest payments are due monthly until December 2004. Under the Term Credit Loan, interest is variable based on the 30-day LIBOR plus 125 basis points. The interest rate on the Term Credit Loan at December 31, 2003 and 2002 was 2.42% and 2.63%, 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 7.

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. This facility was subsequently increased to \$10.5 million on November 8, 2002. By December 31, 2002, the entire \$10.5 million on this line of credit facility was drawn and 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 LIBOR plus 125 basis points or the prime rate. At December 31, 2003 and 2002, the interest rate on the Equipment Term Notes ranged from 2.37% to 2.44% and

2.63% to 2.69%, respectively. Computer hardware, software and accessories with a book value of \$10.5 million were pledged as collateral for the Equipment Term Notes.

On February 13, 2003, NYISO entered into a \$59.3 million unsecured line of credit facility, the proceeds of which may be drawn until February 29, 2004 to fund the 2003 development of significant information technology projects. Principal repayment of borrowings under this 2003 Budget Facility Loan will be made over four years, beginning in March 2004. Interest on borrowings under this facility is based on NYISO's option of varying rates of interest tied to either LIBOR plus 137.5 basis points or the prime rate. Interest payments on borrowings during the draw period are due according to the LIBOR period chosen or quarterly for prime, and monthly thereafter. At December 31, 2003, NYISO borrowed \$47.0 million on this facility, with interest rates on these borrowings ranging from 2.53% to 2.55%. On December 19, 2003, NYISO entered into an interest rate cap agreement on this debt, effective January 2, 2004, which caps the maximum interest rate at 5.375%. See additional information in Note 7.

At December 31, 2003, the following amounts were outstanding on the Long-Term Debt:

	Term Credit Loan	Equipment Term Notes	2003 Budget Facility Loan	Total
Outstanding balance	\$ 12,656,961	\$ 5,833,334	\$ 47,000,000	\$ 65,490,295
Less: Current portion	12,656,961	3,450,000	9,791,667	25,898,628
Long-term portion	\$ -	\$ 2,383,334	\$ 37,208,333	\$ 39,591,667

At December 31, 2003, scheduled maturities of Long-Term Debt are as follows:

	Term Credit Loan	Equipment Term Notes	2003 Budget Facility Loan	Total
2004	\$ 12,656,961	\$ 3,450,000	\$ 9,791,667	\$ 25,898,628
2005	-	2,383,334	11,750,000	14,133,334
2006	-	-	11,750,000	11,750,000
2007	-	-	11,750,000	11,750,000
2008	-	-	1,958,333	1,958,333
Total	\$ 12,656,961	\$ 5,833,334	\$ 47,000,000	\$ 65,490,295

7. DERIVATIVES AND HEDGING ACTIVITIES

In January 2001, NYISO entered into an interest rate swap agreement with a commercial bank to fix interest payments on its 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. As of December 31, 2003 and 2002, the fair value of the interest rate swap was \$313,811 and \$1,096,388, respectively. For the years ended December 31, 2003 and 2002, NYISO recorded revenue of \$782,577 and \$250,806, respectively, related to this derivative instrument.

In December 2003, NYISO entered into an interest rate cap agreement with a commercial bank to cap

interest payments at 5.375% on its 2003 Budget Facility Loan. The notional amount of the debt on the date of the cap agreement was \$47,000,000. Under the cap agreement, NYISO pays a variable interest rate tied to LIBOR on the outstanding principal amount of the 2003 Budget Facility Loan from January 2004 through February 2008; however, this variable interest rate cannot exceed 5.375%. As of December 31, 2003, the fair value of the interest rate cap was \$414,405. For the year ended December 31, 2003, NYISO recorded revenue of \$56,405 related to this derivative instrument.

NYISO is exposed to credit loss in the event of nonperformance by the commercial bank under the swap or cap agreements. However, NYISO does not anticipate nonperformance by the commercial bank.

8. EMPLOYEE BENEFIT PLANS

Pension 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 an NYPP member company. Employees become vested in pension benefits after five years of credited service.

NYISO also has an unfunded nonqualified pension plan to provide employees with the full level of benefits as stated in the qualified plan without reductions

due to various limitations imposed by the provisions of federal income tax laws and regulations.

NYISO expects to contribute \$2.0M to the pension plan for 2004.

The schedules that follow show the benefit obligations, the plan assets, and the funded status as of December 31, 2003 and 2002, and the change in benefit obligations and the components of net periodic cost for NYISO's pension plans for the years ended December 31, 2003 and 2002.

For the year ended December 31,	2003	2002
Change in benefit obligation:		
Benefit obligation, beginning of year	\$ 10,353,083	\$ 7,509,131
Service cost	1,520,613	1,213,271
Interest cost	684,055	553,360
Actuarial loss	108,272	1,077,321
Benefits paid	(15,488)	-
Benefit obligation, end of year	\$ 12,650,535	\$ 10,353,083
Change in plan assets:		
Fair value of plan assets, beginning of year	\$ 5,094,395	\$ 3,570,159
Actual return on plan assets	1,335,622	(302,808)
Employer contributions	1,966,515	1,868,638
Benefits paid	(15,488)	-
Expenses paid	(16,956)	(41,594)
Fair value of plan assets, end of year	\$ 8,364,088	\$ 5,094,395
Funded status	\$ (4,286,447)	\$ (5,258,688)
Unrecognized prior service cost	2,374,785	2,846,089
Unrecognized loss	2,550,763	3,192,478
Additional minimum pension cost	(1,301,347)	(2,039,973)
Total accrued liability	\$ (662,246)	\$ (1,260,094)

Amounts recognized in the Statement of Financial Position consist of:

	2003	2002
Benefit obligation	\$ (662,246)	\$ (1,260,094)
Intangible asset	1,270,841	2,039,973

The components of net periodic pension cost are as follows:

Service cost	\$ 1,520,613	\$ 1,213,271
Interest cost	684,055	553,360
Expected return on plan assets	(522,418)	(402,303)
Amortization of unrecognized prior service cost	295,326	295,326
Amortization of unrecognized loss	129,717	53,453
Total	\$ 2,107,293	\$ 1,713,107

The following table shows the assumptions used to calculate the pension benefit obligations and net periodic costs as of December 31, 2003 and 2002:

	2003	2002
Benefit obligations:		
Discount rate	6.25%	6.50%
Rate of compensation increases	5.06%	5.56%
Net cost or credit:		
Discount rate	6.50%	7.25%
Rate of compensation increases	5.56%	5.56%
Expected return on plan assets	8.00%	9.00%

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

	Target Allocation	December 31,	
		2003	2002
Equity securities	60%	63%	59%
Fixed income	40%	37%	41%
Total	100%	100%	100%

Postretirement Plan - NYISO committed to sponsor a defined benefit postretirement plan to provide medical and life insurance benefits for eligible retirees and their dependents. The terms of the plan were finalized during 2003. Substantially all employees who retire from NYISO become eligible for these benefits provided they have been credited with at least five years of NYISO service. 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. Prior to 2003, amounts recovered through Rate Schedule 1 for estimated costs before the plan coverage and terms were finalized were classified as regulatory liabilities. At December 2003 the plan has been finalized, but not funded and the estimated benefit obligations are recorded as a noncurrent liability. See additional information on Regulatory Liabilities in Note 12.

Amounts recognized in the Statement of Financial Position at December 31, 2003 consist of:

	2003
Benefit obligations as of fiscal year end	\$ 2,161,503
Fair value of plan assets at fiscal year end	-
Funded Status	\$ (2,161,503)
Accrued benefit cost recognized in balance sheet	\$ (2,161,503)

Weighted-average rate assumptions:

Discount rate	6.25%
Expected return on plan assets	N/A
Accrued benefit	\$ 543,312

The assumed health care cost trend rates for the postretirement plan are 11% for 2004, decreasing to 4.5% in 2010. A one percentage point change in the assumed health care cost trend rate would change the 2003 postretirement benefit obligation as follows:

	1% increase	1% decrease
Effect on postretirement benefit obligation	\$14,000	(\$19,000)

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 \$975,066 and \$849,523 for 2003 and 2002, respectively.

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 in these deferred amounts after the completion of the third year. For the first three performance cycles (2000-2002, 2001-2003 and 2002-2004) annual distributions are payable in the year following completion of the cycle. In 2005, there will be a one-year performance cycle, payable in 2006. After 2005, distributions will be payable after the completion of each three-year cycle. Accrued Long Term Incentive Plan benefits included in Other Noncurrent Liabilities at December 31, 2003 and 2002, respectively, were \$392,910 and \$595,067. The short-term portion of such liability at December 31, 2003 and 2002, respectively were \$565,315 and \$507,333.

Trust Share Option Agreement - NYISO has entered into a nonqualified share option agreement with a key officer whereby NYISO has granted to such officer the right 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. The options are immediately vested and are subject to certain restrictions of transferability. At December 31, 2003 and 2002, respectively,

the fair market value of securities held by the trust was \$743,065 and \$646,003. Options outstanding at December 31, 2003 expire from November 16, 2009 through February 19, 2012. NYISO records compensation expense for 75% of the fair value of the options granted at the date of grant. A corresponding liability is established until such time as the options are exercised. No options were exercised as of December 31, 2003.

9. LEASE COMMITMENTS

Operating Leases - NYISO has obligations under three operating lease agreements primarily for rental of office space. One lease agreement for property in Altamont, NY, expires in February 2006. Another lease agreement for property in Albany, NY, expires in January 2006. NYISO has the option to renew both leases for two additional five-year periods at the current lease rate. The third lease was entered into in February 2003 for facilities in Albany, NY, and is cancelable after April 2006.

Rent expense related to these leases amounted to \$925,392 and \$727,144 in 2003 and 2002, respectively. The future minimum lease payments under these operating leases at December 31, 2003 are as follows:

2004	\$ 1,032,394
2005	1,032,394
2006	181,372
Total	\$ 2,246,160

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. At December 31, 2003, there were no amounts outstanding under these capital lease obligations.

10. WORKING CAPITAL RESERVE

At December 31, 2003 and 2002, the working capital reserve consisted of:

	2003	2002
Market participant contributions through Rate Schedule 1	\$ 46,451,950	\$ 46,446,627
Interest on market participant contributions	2,333,945	1,975,832
Total	\$ 48,785,895	\$ 48,422,459

Market participants are entitled to interest on their principal contributions to the working capital reserve. Each market participant is allocated interest based on

the ratio share of each market participant's principal contributions to the total working capital fund.

11. DEFERRED REVENUE

Deferred revenue at December 31, 2003 and 2002 consisted of the following:

	2003	2002
Amounts collected through Rate Schedule 1 for capital expenditures, net	\$ 69,593,658	\$ 29,455,282
Prepayments received in advance of settlement dates	15,962,630	17,316,742
Amounts collected for insurance fund	710,000	-
Governance participation fees	347,300	347,300
Total	86,613,588	47,119,324
Less: current portion	(39,783,261)	(29,008,566)
Long-term portion	\$ 46,830,327	\$ 18,110,758

12. REGULATORY LIABILITIES

Certain amounts recovered under NYISO's rate-making mechanisms are based on estimates. The difference between actual results and estimates that result in over collections are reflected as regulatory

liabilities due to market participants. At December 31, 2003 and 2002, respectively, NYISO recorded the following amounts as regulatory liabilities:

	2003	2002
Funding for deferred charges	\$ 2,730,107	\$ 929,870
Rate Schedule 1 underspending	1,362,376	2,860,236
Voltage (reactive power) market	1,013,781	3,347,106
Rate Schedule 1 load overcollections	913,340	1,960,134
Future funding of postretirement plan	-	2,704,815
Total	6,019,604	11,802,161
Less: current portion	(3,289,497)	(8,167,476)
Long-term portion	\$ 2,730,107	\$ 3,634,685

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, result of operations or liquidity of NYISO.

NYISO is a civil suit, filed by New York State Electric and Gas, seeking recovery of \$6.6 million in compensatory damages and unspecified punitive damages, associated with alleged excessive payments for reserves of electricity during the period January to March 2000.

The most significant legal proceeding affecting

14. SUBSEQUENT EVENT

On March 17, 2004, NYISO entered into an unsecured \$100 million line of credit facility, the proceeds of which may be drawn until December 2006 to fund the development of significant information technology projects during 2004-2006. NYISO has the option to convert borrowings under this facility up to

three times to term loans, with principal repayments made over four 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. Interest payments on borrowings are due monthly.

15. 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, 2003 and 2002 (in \$ billions). There was no appreciable increase in volume of gigawatt hours.

	2003	2002
Energy	\$ 6.1	\$ 4.5
Installed capacity	0.7	0.6
Transmission congestion contracts	0.2	0.1
Total	\$ 7.0	\$ 5.2

SENIOR STAFF

William J. Museler
President and Chief Executive Officer

Robert E. Fernandez
General Counsel

Mary K. McGarvey
Controller

Garry A. Brown
Vice President, Strategic Development

Michael C. Calimano
Vice President, Operations and Reliability

S. Kennedy Fell
Vice President and Chief Information Officer

Frank Frankowski
Vice President and Chief Financial Officer

Charles A. King
Vice President, Market Services

Carol E. Murphy
Vice President, Government Affairs and Communications

Andrew R. Ragogna
Vice President and Chief Administrative Officer

John M. Adams
Director, System and Resource Planning

Vincent J. Budd
Director, Corporate and Market Risk Management

Sandra L. Sanford
Director, Human Resources

Belinda Thornton
Director, Regulatory Affairs

Diane L. Egan
Executive Assistant to the Chief Executive Officer



New York Independent System Operator, Inc.

**3890 Carman Road
Schenectady, NY 12303
(518) 356-6000
www.nyiso.com**