

PENDING PETITION MEMO

Date: 12/4/2002

TO : Office of Accounting and Finance
FROM: CENTRAL OPERATIONS
UTILITY: NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
SUBJECT: 02-E-1565

Petition of New York Independent System Operator, Inc. for Authority
to enter into a five year unsecured term loan facility for up to
\$59,300,000.

**HUNTON &
WILLIAMS**

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FILE NO: 55430

December 3, 2002

VIA HAND DELIVERY

Honorable Janet H. Deixler, Secretary
Public Service Commission of the State of New York
Three Empire State Plaza – 9th Floor
Albany, New York 12223

**RE: The New York Independent System Operator, Inc.
Petition for Authorization to Incur Indebtedness**

Dear Secretary Deixler:

On behalf of the New York Independent System Operator, Inc., ("NYISO"), enclosed for filing with the Public Service Commission is an original and five copies of a Petition of The New York Independent System Operator, Inc., for Authorization to Incur Indebtedness for a term in Excess of 12 Months. The Petition seeks the Commission's authorization for a new credit facility to be utilized by the NYISO to finance computer equipment purchases, software upgrades and related expenses.

Please do not hesitate to contact me at the direct dial number indicated above if you have any questions or comments regarding this filing.

Sincerely,



Ira L. Freilicher, Esq.

ILF/

Att.

BEFORE THE
PUBLIC SERVICE COMMISSION
OF THE
STATE OF NEW YORK

-----X
**Petition of The New York Independent System
Operator, Inc. for Authority Under Public
Service Law Section 69 to Incur Indebtedness
for Term in Excess of Twelve Months**

Case No.

-----X
**PETITION OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
FOR AUTHORIZATION TO INCUR INDEBTEDNESS FOR A TERM
IN EXCESS OF TWELVE MONTHS**

Pursuant to Section 69 of the Public Service Law ("PSL") and applicable parts of Title 16 of the New York Code of Rules and Regulations ("NYCRR"), the New York Independent System Operator, Inc. ("NYISO"), by counsel, submits this petition to request authorization from the Public Service Commission of the State of New York ("NYPSC" or "Commission") to incur indebtedness for a term in excess of twelve (12) months.

Established to facilitate the restructuring of the electric industry, the NYISO is a not-for-profit corporation¹ that operates the high-voltage electric transmission system, maintains the reliability of the bulk power system, and administers the wholesale electricity markets within the State of New York. The NYISO is an "electric corporation" under the New York State Public

¹ The NYISO was incorporated under the laws of the State of New York on April 3, 1997. A certified copy of the NYISO's certificate of incorporation, as amended and restated, was included with a prior Petition For Authorization to Incur Indebtedness submitted to the Commission on August 26, 1999.

Service Law² and, therefore, may not incur indebtedness payable at periods exceeding twelve months without prior authorization from the NYPSC.³

The NYPSC has previously authorized three existing NYISO credit facilities. The Commission authorized a \$12,000,000 revolving line of credit ("Revolver") and a five-year \$54,000,000 term loan agreement ("Term Loan") in Orders issued September 9, 1999, and October 20, 1999, in Case No. 99-E-1176. The Commission subsequently authorized an increase in the Revolver to \$50,000,000 in an Order issued September 7, 2000, in Case No. 99-R-1176. The Commission authorized a three-year term note ("Term Note") with a credit line up to a maximum of \$20,000,000 in an Order issued October 25, 2001 in Case No. 01-E-1068.

By this petition, the NYISO requests authorization from the NYPSC for a new five-year term loan credit facility ("New Term Loan") to finance computer equipment purchases, software upgrades and related expenses necessary to ensure compliance with the market design requirements of the Federal Energy Regulatory Commission for a Standard Market Design, and to otherwise improve the operation of the NYISO-administered wholesale electricity markets in New York.

As described below in Section II. of this Petition, the proposed credit facility is a five-year unsecured term loan facility for up to \$59,300,000 with a one-year draw period, and a four-year amortization period thereafter. The NYISO anticipates that it will draw down the entire

² See New York PSL § 2(12-13).

³ See New York PSL § 69.

\$59,300,000 available under the New Term Loan facility to finance expenditures for computer equipment, software upgrades and related expenses that have been budgeted for 2003.

In support of this petition, and in accordance with applicable provisions of the NYCRR, the NYISO, by counsel, submits the following information:

I. Background

The NYISO was formed in 1999 as a result of a comprehensive restructuring of the New York Power Pool, in response to the restructuring policies of this Commission and the Federal Energy Regulatory Commission.⁴ The NYISO's mission is to provide non-discriminatory open-access transmission service, to maintain the reliability of the New York State transmission system and to administer efficient markets for day-ahead and real-time energy, regulation, reserves, and installed capacity. The NYISO also administers auctions for transmission congestion contracts.

II. The Proposed Credit Facility

The NYISO seeks authorization under Section 69 of the New York Public Service Law to incur indebtedness for a term of more than twelve months by executing a five-year New Term Loan facility for \$59,300,000 to fund the purchase of computer equipment, software upgrades and related expenses.

These expenditures for computer equipment and software are included in the NYISO budget for 2003. The Management Committee of Market Participants, and the NYISO Board of

⁴ See *Central Hudson Gas & Electric Corp., et al.*, 83 FERC ¶ 61,352 (1998); *order on reh'g.*, 87 FERC ¶ 61,135 (1999) See also *Central Hudson Gas & Electric Corp., et al.*, 86 FERC ¶ 61,062 (1999); *order on reh'g.*, 88 FERC ¶ 61,138 (1999).

Directors, have approved the NYISO budget for 2003, and they have approved the use of a five-year financing to amortize the impact of these expenditures on the NYISO's Rate Schedule One, the mechanism by which Market Participants fund the NYISO budget.

The NYISO is purchasing this computer equipment and software to upgrade its market management systems to ensure that they will be fully compliant with the electricity market design requirements being developed by the Federal Energy Regulatory Commission in its Standard Market Design rulemaking.⁵ These upgrades will allow the NYISO to improve the efficiency, responsiveness and flexibility of the markets it administers and to address a number of limitations that exist in its current information technology systems.

The terms and conditions proposed for the New Term Loan facility are summarized in Attachment I., attached hereto. These terms and conditions will allow the NYISO to amortize current expenditures over the five-year term of the loan, better matching the costs of the equipment and software with their use. The NYISO will recover the funds needed to pay the principal of the loan, and the interest on the loan, through Rate Schedule One of its Open Access Transmission Tariff, and Rate Schedule One of its Market Administration and Control Area Services Tariff.

The commercial terms and conditions set forth in the attached Term Sheet are representative of those currently available in the commercial loan market and are, therefore, competitive. The NYISO has not yet executed a definitive loan agreement with KeyBank NA,

⁵ See *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, Notice of Proposed Rulemaking, 67 Fed. Reg. 55451 (July 31, 2002).

but expects to do so by the end of January, 2003. While some of the terms and conditions in the final loan agreement may differ from those set out in the attached Term Sheet, the NYISO expects that the material terms and conditions of the final loan agreement will be the same as or consistent with those set out in the attached Term Sheet.

The NYISO cannot use any of the credit facilities previously authorized by the Commission to finance the \$59,300,000 expenditures budgeted for 2003. The Revolver authorized by the Commission in Case No. 99-R-1176 is intended solely as a cash flow management tool, to provide working capital to balance monthly receipts and remittances, and to provide liquidity to the NYISO administered markets. The NYISO must reserve the Revolver for this important purpose. The existing Term Loan authorized in Case No. 99-E-1176 has been fully utilized to finance the start-up costs of the NYISO. The three-year Term Note authorized in Case No. 01-E1068 has been partially utilized to finance other information technology projects. Neither its three-year term nor its remaining authorized capacity of approximately \$10,000,000 are adequate in the present case.

III. Required Information

The information required to support a petition for authorization to incur indebtedness pursuant to Section 69 of the New York Public Service Law is specified in the Commission's regulations, including Parts 18 and 37 of Title 16 of the NYCRR. In compliance with those regulations, the NYISO states as follows:

Financial Conditions of the NYISO

As a not-for-profit corporation, the NYISO has not issued any capital stock or equity shares of any kind and, therefore, has not declared any dividends. To date, the NYISO has not issued any bonds, or executed a mortgage on any of its property.

The \$50,000,000 Revolver authorized in Case No. 99-R-1176, the \$54,000,000 Term authorized in Case No. 99-E-1176, and the \$20,000,000 Term Note authorized in Case No. 01-E-1068 represent the only long-term indebtedness that has been incurred by the NYISO under Section 69 of the New York Public Service Law. As of December 31, 2001, nothing was outstanding on the Revolver, \$35,475,000 was outstanding on the Term Loan, and \$1,750,000 was outstanding on the three-year Term Note. The NYISO has no contingent assets or liabilities.

Included with this petition, as Attachment II. hereto, is a table containing the amounts of interest accrued at each applicable rate of interest on the outstanding indebtedness of the NYISO for the latest fiscal period ending December 31, 2001. Also included, as Attachment III. hereto, is a copy of the Annual Report of the New York Independent System Operator, Inc. for the year ended December 31, 2001 which includes detailed audited income statements and balance sheets for the calendar years ending December 31, 2000 and December 31, 2001. *See* 16 NYCRR §§ 37.1(a) and 18.1.

(A) Book Cost of the NYISO's Utility Property

The net depreciated value of the NYISO's property and equipment as of December 31, 2001, as reported on page 32 of the Annual Report for 2001, attached as Attachment III. hereto, was \$14,000,000. *See* 16 NYCRR § 37.1(b).

(B) No Amounts for a Franchise

The book value reported for the NYISO's property and equipment includes no amount for a franchise, consent, or any other right to operate as a public utility. *See* 16 NYCRR § 37.1(c).

(C) No Issuance of Stock

As a not-for-profit corporation, Type B, the NYISO has not issued any stock or equity shares of any kind, and does not propose in this petition to do so now. *See* 16 NYCRR § 37.1(d).

(D) Amount of Proposed Indebtedness

As described above in Section II. of this petition, the NYISO proposes to execute a five-year unsecured New Term Loan facility for \$59,300,000 . *See* 16 NYCRR § 37.1(e).

(E) Purpose of the New Term Loan

As described above in Section II. of this petition, the NYISO proposes to use the New Term Loan to finance expenditures budgeted for 2003 for new computer equipment, software upgrades and related expenses necessary to ensure compliance with the market design requirements of the Federal Energy Regulatory Commission for a Standard Market Design, and to otherwise improve the operation of NYISO-administered markets. *See* 16 NYCRR, § 37.1(f).

(F) Other Funds Available For Stated Purpose

As described above in Section II. of this petition, the Revolver is intended, and has been used, solely for the purpose of providing working capital to balance cash flows in the NYISO-administered markets. The Term Loan has been utilized in full to finance the start-up costs of the NYISO. The three-year Term Note has been partially utilized to finance earlier purchases of computer equipment and software. Its remaining authorized capacity, and its three-year term, are

inadequate for the proposed financing. Consequently, the proposed New Term Loan represents the only source of funds available to finance the new expenditures for computer equipment and software that have been budgeted for 2003. *See* 16 NYCRR § 37.1(g).

(G) Finalized Loan Agreement

A definitive agreement documenting all the terms and conditions of the proposed New Term Loan has not been finalized. The NYISO anticipates that it will execute this definitive agreement with KeyBank NA by the end of January, 2003. The material terms and conditions of the proposed New Term Loan have been agreed to in a Term Sheet executed by the NYISO and KeyBank NA, attached as Attachment I. hereto. The NYISO anticipates that the final terms and conditions of the proposed New Term Loan will be the same as or materially consistent with those set forth in the attached Term Sheet, and requests authorization for the New Term Loan on the basis of those described terms and conditions. See 16 NYCRR § 37.1(h).

(H) Estimated Costs and Expenses of the New Term Loan

Because the NYISO has not yet executed a definitive loan agreement with KeyBank NA, the NYISO does not know what the exact costs and expenses of the New Term Loan will be. The NYISO believes that the borrowing rates, margins and commitment fees are competitive, and the NYISO anticipates that they will be as stated in the Term Sheet, attached as Attachment I. hereto. The NYISO anticipates that any other costs and expenses associated with the proposed New Term Loan will be comparable to those associated with comparable credit facilities offered by other lenders and, therefore, will be commercially reasonable. *See* 16 NYCRR § 37.1(i).

(I) No Mortgage or Other Security Agreement

As described above in Section II. of this petition, the proposed New Term Loan facility is unsecured. There is no mortgage or other security instrument associated with the proposed credit facility. *See* 16 NYCRR § 37.1(j).

(J) No Planned Merger or Consolidation

The NYISO has no plans to merge or consolidate with another organization. A petition to the Federal Energy Regulatory Commission that might have led to a merger of the NYISO and ISO-New England has been withdrawn. *See* 16 NYCRR § 37.1(k).

(K) No Mortgage; No Stockholders

The proposed New Term Loan facility does not involve a mortgage, and the NYISO has no stockholders. *See* 16 NYCRR § 37.1(l).

(L) No Other Required Approvals

Based on the terms and conditions of the proposed New Term Loan facility, no authorization or approval for the proposed facility is required from any other public authority. *See* 16 NYCRR § 37.1. The NYISO is regulated by the Federal Energy Regulatory Commission, but that federal agency need not approve a financing authorized under Section 69 of the New York Public Service Law. *See* 16 NYCRR § 37.1; *and see* 16 U.S.C. § 824(f).

(M) No Capitalization of Any Franchise

The NYISO is not proposing to capitalize any franchise in connection with the proposed New Term Loan. *See* 16 NYCRR § 37.1(n).

(N) Affidavit of Principal Accounting Officer

The affidavit of Andrew R. Ragogna, the NYISO's Chief Financial Officer and principal accounting officer, is attached as Attachment IV. hereto, attesting that the NYISO is in compliance with all applicable accounting standards. *See* 16 NYCRR § 37.1(o).

IV. The Proposed Financing Is In the Public Interest

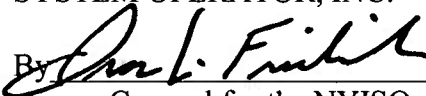
The NYISO respectfully submits that the proposed New Term Loan is in the public interest. The NYISO depends on extensive systems of information technology to administer the wholesale electricity markets in New York effectively. Such systems require frequent modifications and upgrades. These are expensive. The proposed financing will enable the NYISO to economically fund and amortize significant expenditures in 2003 for computer equipment and software needed to ensure compliance with FERC requirements for market design, and to otherwise improve the administration of wholesale electricity markets in New York. These expenditures will help further the development of competitive wholesale electricity markets in New York, for the benefit of all its citizens.

CONCLUSION

For the foregoing reasons, the NYISO respectfully submits that the proposed New Term Loan described in this Petition is reasonably required for the purpose specified, and that the purpose specified is proper and in the public interest. The NYISO requests that the Commission approve this petition in all respects.

Respectfully submitted,

NEW YORK INDEPENDENT
SYSTEM OPERATOR, INC.

By 
Counsel for the NYISO

Ira L. Freilicher, Esq.
Steven D. Schell, Esq.
Hunton & Williams
200 Park Avenue, 43rd Floor
New York, New York 10166-0136

J. Kennerly Davis, Jr., Esq.
Hunton & Williams
Riverfront Plaza-East Tower
951 E. Byrd Street
Richmond, Virginia 23219-4074

December 3, 2002

Attachment I.

Summary of Terms and Conditions
December 2002

Borrower:	The New York Independent System Operator, Inc. ("NYISO", the "Borrower", or the "Company")
Administrative Agent & Lead Arranger:	KeyBank National Association ("KeyBank", "Agent", or "Arranger").
Lenders:	KeyBank and a group of Lenders acceptable to the Arranger and the Borrower.
Total Facility Amount:	US\$59,300,000 to be arranged by the Agent on a "best efforts" basis.
Facility:	US\$59,300,000 Five (5) year Term Loan including a One (1) year draw period (the "Draw Period") and a Four (4) year amortization period thereafter.
Purpose:	To upgrade the Borrower's Standard Market Design (SMD) software and Other Strategic Initiatives (OSI) related to managing New York's power grid.
Amortization:	Interest only, payable quarterly, during One (1) year draw period then monthly principal and interest payments based on a Four (4) year straight-line amortization thereafter.
Maturity:	The Facility will mature Five (5) Years from closing.
Security:	Unsecured. Negative pledge on assets.
Guarantor(s):	None
Voluntary Prepayments:	Base Rate borrowings may be repaid at any time. LIBOR borrowings may not be repaid before the end of an interest period without indemnification for funding losses.

This document is to be used for internal use only and not to be disclosed to outside third parties without KeyBank's consent. This Summary of Terms and Conditions is intended as an outline of certain of the material terms of the senior credit facility and does not purport to summarize all of the conditions, covenants, representations, warranties and other provisions which would be contained in definitive documentation for the senior credit facility contemplated hereby.

Summary of Terms and Conditions
December 2002

<i>Borrowing Rates:</i>	At Borrower's option, advances under the Facility shall bear interest at either (a) the London Interbank Offered Rate (LIBOR) plus the applicable LIBOR Margin or (b) the Base Rate plus the applicable Base Rate Margin. The Base Rate shall mean a rate per annum equal to the greater of (a) KeyBank Prime Rate or (b) one-half of one percent in excess of the Federal Funds Effective Rate. LIBOR borrowings may be made for interest periods of 30, 60 or 90 days as selected by Borrower from time to time but no interest period may extend beyond the Maturity of the Facility.
<i>Applicable Margin:</i>	LIBOR borrowings: 137.5 basis points. Base Rate borrowings: 0.0 basis points.
<i>Commitment Fee During Draw Period:</i>	15.0 basis points per annum times the unused Facility Amount, payable quarterly.
<i>Interest Rate Protection:</i>	To be determined.
<i>Interest Payment Dates:</i>	During the Draw Period: For Prime Rate borrowings, the Interest Payment Dates shall be quarterly; for LIBOR borrowings the Interest Payment Dates shall be at the end of an Interest Period but in no case more than ninety (90) Days. During the Four (4) year amortization period: monthly.
<i>Overdue Rate:</i>	After the occurrence and during the continuance of a default, the Loans and all other past due amounts owed under the Facility will bear interest at 2% above the rate otherwise applicable thereto.
<i>Reserve Requirements/ Yield Protections:</i>	The rate quoted as the LIBOR rate will be grossed-up for the maximum statutory reserve requirements for eurocurrency liabilities. In addition, the financing agreements will contain customary provisions relating to increased costs, capital adequacy protection, withholding and other taxes and illegality.

**Summary of Terms and Conditions
December 2002**

**Representations and
Warranties:**

Similar to the Representations and Warranties in the Borrower's existing Senior Revolving Credit and Term Loan Facilities and customary for transactions of this size and nature.

Financial Covenants:

Minimum Fixed Charge Covenant.

Other Covenants:

Similar to the Representations and Warranties in the Borrower's existing Senior Revolving Credit and Term Loan Facilities and customary for transactions of this size and nature, including but not limited to:

- Financial Reporting and ERISA.
- Restrictions on sale of assets, investments, change in control, acquisitions, mergers, joint ventures or consolidations.

**Conditions Precedent to
Borrowing:**

Customary for transactions of this nature and subject to materiality provisions where appropriate, including but not limited to:

- Satisfactory review by Agent's counsel of (a) Borrower's authority to borrow the Facility for the Purpose set forth herein under: (i) the Federal Power Act and applicable FERC regulations and rulings; and (ii) New York State Law and applicable rules and regulations of the New York State Public Service Commission ("PSC"); and (b) Borrower's ability to recover from its customers through charges under Borrower's existing tariffs and the schedules thereto all of the interest, principal and other fees and expenses payable under the Facility;
- Satisfactory opinion of independent counsel to the Borrower substantially similar to the opinions of counsel previously delivered to Agent and the applicable lenders in connection with Borrower's existing Revolving Credit Financing, Term Credit Financing and Line of Credit Financing.
- Absence of Default;
- Accuracy of Representations and Warranties;
- Negotiation and Execution of Satisfactory Closing Documents.

This document is to be used for internal use only and not to be disclosed to outside third parties without KeyBank's consent. This Summary of Terms and Conditions is intended as an outline of certain of the material terms of the senior credit facility and does not purport to summarize all of the conditions, covenants, representations, warranties and other provisions which would be contained in definitive documentation for the senior credit facility contemplated hereby.

Summary of Terms and Conditions
December 2002

Financial Reporting:

The Borrower will provide to the Agent and the Lenders:

- Annual (audited) consolidated and consolidating financial statements within 120 days of the end of each fiscal year;
- Other financial reports as the Lenders may reasonably request.

Events of Default:

Customary for transactions of this nature and subject to materiality provisions where appropriate, including but not limited to:

- Failure to pay any principal under the Facility when due;
- Failure to pay any interest or fees within five (5) business days of the due date;
- Defaults in the payment of principal, interest and or fees on other debt instruments;
- Revocation by FERC of its approval of the Borrower's ISO Agreement, NYSRC Agreement, ISO-NYSRC Agreement or the ISO-Transmission Owners Agreement or the Borrower's existing OATT or Services Tariffs or the schedules thereto (collectively, the "ISO Related Documents") or there occurs a material adverse change in, cancellation of, or expiration or termination of, the ISO Related Documents or if there is a change in, cancellation or termination of, any FERC or PSC orders or rulings relevant to the operations of the Borrower, if any of these could have a material adverse effect upon the business, financial condition or operations of the Borrower or which could impair, prohibit or restrict the repayment of the Facility or the remedies of the Agent and the Lenders under the loan documents;
- Material Adverse Effect;
- Violations of covenants;
- ERISA termination;
- Cross default, subject to materiality;
- Change of control.

Summary of Terms and Conditions
December 2002

Remedies:

Customary for transactions of this nature including but not limited to:

- Acceleration;
- Recovery of amounts;
- Costs of collection;
- No advances.

Required Lenders:

No amendment or waiver of any provision of the Facilities shall be effective unless agreed to in writing by the Lenders holding not less than 66 2/3% of the aggregate commitments or unpaid principal amount of loans provided however, that no amendment, waiver or consent shall increase the commitments, reduce the principal, interest or fees on the notes, change the method for computing interest or fees on the notes, or postpone the date for payment of principal, interest or fees on the notes, without the written consent of all of the Lenders.

**Assignments and
Participations:**

The Borrower may not assign its rights or obligations under the Facility without the prior written consent of the Lenders. Any Lender may at any time assign or participate its rights and obligations under the Facility, in agreed upon minimum amounts, and subject to approval of the Borrower (unless in default) and the Agent, which approval shall not be unreasonably withheld. Each assignment shall be accompanied by the payment of an assignment fee by the assignor to the Agent of \$3,500 per assignment. The Facility shall provide for a mechanism, which will allow for each assignee to become a direct signatory to the Facility and will relieve the assigning Lender of its obligations with respect to the assigned portion of its commitment.

**Summary of Terms and Conditions
December 2002**

***Expenses and
Indemnifications:***

Borrower agrees, upon request of the Agent, to indemnify and hold harmless, and reimburse the Agent and the Lenders, (and their respective officers, directors, agents, affiliates, employees and the attorneys) from time to time for all reasonable costs, liabilities, losses, obligations and expenses (including, but not limited to, with respect to the Agent only, expenses of due diligence investigation, consultants' fees, syndication expenses, IntraLinks expenses, travel expenses and fees, disbursements incurred and other charges of counsel) incurred in connection with the Facility and the preparation of this Summary of Terms and the preparation, negotiation and enforcement of the definitive documentation for the Facility, regardless of whether the transactions contemplated hereby are consummated or any loan documentation actually executed; provided, however, Borrower shall not be obligated to reimburse or indemnify the Agent or the Lenders for any such cost, liabilities, losses, obligations or expenses caused by the Agent's or the Lender's gross negligence or willful misconduct. The fees and expenses of counsel to the Agent shall not exceed \$45,000 for the negotiation and preparation of this Summary of Terms and the definitive documentation in connection therewith. The fee and expenses, if any, of counsel to each of the Lenders which are for the account of the Borrower shall be negotiated by Borrower, the Agent and the applicable Lender prior to such Lender becoming a "Lender" under the Facility.

Agent's Counsel:

Phillips, Lytle, Hitchcock, Blaine, & Huber LLP.

Governing Law:

State of New York.

Proposal Expiration Date:

December 5, 2002.

BBks
WORD1248906.4

Attachment II.

**NYISO
PETITION TO PSC TO ASSUME INDEBTEDNESS
ACCRUED INTEREST ON INDEBTEDNESS**

<i>At December 31, 2001:</i>			
	<u>Interest Rate</u>	<u>Outstanding Principal</u>	<u>Accrued Interest</u>
Revolving Line of Credit	n/a	\$ -	\$ -
Term Loan	6.99%	\$ 35,474,553	\$ 213,527
Term Note	3.39%	\$ 1,750,000	\$ 5,124
Totals		\$ 37,224,553	\$ 218,651

Attachment III.



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 dark ink, appearing to read "Richard J. Grossi".

Richard J. Grossi,
Chairman of the Board

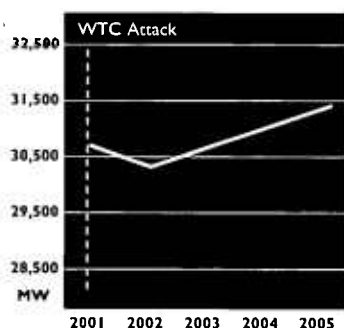
A handwritten signature in dark ink, appearing to read "W. J. Museler".

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:

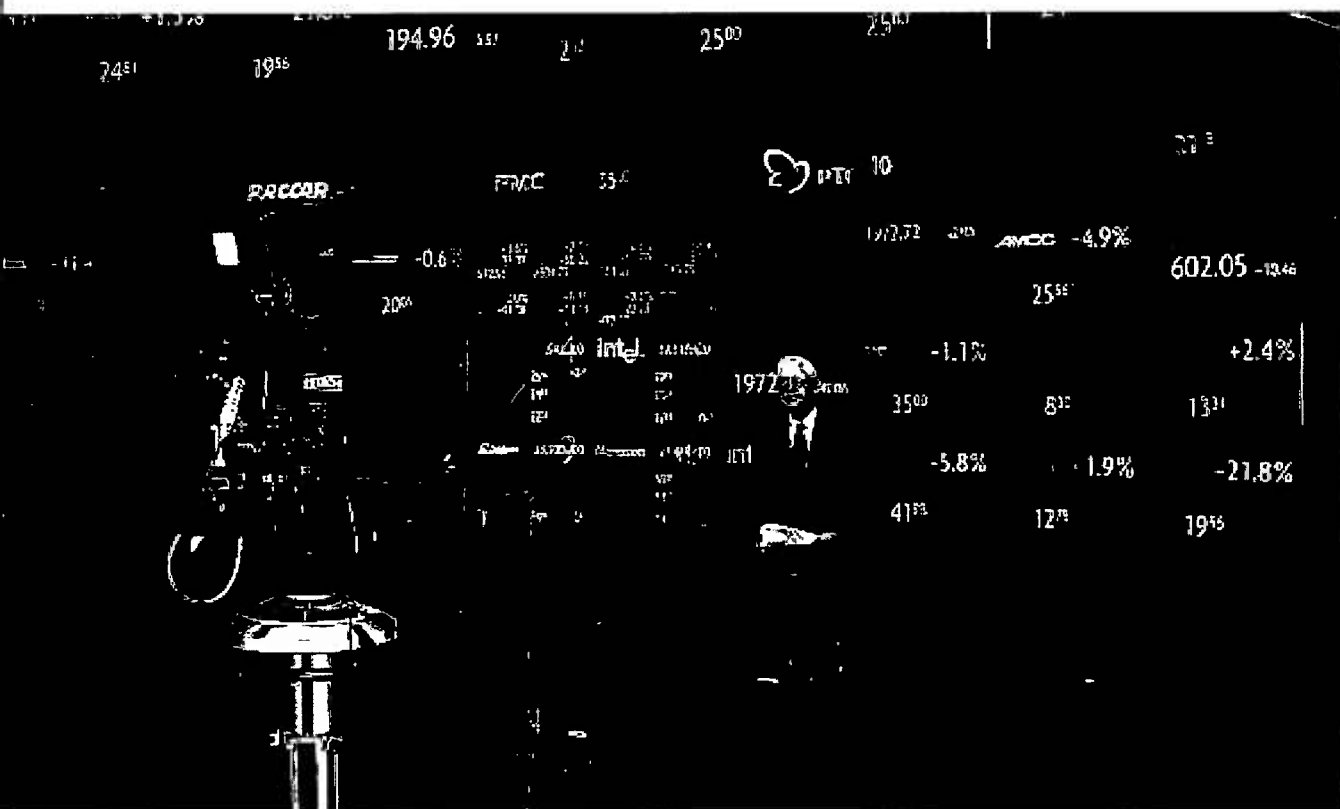
In the Day Ahead Market, load-serving companies (for example, distribution companies) inform the NYISO of their anticipated electricity needs for the following day. Suppliers submit bids for energy they can supply. The NYISO accepts the lowest bid supplies to meet demand, setting a "market-clearing price."

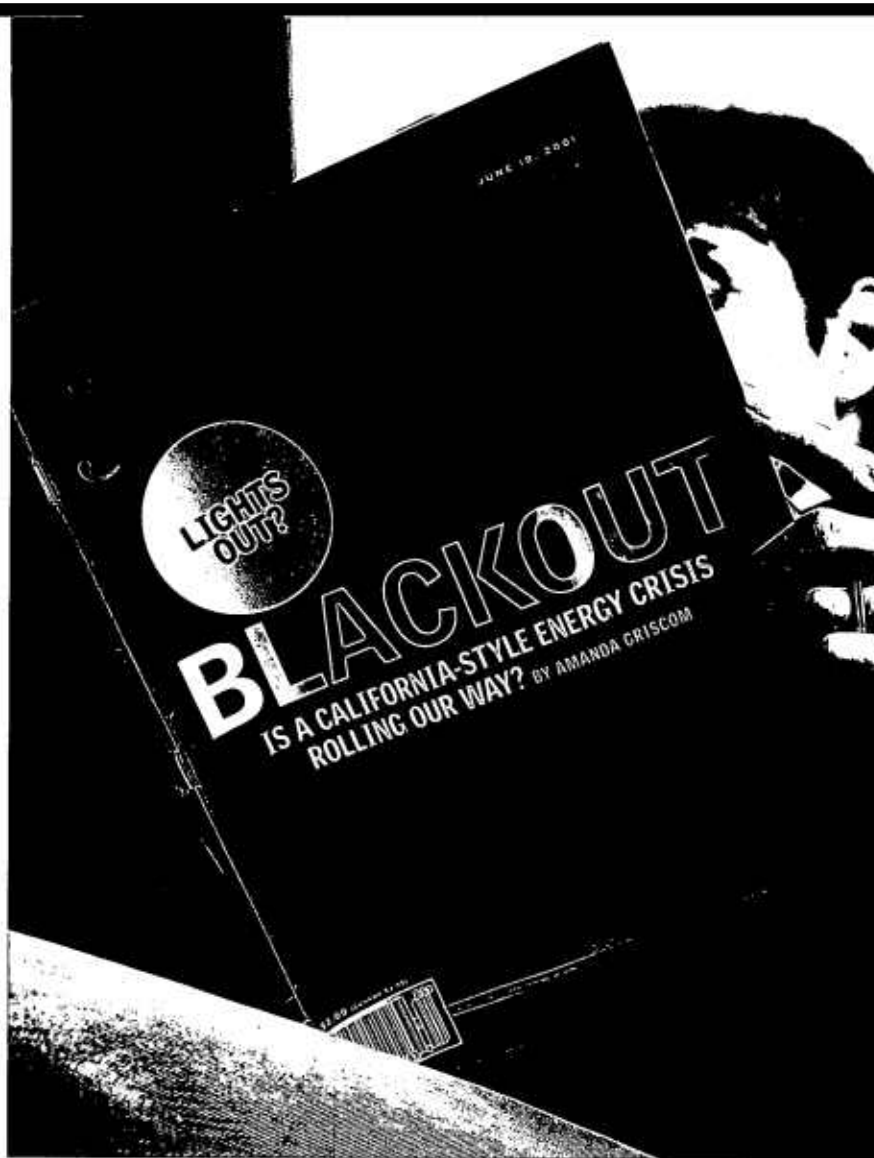
In the Real Time Market, load-serving companies buy the electricity they need to

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.





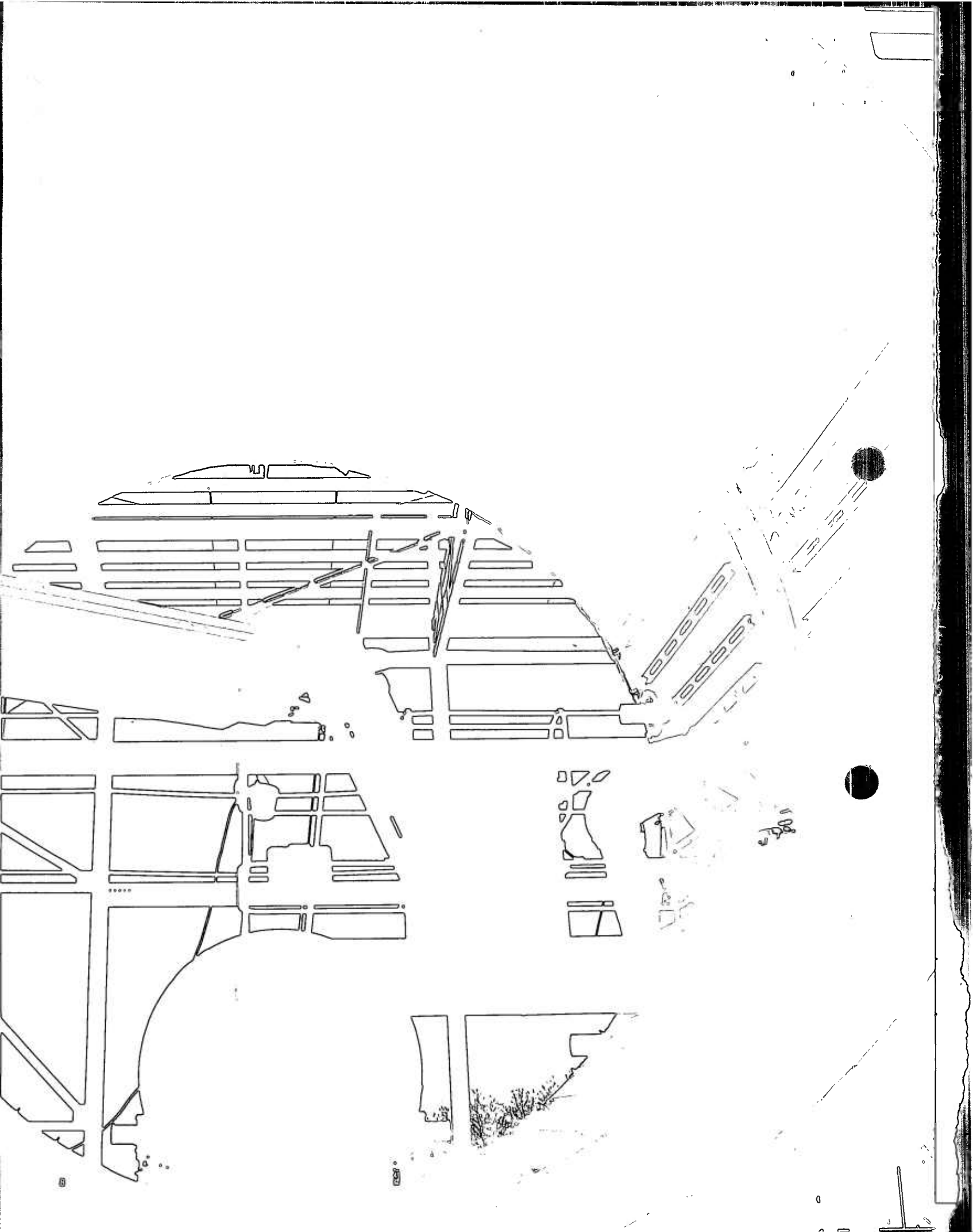
One of the major industry stories during 2001 was whether New York would experience the kind of crisis that was devastating California. After a summer during which New York set three consecutive electricity consumption records, while successfully keeping the lights on, the answer came back a resounding "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-

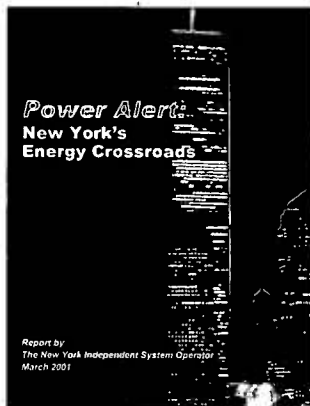
nia experience nevertheless provides warning to New York. The disparity between electricity demand and supply in New York must be resolved. Failure to correct this imbalance will result in environmental and economic degradation, a decrease in the reliability of the State's electric infrastructure, and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

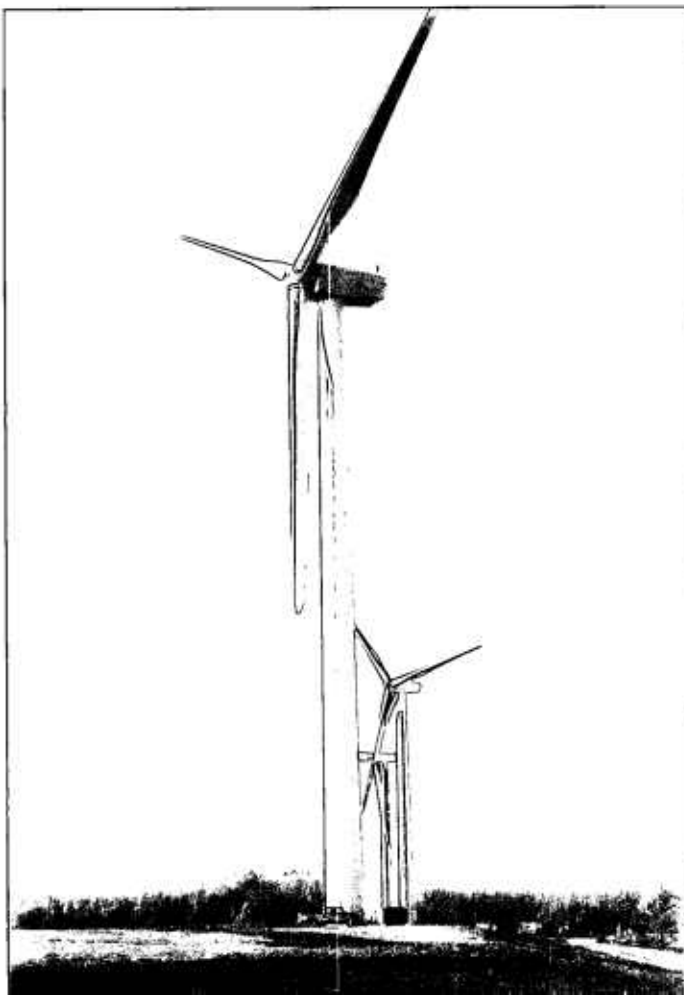
mended new generation programs are implemented, together with conservation measures and the development of markets for renewable energy, New Yorkers can be assured of reliable, affordable and environmentally responsible sources of power to fuel economic growth. Increased electricity production drives 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.

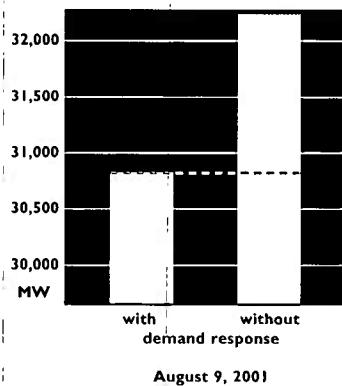


Supply and demand must achieve a stable balance for the more than 7,000,000 residential and business customers who purchase electricity in New York State to enjoy reliable power at fair prices

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.

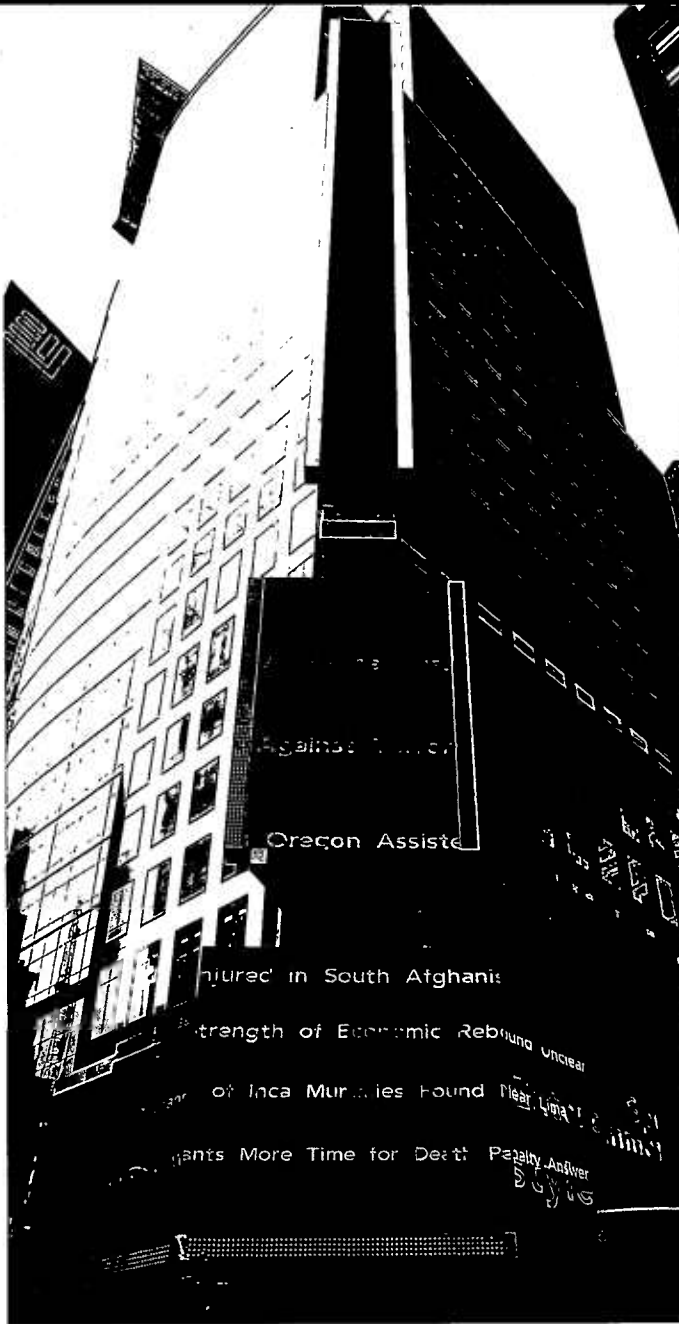
The Day-Ahead Demand Response Program allows consumers or groups of consumers to bid what they would normally consume on a given day. If the offer is accepted on the open market, the consumer must reduce its electric use accordingly and be paid for whatever demand reduction was sold.

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

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.



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.



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

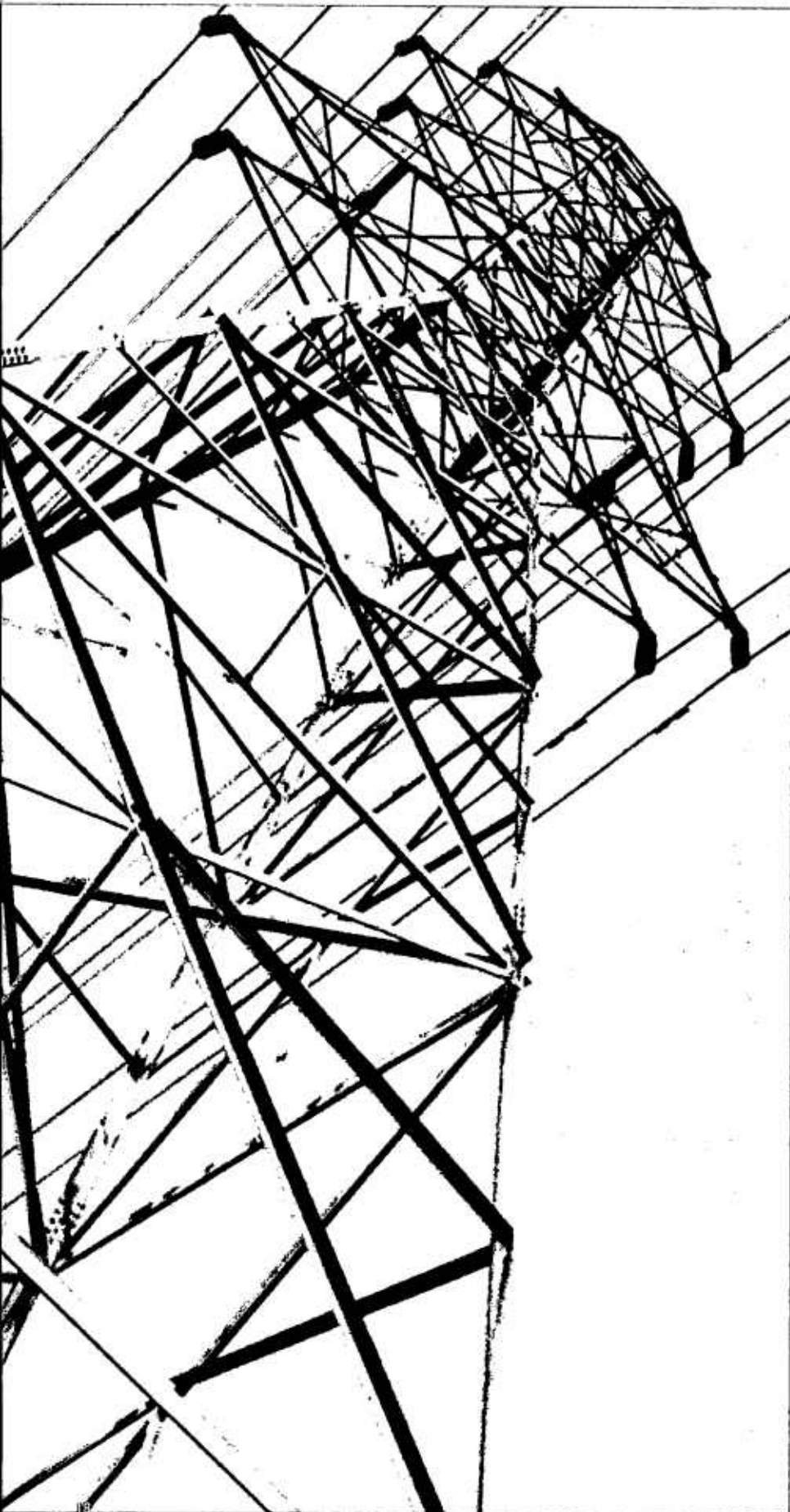


**Electric demand
in the Northeast
totals 56,000
megawatts**

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.



NORTHEAST REGIONAL TRANSMISSION ORGANIZATION

July 16, 2002

home

news

about nerto



Stakeholder Information

*****NOTICE***** The revised version of the NERTO Joint FERC filing is now posted in the Stakeholder Exchange

access to Stakeholder Exchange

request access



Welcome!

On January 28, 2002, ISO New England Inc. (ISO-NE) and the New York Independent System Operator (NYISO), the two organizations that oversee the electric power and wholesale market systems in New England and New York respectively, executed an agreement to develop a common electricity marketplace for their adjacent regions based on a common market design and to jointly evaluate the feasibility of creating a Northeast Regional Transmission Organization (NERTO). This website is devoted to facilitating these two endeavors by creating a portal for information exchange.

This website is divided into two sections:

- ▶ the "open space" for viewing by the general public and media who are interested in learning more about the background and development of a common market design and NERTO; and
- ▶ a password secured "stakeholder exchange" where market participants from both regions can review and comment on specific market design proposals, track project progress and keep current with emerging events.

Both our organizations are very excited by the prospect of delivering significant benefits to electricity consumers by developing a standardized market design for the Northeast. We invite you to join us as we grow larger markets to better serve you.

ISO New England
Holyoke, MA
(413) 535-4000
www.iso-ne.com

NYISO
Schenectady, NY
(518) 356-6000
www.nyiso.com

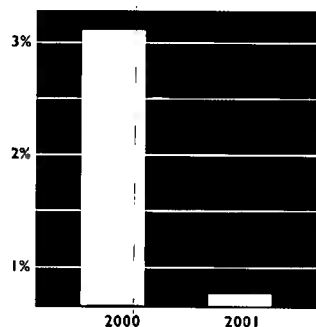
The Northeast Regional Transmission Organization represents a year's efforts to merge NYISO and ISO-NE operations into one seamless, efficient market in the Northeast. As the synthesis to one market proceeds, the NERTO Web site (www.nerto.com) serves as an important connection among market participants, 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 Ragogna, 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
ASSETS		
<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
LIABILITIES		
<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

notes to financial statements.

STATEMENTS OF ACTIVITIES NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

	Years ended December 31	
	2001	2000
Revenues:		
Rate Schedule 1 tariff charge	\$ 87,048,756	\$ 61,373,324
Fees and services	1,842,693	215,764
Interest income	1,152,507	3,434,406
Total revenues	90,043,956	65,023,494
Operating Expenses:		
Compensation and related benefits	25,211,177	19,207,800
Pension expense (Note 7)	1,604,907	1,274,800
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. 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
	54,942,444	54,942,444
Accumulated amortization	(21,976,978)	(10,988,488)
Transition asset, net	\$ 32,965,466	\$ 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
	21,391,903	10,831,038
Accumulated depreciation and amortization	(7,367,941)	(2,586,914)
Property and equipment, net	\$ 14,023,962	\$ 8,244,124

4. SHORT-TERM DEBT

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

5. LONG-TERM DEBT

On September 8, 2000, NYISO borrowed \$48,460,444 under a Term Credit Loan to reimburse NYPP member companies for their investment in the transition of the NYPP to the NYISO, and for the purchase of certain NYPP assets. Principal and interest payments are due monthly until December 2004. Under the Term Credit Loan, interest is variable based on the 30-day LIBOR plus 125 basis points. The interest rate on the Term Credit Loan at 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 1 for postretirement benefits during 2001 and 2000, respectively. These amounts are included in Regulatory Liabilities on the Statement of Financial Position, pending plan formation and approval. See additional information on Regulatory Liabilities in Note 9.

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

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

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

8. LEASE COMMITMENTS

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

2002	\$ 734,236
2003	\$ 734,236
2004	\$ 734,236
2005	\$ 734,236
2006	\$ 81,116
Total	\$ 3,018,050

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

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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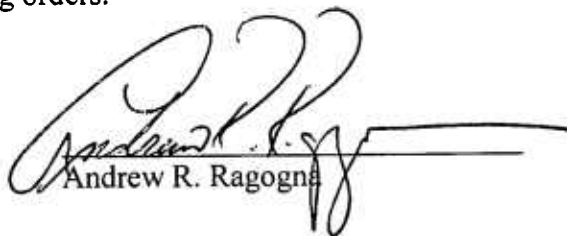
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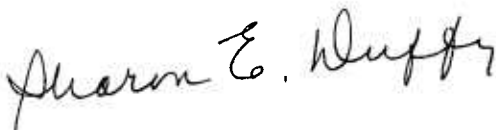
VERIFICATION and AFFIDAVIT

STATE OF NEW YORK)
COUNTY OF ALBANY)

Andrew R. Ragogna, being duly sworn, deposes and states:

1. I am the Chief Financial Officer and the principal accounting officer of the New York Independent System Operator, Inc. ("NYISO"), the Petitioner in this proceeding, and am responsible for maintaining the accounting and financial records of the Petitioner.
2. I have read the foregoing Petition and, based on my own knowledge, believe the contents thereof to be true and correct. As to those matters therein stated to be alleged upon information and belief, I believe them also to be true and correct.
3. Because the Petitioner is a domestic corporation, pursuant to PSL 69, I am making this verification. I further state that the grounds of my belief as to all matters in this Petition not stated upon my personal knowledge are my communications with the other officers and personnel of the Petitioner and my review of correspondence and other pertinent records.
4. Since the commencement of NYISO operations, all accounts of the NYISO have been maintained strictly in accordance with generally accepted accounting principles and with any and all accounting orders of the New York Public Service Commission that are applicable to the NYISO. Additionally, there have been no charges or credits to asset accounts that have not been in strict accordance with such accounting orders.


Andrew R. Ragogna



SHARON E. DUFFY
Notary Public, State Of New York
No. 01DU4515852
Qualified In Schenectady County
Commission Expires February 28, 2003