1991 ANNUAL REPORT

New England Electric System

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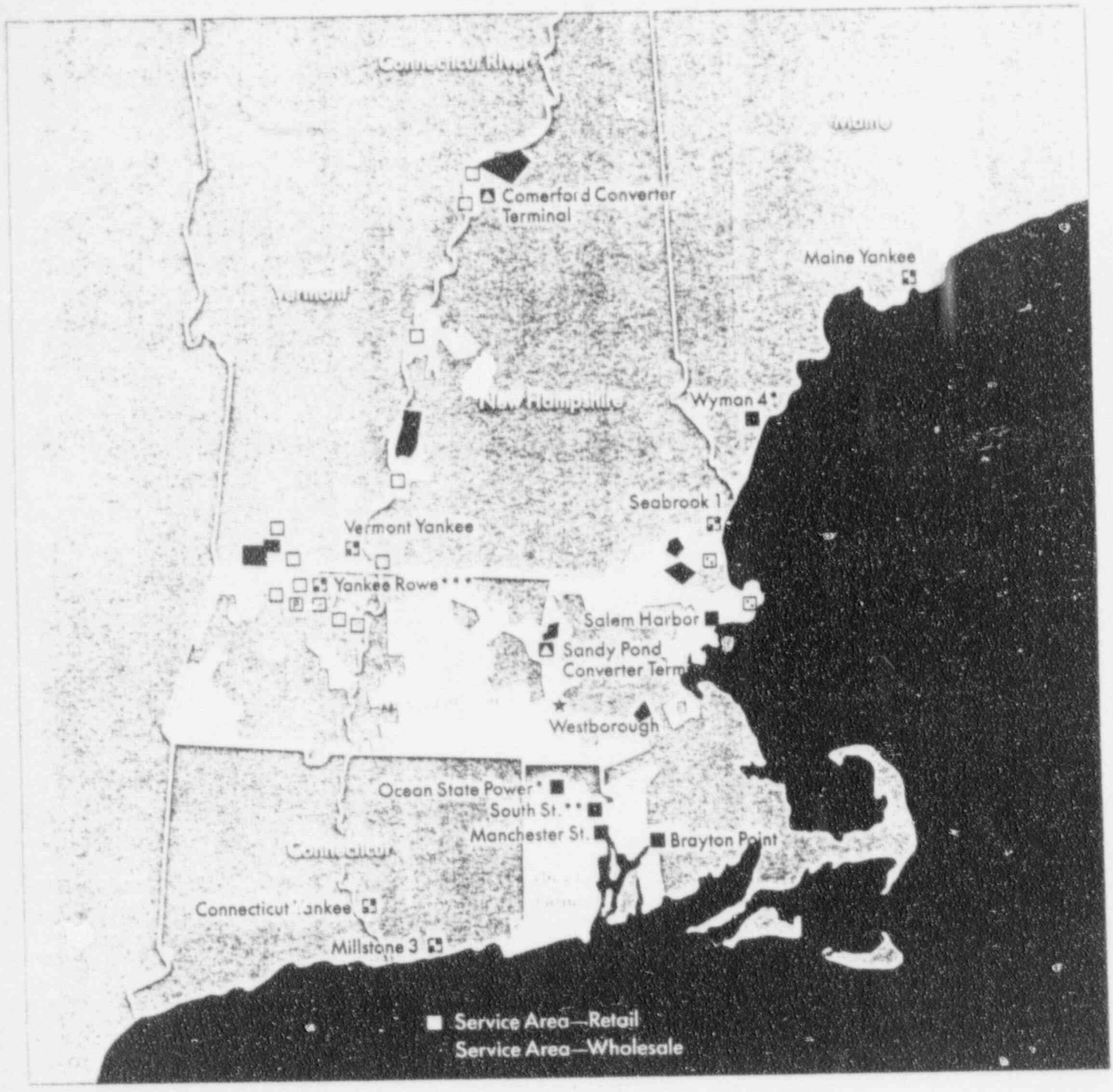

About the cover:
Burning gas at Brayton Point Station's Unit 4 will contribute to the environmental goals of the System. Edward Pollard, welder first class, helps secure the gas pipeline connection to the plant.

- Pumped Storage Plant
- Hydro Plant
- Fossil-fueled Plant
  *(Partial ownership interest)
  **(Deactivated status)
- Nuclear Plant, Partial Ownership Interest
  ***(Operation discontinued)
- Diesel Plant
- High Voltage DC Terminal
- ★ Corporate Headquarters

	1991	1990
Earnings per average share	$ 2.77	$ 4.11*
Dividends declared per share	$ 2.07	$ 2.04
Book value per share—year end	$22.17	$21.43
Market price per share—year end	$32⅛	$24⅞
Growth (decline) in kilowatthour (KWH) sales to ultimate customers	(1.2)%	.3%
Cost per KWH to ultimate customers (cents)	8.99	8.27

*Includes $1.80 per share resulting from the reversal of a portion of the 1988 write-down related to Seabrook 1 (see Note C).

New England Electric System (NEES) is a public utility holding company headquartered in Westborough, Massachusetts. Subsidiaries include three retail operating companies—Massachusetts Electric Company, which serves 904,000 customers in 146 Massachusetts communities; The Narragansett Electric Company, which serves 319,000 customers in 27 Rhode Island communities; and Granite State Electric Company, which serves 34,000 customers in 21 New Hampshire communities. Other subsidiaries include two wholesale generating companies: New England Power Company, which operates 21 generating stations, and Narragansett Energy Resources Company, which owns 20 percent of the Ocean State Power project; an oil and gas exploration and fuels company, New England Energy Incorporated; three transmission service companies: New England Electric Transmission Corporation, New England Hydro-Transmission Corporation, and New England Hydro-Transmission Electric Company, Inc.; and a service company, New England Power Service Company.

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TO OUR FELLOW SHAREHOLDERS:

Joan T. Bok, chairman, and John W. Rowe, president and chief executive officer.

In 1991, New England Electric System (NEES) delivered solid financial and operating performance in spite of weak economic conditions throughout the Northeast. Our financial highlights include the following:

- Earnings were $2.77 per average share. This resulted in a return on equity of 12.6 percent, which was among the best for electric utilities in the Northeast and well above average for electric utilities across the country.
- Our share price closed at $32⅛ at year's end compared with $24⅞ at the end of 1990, reflecting the quality of our earnings as well as reduced interest rates and a favorable stock market.
- In May, the Board of Directors increased the annual dividend rate to $2.08.

These results reflect our early preparation for the recession and the ability of our employees to accomplish a great deal with constrained resources. A portion of the savings created by our path-breaking conservation and load management (C & LM) programs yielded seven cents per share under incentive mechanisms adopted by public utility commissions in each of the three states we serve. These conservation incentives, along with recovery of other costs from both state and federal regulatory agencies, have been vital components of our financial performance. In addition, as further discussed in the Financial Review, the gain from the sale of our unregulated oil and gas properties contributed to the bottom line.

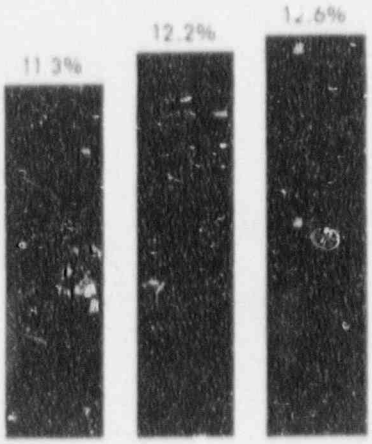
1991 was the second year of our quality management effort, which fosters continuous improvement in all aspects of our electric service. The renewed emphasis on efficiency and cost control generated by this process was particularly important since

our 1991 kilowatthour sales to ultimate customers were 1.2 percent lower than in 1990. We further tightened operating budgets; terminated a power purchase contract, which will save our customers $18 million; completed the first step in a 4 percent across the board employment reduction through attrition; and deactivated our oldest and least efficient fossil-fired generating facility, the 100 megawatt (MW) South Street Station. Close coordination of financial planning, budgeting, and rate cases assisted our efforts to manage both expenses and investments. While rate increases have been substantial in recent years, we are pleased that our average prices to customers continued to be among the lowest third of major New England utilities. This cost advantage meets a key service quality benchmark and is likely to continue in 1992 when we expect our price increases to be below inflation.

Team problem-solving is a primary tool for quality improvement. Some 180 employee teams are exploring ways to improve our performance and cost effectiveness in dozens of areas such as environmental protection, power plant efficiency, and fuel inventory management. During the past year, our quality improvement teams:

- studied one of our key employee benefit plans and recommended improvements that are expected to save $200,000 annually, reducing costs by 60 percent while improving the service to employees;
- found ways to reduce by half the duration of a planned maintenance outage at the Bear Swamp pumped storage facility, reducing replacement power costs; and
- implemented a computer-based system that reduces paperwork, time, and costs associated with installing electric service to new customers.

Return on Common Equity—1991



In the aftermath of Hurricane Bob, System line crews such as this one were joined by crews from outside New England to replace hundreds of utility poles and repair thousands of miles of wire.

The largest single challenge to our service in 1991 was Hurricane Bob in August. This storm left nearly one-third of our 1.2 million customers in Rhode Island, Massachusetts, and New Hampshire without power. Through the total commitment of our line crews, customer service representatives, engineers, and many other employees, we successfully restored service to half of these customers within 24 hours. By the second day, help was arriving from as far away as Virginia, Quebec, and Ontario. With this assistance, System employees restored service to all customers within five days. While our line crews worked all hours of the day and night, sometimes in the downpour of a second storm, our customer service personnel answered more than 100,000 calls. The overall effort by our employees has been praised by customers and public officials. We are grateful to all of the people who, yet again, demonstrated their commitment to keeping the lights on.

Now in its ninth year, our all-employees goals program is designed to focus our employees' talent and commitment on the objectives that have greatest value to the System. Again in 1991, our employees earned bonuses through this program for meeting earnings per share, customer cost, safety, and other operating goals.

We are making the System's electric service more valuable wherever we can. In 1991, we initiated intensive efforts with commercial and industrial customers to improve power quality, working both on our own facilities and within customer facilities. In the residential sector, we can now respond to customer calls in 140 languages through a special telephone service. With growing Hispanic and Asian populations in our region, this service has been very popular. Our residential space heating conservation

program is helping electric heat customers control their bills. Since these customers have seen significant cost increases, this help can be particularly important.

Our surveys show the importance our customers place on reducing environmental impacts. In 1991, we took a critical step in meeting this expectation by developing our new resource plan, "NEESPLAN 3: Environment, Economy, and Energy in the 1990s." Through this plan, we intend to substantially reduce our emissions over the next decade; hold average rate increases to no more than the level of inflation; and maintain a reliable energy supply in a competitive marketplace. A summary of NEESPLAN 3 can be found on pages 6-11.

During the 1990s, the companies that succeed in the electric utility industry will be those that meet the combined challenges of environmental improvement, cost control, and increased competition. NEESPLAN 3 stakes our claim to leadership in meeting those challenges.

Oscar Langlais, watch engineer, supervises the monitoring of the pressure and temperature of pipeline gas that fuels Brayton Point Unit 4.

Joan T Bok

Joan T. Bok
Chairman

John W Rowe

John W. Rowe
President and Chief Executive Officer

February 27, 1992

ENVIRONMENTAL IMPROVEMENT

Licensing and permitting are nearing completion for our planned Manchester Street Station repowering project in Providence, Rhode Island.

As part of NEESPLAN 3, we plan to reduce weighted net air emissions from our operations by an estimated 45 percent by the year 2000. This reduction takes into account emissions from all of the owned or purchased generating sources serving our customers as well as actions we may take to offset those emissions. Greenhouse gases including carbon dioxide (CO_2) as well as regulated emissions like sulfur dioxide (SO_2) and nitrogen oxides (NO_x) will be included.

The 45 percent figure is based on the targets we have set to reduce specific air emissions and the relative weights we have assigned to each of them. Changes in the relative values would result in a modified overall percentage reduction.

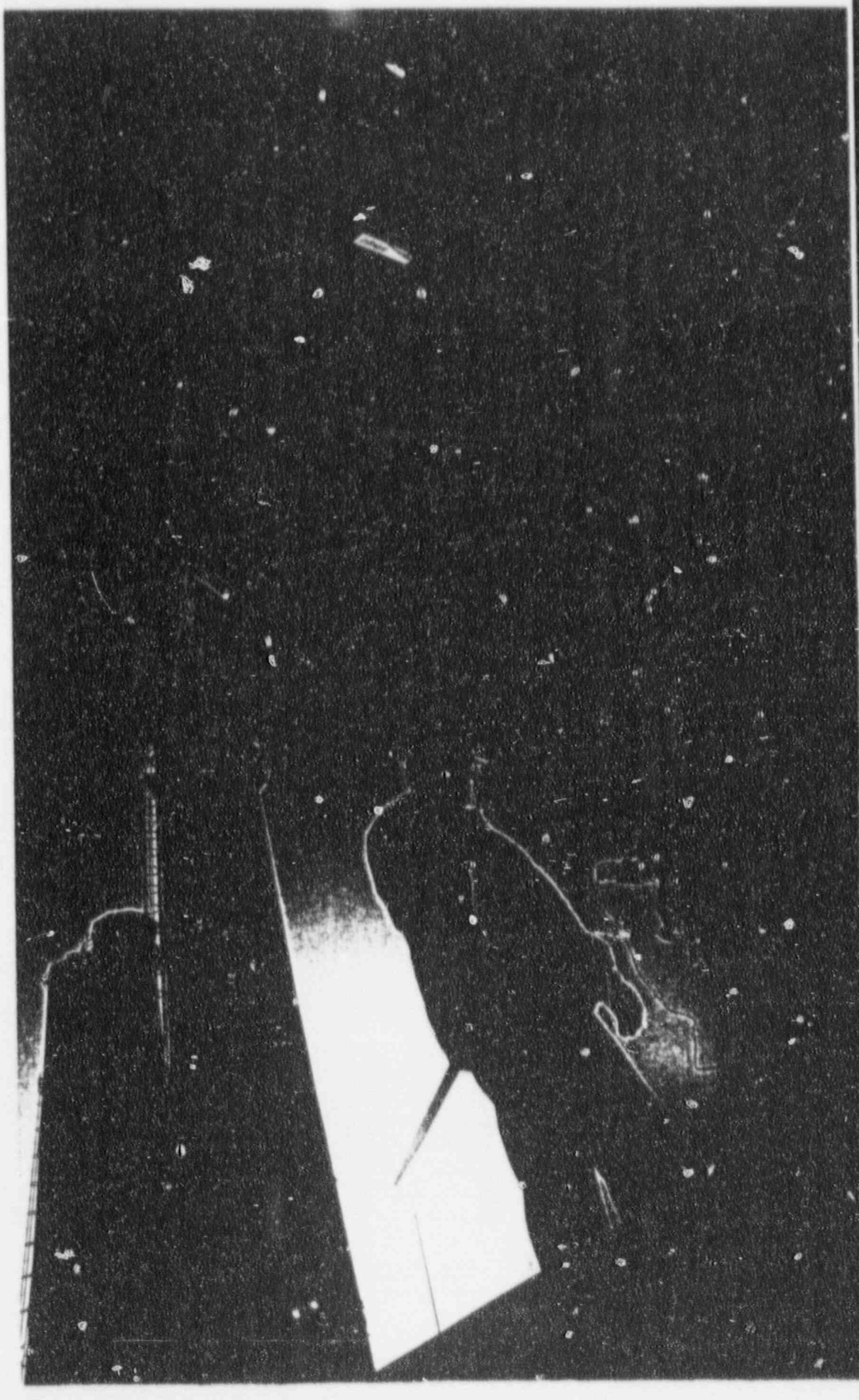
A key contributor to our environmental improvement will be the planned expansion and modernization of our Manchester Street Station in Providence, Rhode Island. This old 140 MW plant will be rebuilt into a state-of-the-art 490 MW combined cycle facility. It will then rely primarily on natural gas, which emits virtually no SO_2 and produces 30 percent less CO_2 per kilowatthour than oil-fired generation. The repowering project will also include substantial improvements to the appearance of the power plant and the surrounding river front.

Our Brayton Point Station Unit 4 in Somerset, Massachusetts, has been modified to enable the burning of natural gas as well as oil. Using gas at Brayton Point 4 is a vital component of our plan to meet state and federal acid rain regulations as well as our long-term environmental commitments.

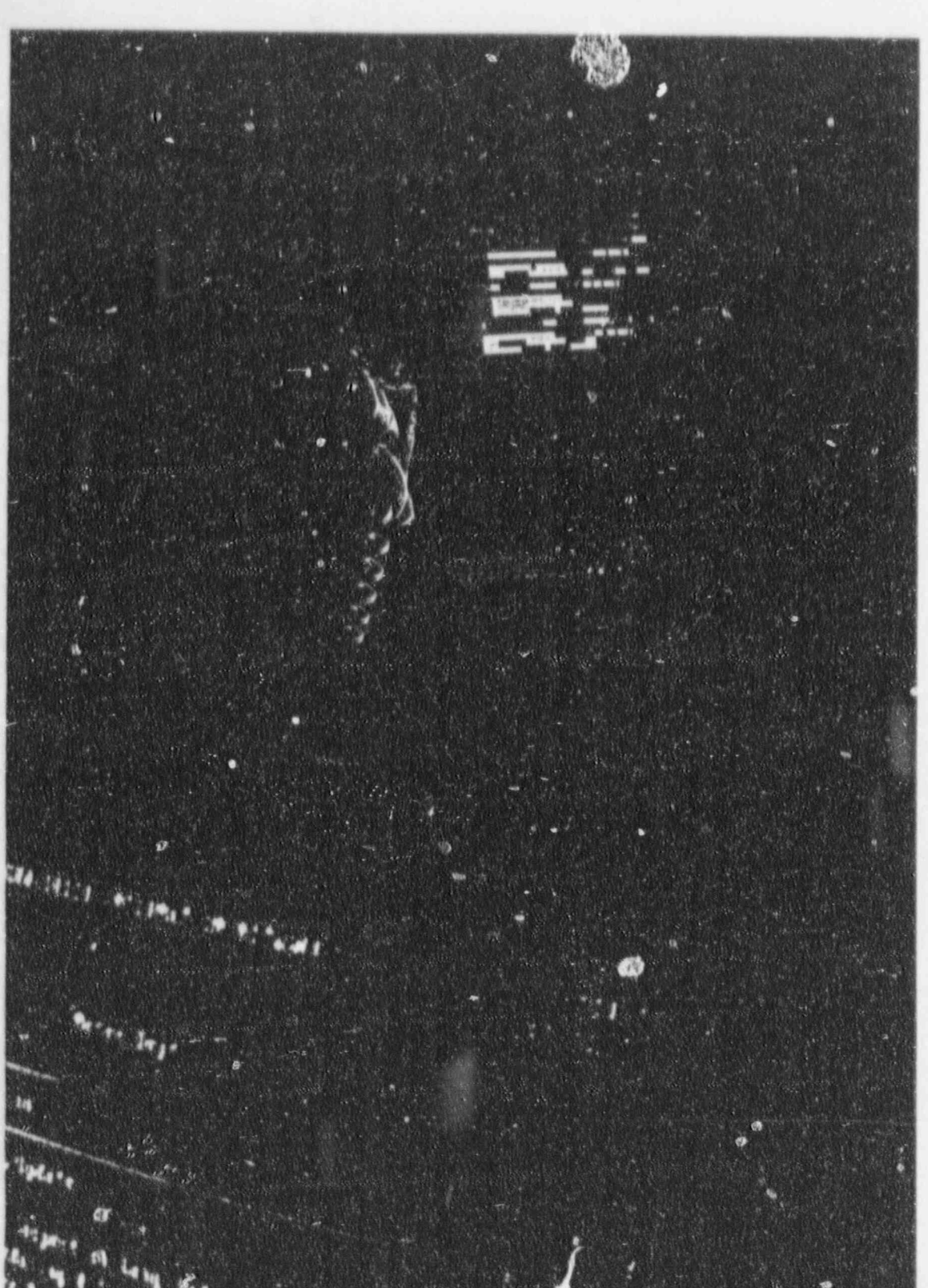
Also contributing to our air emissions reduction will be:

- the use of lower sulfur coal and oil;
- new supplies of energy obtained from non-utility generators, fueled primarily by natural gas;
- continued leadership in conservation and load management;
- initiatives to offset the effects of emitting greenhouse gases such as CO_2; and
- purchases from new renewable energy projects.

We are currently obtaining about 930 MW, or 17 percent of our overall capacity, from hydroelectric power, a major form of renewable resource, and are obtaining 155 MW from waste-to-energy facilities.



Atop a newly-refurbished precipitator at Salem Harbor Station, Andre Lemoine (left), working foreman, and Timothy Brennan, mechanical engineer, prepare to make a final check of the metal plates that intercept ash before it can enter the Unit 4 stack.



Estelita Keisling, meter clerk, makes use of the computer-based work order information network to record requests for electrical service.

In December 1991, our wholesale generation subsidiary invited proposals to develop renewable energy projects including wind, solar, advanced biomass, and methane recovery to explore the commercial feasibility of these technologies in our region. We intend to purchase up to 40 MW based on the economics and experimental value of the proposals received.

We also plan to develop several pilot programs in 1992 to evaluate methods of offsetting greenhouse gas emissions. These pilot programs may include tree-planting to absorb CO_2 from the environment and the recovery of methane released in the mining of coal.

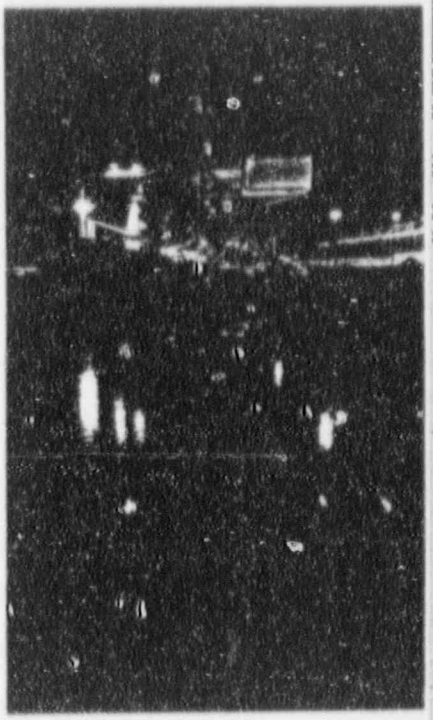
COST CONTROL

Since 1982, the NEES companies have maintained an average price for electricity that is within the lowest cost one-third of major New England electric utilities. After substantially reducing inflation-adjusted electricity prices in the mid-1980s, we have faced a 13 percent increase in real prices from 1988 through 1991.

We are committed to stopping the recent upward trend. With NEESPLAN 3, we set a goal that average rates to ultimate customers not increase more than the overall inflation rate over the period 1991 through 2000. While this does not mean we can keep price increases below the level of inflation each year, we believe the goal is achievable when viewed across the decade. We now have behind us most of the rate increases necessary to pay for our conservation programs and for the power purchase commitments made in the 1980s.

The System is improving its budgeting and cost monitoring process to help achieve the new rate goal. Our five-year budgeting and planning process will serve as an "early warning system" that will allow us to prevent or moderate actions that would result in significant departures from our price projections.

Stable electric rates will permit the NEES companies to compete more successfully with other electric utilities, non-utility generators, and other energy suppliers and will help make our region more attractive to prospective customers. Equally important, our new rate goal represents a benchmark that will require us to seek out the most cost-effective strategies in pursuing all of our objectives, including environmental improvement.



Because all of our coal and oil is delivered by ocean-going vessel rather than rail, we have access to both domestic and foreign fuel markets, which helps hold down our fuel costs.

DIVERSITY AND RELIABILITY

The System is using infrared imaging on distribution lines to locate hidden "hot" spots that could cause outages or equipment failure. Checking a line in Beverly, Massachusetts, are Michael McCallan (left), a System reliability coordinator, and Frank Bryson, co-owner of Applied Infrared Technologies.

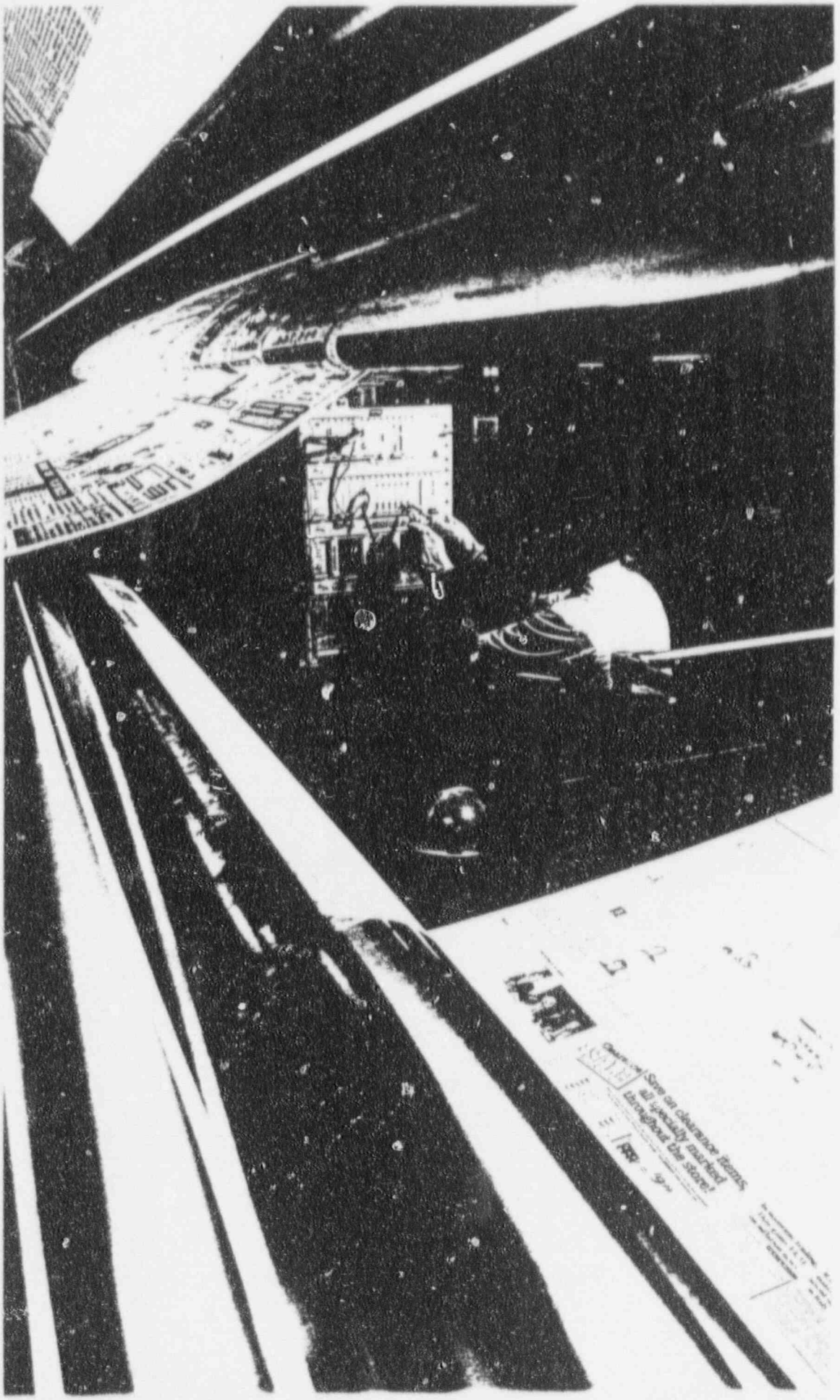
We are developing an increasingly diverse and competitively-procured power supply to help us meet our fundamental obligation to provide reliable service. Between 1990 and 2000, we expect to bring into service more than 600 MW of new non-utility generation capacity, including co-generators and independent power producers. This new generation will bring our total purchases from non-utility sources to approximately 900 MW.

At the same time, we plan to continue improving our own generating facilities, including our thermal generating stations in Massachusetts, Manchester Street Station in Rhode Island, and our hydroelectric stations on the Connecticut and Deerfield rivers. These facilities will continue to represent the bulk of the resources we devote to meeting our capacity needs in the year 2000. Their operating efficiency is therefore critical to both our System's reliability of supply and to the attainment of our environmental and cost goals. We are pleased that in 1991 our thermal and hydro units, respectively, achieved or matched their 10-year highs for availability.

The ability to meet our customers' energy requirements from a diverse range of technologies and fuels helps insulate our customers from price and supply fluctuations. Coal, gas, oil, nuclear, and renewables such as hydro will all contribute to our balanced mix in the year 2000. Natural gas is rising from approximately 3 percent in 1990 to an anticipated 26 percent in the year 2000, reflecting our recognition of the relative cleanliness of that fuel and its economical availability. Our pilot programs will help us assess the possibility of a greater contribution from renewables.

These diverse resources will continue to include a strong conservation and load management (C & LM) component to reduce the need for more expensive supply-side resources. In 1991, C & LM measures were installed in approximately 56,000 residences and 6,900 commercial, industrial, and municipal facilities, displacing the need for approximately 88 MW of generating capacity. We expect to avoid the need for some 800 MW of generating capacity by the year 2000 through C & LM. Energy efficiency will help us meet our environmental goals, deliver maximum value to customers, and add value to shareholder investment through the financial incentives earned on successful C & LM programs.

The System is working closely with certain large customers to find ways to prevent or counteract power disturbances such as fluctuations in the voltage of electricity provided to their equipment. James Mitchell, a System lab technician, monitors power quality supplied to the presses of The Providence Journal.



Earnings were $2.77 per average share in 1991, and the return on common equity was 12.6%. Earnings in 1990 were $4.11 per share and $2.36 per share in 1989. The 1990 earnings were increased by $1.80 per share due to the reversal of a portion of a 1988 write-down, which resulted from a rate settlement involving the Seabrook 1 nuclear unit (Seabrook 1). Excluding the effects of the Seabrook 1 adjustment on 1990 earnings, earnings for 1991 increased by $.46 per share. The increase in earnings primarily reflects 1990 and 1991 rate increases for subsidiary companies. Also contributing to 1991 earnings was a $.07 per share gain due to the March 1991 sale of the unregulated oil and gas properties of New England Energy Incorporated (NEEI) (see Oil and Gas Operations). The operations of these properties resulted in losses of $.11 per share in 1990 and $.06 per share in 1989.

Earnings of $2.36 per share for 1989 included a $.16 per share gain from the settlement of an arbitration case and the related sale of our interest in a coal ship.

The annual dividend rate was raised by four cents per share in May 1991 and is now $2.08 on an annual basis. The market price of New England Electric System (NEES) common shares at year end 1991 was $32⅛ per share, compared with $24⅞ at the end of 1990.

Kilowatthour sales to ultimate customers decreased by 1.2 percent in 1991. In 1990, kilowatthour sales increased by 0.3 percent. For the five years ended 1990, kilowatthour sales growth averaged 4.0 percent per year. Due to a substantial slowdown in the New England economy, current forecasts are for a continued decline in kilowatthour sales for 1992.

In 1991, we continued our commitment to and expanded our efforts in conservation and load management (C&LM). During the year, we spent a total of $92 million on C&LM and have budgeted to spend $108 million in 1992. Our C&LM programs provided benefits not only for our customers, but for our shareholders as well. In 1991, earnings included approximately $7 million (before tax) of incentives relating to these programs. We have received regulatory approvals that will give us the opportunity to continue to earn incentives in 1992.

New England Power Company (NEP) owns approximately 10 percent of Seabrook 1, a 1,150 MW nuclear generating unit, which entered commercial service on June 30, 1990.

As part of a 1988 NEP rate settlement, all issues associated with NEP's investment in Seabrook 1 through December 31, 1987 were resolved. Recovery of Seabrook 1 costs incurred since January 1, 1988 was covered by a separate Federal Energy Regulatory Commission (FERC) settlement in connection with NEP's W-11 rate filing (see Wholesale Rate Activity).

The 1988 settlement had initially limited NEP's Seabrook 1 recovery to $61 million per year for seven years and five months commencing in March 1988. The settlement also required that in the event of cancellation of the unit, NEP would reduce rates by $12 million for five years, but provided that if the unit went into service, NEP could increase rates by $16.8 million for five years. The 1988 rate settlement agreement resulted in a $179 million after-tax write-down ($260 million before tax) in 1988 of NEP's Seabrook 1 investment. The write-down assumed that the unit would be cancelled. However, after Seabrook 1 entered commercial service in 1990, NEP recorded adjustments in the third quarter reversing a portion of the write-down taken in 1988. These adjustments increased net income by $115 million after-tax ($134 million before tax) or $1.80 per share for the year ended 1990. The adjustments were recorded in the other income section of the income statement.

In February 1991, EUA Power Corporation (EUA Power), a 12 percent joint owner of Seabrook 1, filed for protection from its creditors under Chapter 11 of the Bankruptcy Code. In August 1991, EUA Power failed to fund its share of monthly Seabrook 1 operating and capital costs. Subject to certain limitations, two joint owners of Seabrook 1, that are not affiliated with NEP, have agreed to loan EUA Power up to $15 million to cover its monthly obligations to Seabrook 1. This sum is currently estimated to be sufficient to cover such obligations until the summer of 1992. At this time, no further arrangements have been made with respect to EUA Power's obligations.

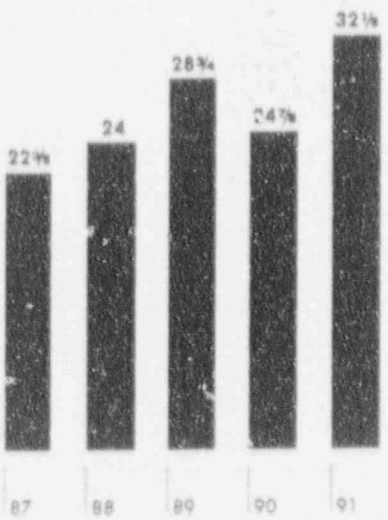
On October 7, 1991, the U.S. Supreme Court declined to review the Nuclear Regulatory Commission's (NRC) licensing of Seabrook 1. The only outstanding appeal of the license is pending before the NRC. It was brought by opponents of Seabrook 1 challenging an NRC Atomic Safety and Licensing Board decision that adequate provision had been made for sheltering persons who might be on the beach near Seabrook 1 at the time of an incident.

Because of the highly controversial nature of nuclear power in general, and the Seabrook plant in particular, many challenges to, and investigations of the safety of the design, construction, and operation of the plant have been raised in the past and are likely to continue to be raised in the future. NEP does not believe that the currently pending appeal will result in Seabrook 1 being permanently withdrawn from service or cancelled. However, if it were, either as a result of currently pending or unanticipated future events, NEP could be required to cease collecting revenue permitted by its 1988 rate settlement and/or make refunds and lower rates for five years, depending upon the circumstances. A write-down could be required at that time (see Note C).

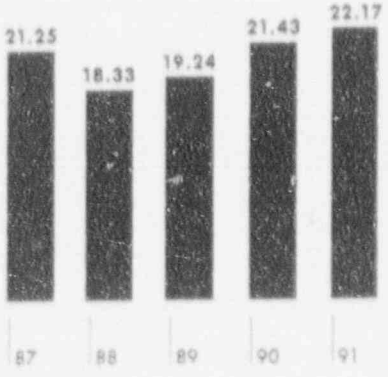
NEP has a 30 percent ownership interest in Yankee Atomic Electric Company (Yankee), which owns and operates a 185 megawatt nuclear generating station in Rowe, Massachusetts. The station began commercial service in 1960. At December 31, 1991, NEP's investment in Yankee was approximately $6 million. On September 30, 1991, the NRC staff recommended to the NRC Commissioners that the Yankee facility be shut down, pending review of concerns as to the possible embrittlement of the facility's reactor vessel. Yankee began shutting down the facility the next day. On February 26, 1992, the Yankee board of directors decided to permanently cease power operation of the facility and, in time, decommission the facility.

Yankee intends to seek FERC authorization to collect, over the remaining term of the plant's present NRC operating license, the ongoing costs of maintaining and decommissioning the unit as well as previously unrecovered plant investment. The license extends through July 2000. Although these costs are substantial, they are expected to be less than the costs of continued operation. NEP believes that the FERC will continue to allow it to recover from its customers all costs billed to it by Yankee.

Market Price Per Share—Year End ($)



Book Value Per Share—Year End ($)



NEEI participates in a rate-regulated domestic oil and gas exploration, development, and production program consisting of prospects acquired prior to December 31, 1983. No new prospects will be acquired under this program. NEEI has incurred operating losses since 1986, due to precipitate declines in oil and gas prices, and expects to incur substantial additional losses in the future. These losses are being passed on to NEP under an intercompany pricing policy approved by the Securities and Exchange Commission. NEP's ability to pass such losses on to its customers was favorably resolved in NEP's 1988 FERC rate settlement. This settlement covered all costs incurred by or resulting from commitments made by NEEI through March 1, 1988. Other subsequent costs incurred by NEEI are subject to normal regulatory review.

Prior to April 1991, NEEI participated in a non-rate-regulated program composed of prospects entered into after December 31, 1983. Profits or losses on the non-rate-regulated program were borne by shareholders. In March 1991, NEEI sold substantially all of the properties in the program, resulting in a gain being recorded in the first quarter of 1991. During 1991, the System recorded earnings of $4.0 million from NEEI's non-rate-regulated oil and gas operations primarily reflecting this gain. The System recorded after-tax losses of $6.9 million and $3.6 million on these operations in 1990 and 1989, respectively.

On August 1, 1991, NEP filed a $42 million rate case with the FERC. The FERC authorized these new rates to go into effect on March 1, 1992, subject to refund pending its review of the requested increase. As part of this filing NEP also proposed to recover through base rates $39.7 million of purchased power expense associated with Unit 2 of Ocean State Power. On February 14, 1992, a partial settlement of this rate case was filed with the FERC. If approved, the partial settlement would resolve all but one issue in the pending case and eliminate the $42 million rate increase. Among other things, the partial settlement approves new depreciation rates proposed in NEP's filing, which have the effect of reducing NEP's overall revenue requirement in 1992 by $18 million. Under the partial settlement, the $39.7 million increase associated with Ocean State Power would still go into effect on March 1, 1992. NEP had been allowed to recover these costs through its fuel clause since the unit entered service in late 1991. The partial settlement does not resolve the issue of the appropriate ratemaking treatment for expenses associated with postretirement benefits other than pensions provided to NEP's employees (see New Accounting Standards). Under the partial settlement, this issue will be litigated and decided by the FERC.

The FERC approved a settlement agreement in NEP's W-12 rate case, which allowed NEP to increase rates by $31.1 million as of January 1, 1991 and also allowed additional rate increases of $21.9 million and $17.4 million to take effect as of November 1, 1990 and December 31, 1990, the in-service dates of Hydro-Quebec Phase 2 and Unit 1 of Ocean State Power, respectively.

Effective March 1, 1990, the FERC approved a settlement in NEP's W-11 rate case, which allowed NEP to increase its rates by $39.4 million annually. The FERC also allowed NEP to increase rates by $25.7 million annually effective June 30, 1990, the in-service date of Seabrook 1. This increase was related to the costs associated with Seabrook 1 that were not included in the 1988 settlement. In addition, the FERC approved a request to increase rates by $16.8 million per year for five years, effective June 30, 1990, in accordance with the terms of the 1988 rate settlement (see Note C).

Both the W-11 and W-12 settlements provided that if actual 1990 and 1991 sales varied from the estimated levels reflected in each filing, NEP would recover or refund the variance of up to $17.4 million in each year. In 1990, actual sales were less than the estimated levels, and in 1991 they exceeded the estimated levels. Through 1991, NEP accrued net revenues of $5.8 million under this rate mechanism.

Effective October 1, 1991, the Massachusetts Department of Public Utilities (MDPU) approved a settlement, under which Massachusetts Electric Company (Massachusetts Electric) agreed to a $3 million rate decrease. The settlement reflects the net effect of a $17 million increase in Massachusetts Electric's cost of service, offset by a reduction due to the correction of certain purchased power billings from NEP to Massachusetts Electric. Included in the reduction is $2.4 million, which represents the annual amount of

a five-year refund, recorded in 1991, of past base rate overrecoveries due to the incorrect purchased power billings from NEP. In addition to the rate decrease, Massachusetts Electric recorded refunds of $13 million of revenues it had previously collected related to these incorrect billings.

Effective April 1, 1990, the MDPU approved a rate increase for Massachusetts Electric of approximately $41 million and approved an additional $1 million effective August 1, 1990.

In 1991, the Narragansett Electric Company (Narragansett) filed a general rate increase with the Rhode Island Public Utilities Commission (RIPUC), which would increase rates by approximately $14 million. If approved by the RIPUC, the rate increase would become effective in April 1992.

The RIPUC approved Narragansett's settlement of a July 1990 rate filing which resulted in a $13 million rate increase effective April 1, 1991.

Effective January 1, 1990, the RIPUC approved a settlement of a Narragansett general rate increase request, which increased rates by $5.8 million. In addition, certain discounts offered by Narragansett, amounting to approximately $4.5 million annually, were discontinued on January 1, 1990.

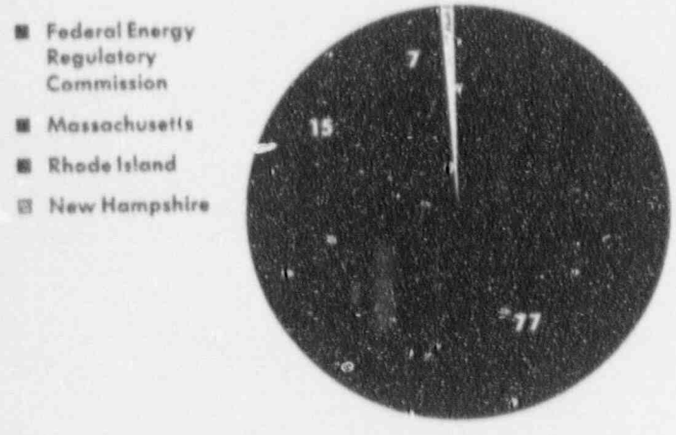
Effective June 1, 1990, the New Hampshire Public Utilities Commission approved a $1.7 million rate increase settlement agreement for Granite State Electric Company (Granite).

In December 1991, Massachusetts Electric, Narragansett, and Granite received approval of their 1992 C&LM programs from their respective state regulatory commissions. These approvals will allow current recovery of budgeted 1992 C&LM expenses of $89.5 million, with a reconciliation mechanism to adjust for differences between actual and budgeted expenditures. The approvals also give the companies an opportunity to earn incentives based on the results of each company's 1992 programs.

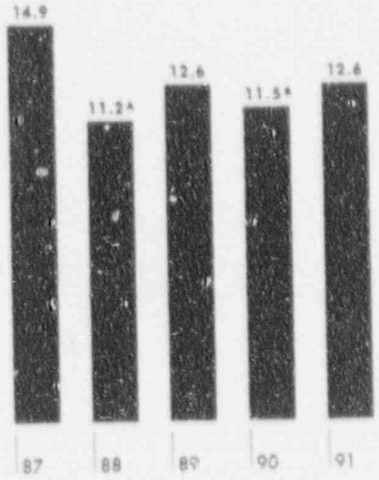
Massachusetts Electric, Narragansett, and Granite previously received approval from their respective state regulatory commissions to recover estimated 1991 and 1990 C&LM expenses, including the reconciliation mechanism referred to above. Actual C&LM expenditures subject to this mechanism in 1991 and 1990 were $77 million and $50 million, respectively. The commission orders also allowed the companies an opportunity to earn incentives based on the results of their 1991 and 1990 programs. Earnings for 1991 and 1990 include approximately $7 million and $4 million (before tax), respectively, of incentives recorded by these companies.

On August 19, 1991, Hurricane Bob hit the System's service territory, causing customer outages and significant damage to distribution and transmission facilities. Massachusetts Electric and Narragansett deferred $5.1 million and $7.6 million, respectively, of storm costs based on the expectation of recovery of these costs through rates. Based on past precedents, Massachusetts Electric expects to recover its costs over several years as part of its next rate filing. Narragansett previously established, through the ratemaking process, a storm contingency fund which had accumulated to approximately $1.6 million at the time of the storm. Costs in excess of this fund are recoverable in future rates under the provisions of the fund.

Regulation – Percent of 1991 Electric Revenue



Return on Common Equity (%)



A Before Seabrook rate settlement write-down, (4.8%) after write-down.
B Before reversal of portion of 1988 write-down, 20.5% after reversal.

Operating revenue increased by $186 million in 1991 due principally to rate increases for NEP and the retail subsidiaries. Kilowatthour sales to ultimate customers decreased by 1.2 percent in 1991, reflecting the New England recession and a mild winter in early 1991. This decrease was partially offset by increased wholesale sales to other utilities.

In 1990, operating revenue increased by $203 million due to the effects of NEP's and the retail subsidiaries' rate increases.

Certain revenues and purchased power expenses relating to power interchange, previously reported on a net basis as purchased power expense, have been reclassified to reflect gross amounts in all financial statements presented. This reclassification has no effect on net income and was made to comply with changes in FERC accounting rules.

Total operating expenses increased by $148 million in 1991. Total fuel costs, including the energy component of purchased power, increased by $53 million due to increased costs associated with new alternate energy purchases. Purchased energy excluding fuel decreased by $12 million, reflecting a decrease in purchases of capacity and reduced nuclear plant overhaul costs. Other operation and maintenance expenses increased by $55 million during 1991 which includes $15 million of increased C&LM costs and increased costs of $10 million and $8 million, respectively, related to Seabrook 1 and Hydro-Quebec Phase 2 entering service part way through 1990. The remainder of the increase reflects increased insurance and claims related costs, increased uncollectible accounts expense, and general increases in other areas.

Depreciation and amortization expense increased by $19 million during 1991, principally reflecting increased amortization of a portion of Seabrook 1 costs as a part of the 1988 rate settlement (see the Seabrook 1 section), Hydro-Quebec Phase 2 entering into service in 1990, and new construction expenditures.

In 1990, total operating expenses increased by $192 million. The non-fuel component of purchased electric energy increased by $38 million due to increased capacity purchases and increased costs associated with plant overhauls by nuclear power suppliers. Other operation and maintenance expense increased by $111 million, primarily due to increased C&LM costs amounting to $65 million and increased costs associated with overhauls at generating units amounting to $15 million. The remainder of the increase reflects operating costs associated with Seabrook 1 and Hydro-Quebec Phase 2 entering into service and general increases in other areas.

The 1991 increase in "Other income (expense)—net" reflects the gain on the sale of NEEI's unregulated oil and gas operations and increased interest income, whereas 1990 includes an after-tax loss of $3 million on the sale of our energy management services subsidiary.

Allowance for funds used during construction (AFDC) decreased in 1991 due to the commercial operation of the Hydro-Quebec Phase 2 project in November 1990.

NEES and its utility subsidiaries have been contacted, or have had legal proceedings initiated against them, by federal and state environmental agencies or by private parties regarding the cleanup of sites designated as containing hazardous waste. While the cost to clean up these sites cannot be estimated, it is believed at this time that such costs will not be material (ten percent of common equity) to the System's financial position (see Note F). Although rate recovery may be sought for cleanup costs incurred, it is uncertain what portion, if any, would be allowed in rates, particularly in circumstances in which NEES, rather than one of its utility subsidiaries, incurs those costs.

In recent years, concerns have been raised about whether electric and magnetic fields (EMF), which occur near transmission and distribution lines as well as near household wiring and appliances, cause or contribute to adverse health effects. Numerous studies on the effects of these fields, some of them sponsored by electric utilities (including NEES subsidiaries), have been conducted and are continuing. A few of the studies have suggested associations between certain EMF and various types of cancer. Other studies have not substantiated such associations. It is impossible to predict the ultimate impact on the System and the utility industry if further investigations were to demonstrate that the present electricity delivery system is contributing to increased risk of cancer or other health problems.

A bylaw was approved in 1991 by the Town of Millbury, Massachusetts, which would have established a magnetic field standard for transmission lines in that town. Millbury is a hub for NEP transmission lines. The bylaw was recently held invalid by the Massachusetts Attorney General. The Massachusetts Supreme Judicial Court has previously struck down attempts by municipalities to regulate transmission lines. Ordinances placing a three-year moratorium on the construction of transmission lines passed in three Rhode Island communities and have been challenged by Narragansett before the RIPUC and in state court proceedings. The Superior Court of Rhode Island decided that one such ordinance was invalid. The Superior Court also held that the RIPUC does not have the authority to review this ordinance. The decision is on appeal to the Rhode Island Supreme Court. Adoption of similar ordinances has been discussed in other Rhode Island communities.

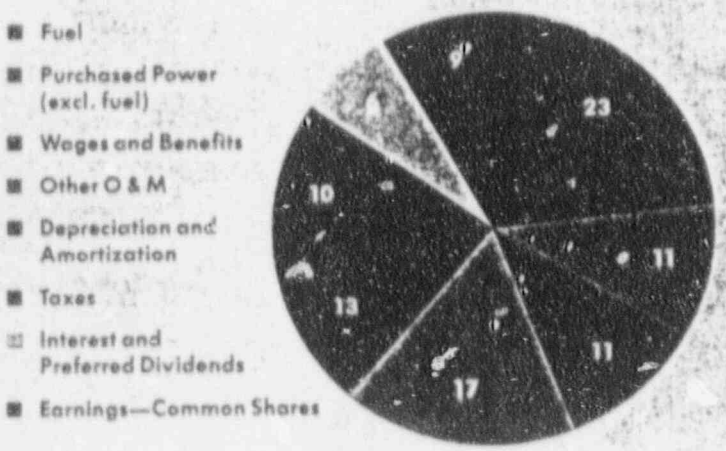
On November 15, 1990, amendments to the federal Clean Air Act were signed into law. This law requires a significant reduction in the nation's annual sulfur dioxide (SO_2) and nitrogen oxide (NO_x) emissions by the year 2000. Although NEES subsidiaries are not subject to the first phase of the acid rain provisions of the federal law that will become effective in 1995, NEES subsidiaries are subject to the Massachusetts acid rain law that is effective in 1995. Also, federal ozone nonattainment requirements will likely affect NEES subsidiaries by 1995. In an effort to comply with the Massachusetts law, the NEES subsidiaries have been planning and implementing programs, including C&LM initiatives and use of lower sulfur fuels, to reduce SO_2 emissions at generating stations. To meet the additional federal requirements, NEES subsidiaries plan, as necessary, to install low NO_x burners and burn additional low-sulfur fuels.

The System expects to incur onetime operation, maintenance, and capital costs of approximately $120 million between 1991 and 1995 to comply with the clean air requirements. To date, the System has expended $18 million in connection with Massachusetts compliance requirements. In addition, increased fuel costs are expected to be incurred starting in 1992. These ongoing fuel costs are estimated to reach an annual level of $22 million by 1995.

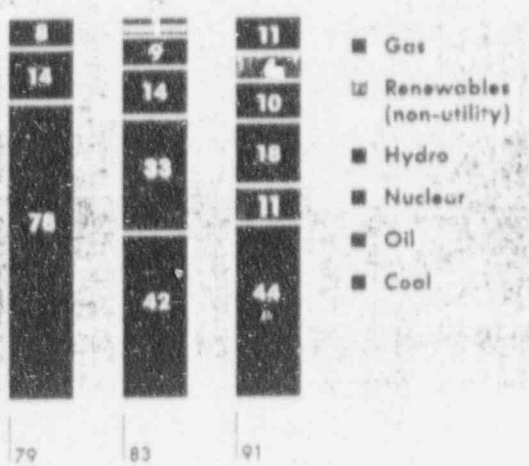
Under the federal Clean Air Act, state environmental agencies must develop requirements to address ozone nonattainment by November 1992. An advisory board composed of environmental officials from eight northeastern states is considering a recommendation that would, if adopted, impose extremely stringent NO_x emission requirements. In the event these requirements are adopted, the System would incur substantial additional costs.

In November 1991, the System announced NEESPLAN 3. As part of this plan, the System will be exploring methods of offsetting emissions of greenhouse gases that have been associated with the warming of the global environment. NEES plans to implement pilot programs to evaluate emissions offsets.

Where Each Dollar of 1991 Revenue Went (%)



NEES Energy Mix (%)



Currently, NEES subsidiaries record postretirement benefit costs other than pensions, principally health care costs, when paid. New accounting rules, issued by the Financial Accounting Standards Board, effective in 1993, will require employers such as the NEES subsidiaries to commence the establishment of a liability during the working years of employees for the expected cost of providing postretirement benefits to those employees. The impact of the new rules will significantly increase annual cost. Had the new accounting rules been in effect in 1991, it is estimated that the accumulated postretirement benefit obligation would be approximately $400 million at December 31, 1991, and annual cost would have increased by approximately $50 million (before taxes) in 1991. The NEES subsidiaries are seeking to recover these costs through rates.

New accounting rules, which will be effective in 1993, will require all deferred tax balances to be restated at the current tax rate, currently percent, and will require any excess to be reclassified from a deferred tax liability account to a customer-related liability account. It is expected that, through the regulatory process, excess reserves for deferred taxes will be passed back to customers with no significant impact on net income. The pass-back of such excess deferred tax reserves commenced in 1987, with the reduction of the corporate federal income tax rate.

Capital requirements for 1991 and projections for 1992 are shown below:

Year ended December 31 (millions of dollars)	1991	1992
Cash construction expenditures	$193	$300
Oil and gas exploration and development	33	20
Total capital expenditures	226	320
Maturing debt and prepayment requirements	47	105
Ocean State Power equity investment	20	—
Total capital requirements	$293	$425
Cash from operations excluding dividends	$315	$310

The funds necessary for construction expenditures in 1991 for NEP and the retail subsidiaries were primarily provided by net cash from operating activities after the payment of dividends. Funds for Narragansett and Granite construction expenditures were also provided from the proceeds of long-term debt issues. In 1991, Narragansett issued $65 million of first mortgage bonds to reduce short-term debt, fund construction expenditures, and redeem $40 million of its Series P first mortgage bonds. NEP redeemed $90 million of outstanding Series B and Series C general and refunding mortgage bonds. NEP also issued $50 million of Series T variable rate general and refunding mortgage bonds to support taxable pollution control revenue bonds. Granite issued $5 million of notes to reduce its short-term debt and fund construction expenditures.

Internally generated funds are expected to meet approximately 80 percent of the 1992 capital expenditures for NEP and the retail subsidiaries. The retail subsidiaries plan to issue $115 million of long-term debt in 1992. Included in that amount is $25 million of bonds that Massachusetts Electric has committed to issue during the first quarter of 1992. These bonds will bear interest rates ranging from 5.875 to 8.55 percent. Depending on market conditions, NEP plans to refinance $90 million of long-term debt in late 1992 or early 1993.

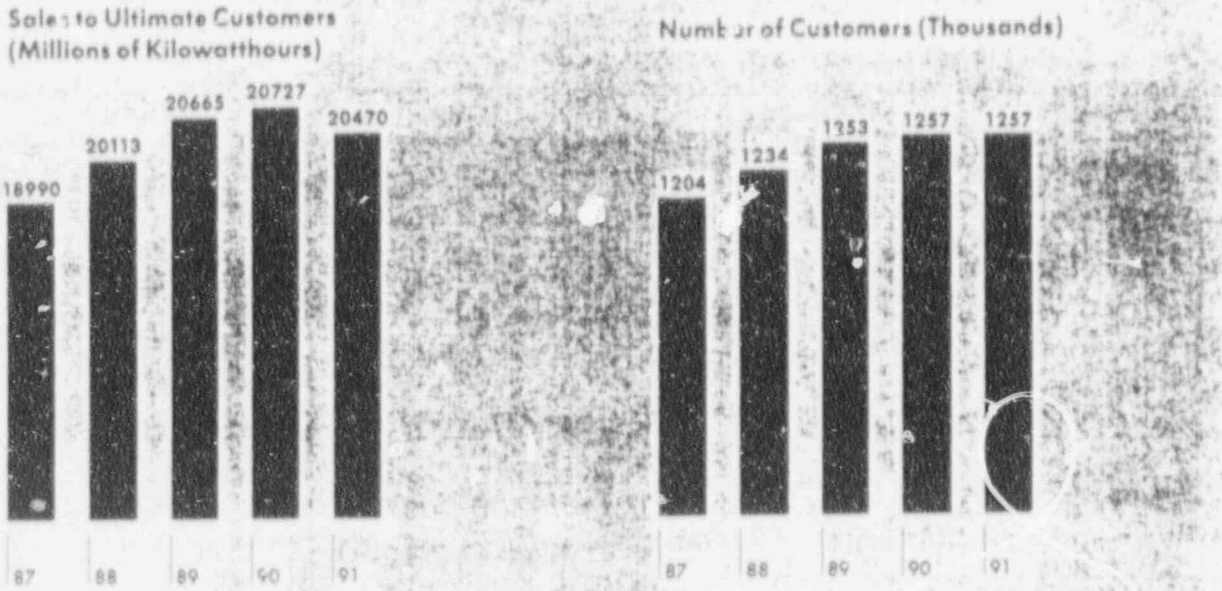
Net cash from operating activities, after the payment of dividends, provided the funds necessary for New England Hydro-Transmission Corporation and New England Hydro-Transmission Electric Company, Inc. construction expenditures. In May 1991, these companies issued $215 million of long-term notes to a group of institutional investors. The proceeds were used principally to refinance outstanding borrowings under a revolving credit agreement.

Net cash from operating activities provided all of the funds necessary for oil and gas expenditures. NEEI's 1991 oil and gas exploration and development costs include $22 million of capitalized interest costs.

NEES raised $15 million of equity in the first quarter of 1991 through the issuance of new common shares under its dividend reinvestment and common share purchase plan and employee share plans. In March 1991, NEES began meeting the requirements of these plans through open market purchases of NEES shares. During 1992, NEES plans to continue meeting plan requirements through open market purchases.

The System's major proposed construction project is the repowering of the Manchester Street Station in Providence, Rhode Island. Narragansett currently operates a 140 MW electric generating station at Manchester Street; the units went into service in the 1940s. To facilitate this joint NEP/Narragansett project, Narragansett plans to sell a 90 percent interest in the existing station to NEP in 1992. Under the proposal, this generating station, which is presently fueled by residual oil and natural gas, will be converted to be primarily fueled with natural gas, with distillate oil as backup. Repowering will more than triple the power generation capacity of Manchester Street and substantially increase the plant's thermal efficiency. The total cost for the project is estimated to be between $600 million and $650 million, including AFDC and related transmission work. It is estimated that NEP's share of this cost will range between $475 million and $520 million, with the balance being incurred by Narragansett. Licensing of the project is nearing completion, and construction is scheduled to begin thereafter, with completion planned for 1995.

As of December 31, 1991, NEES and its consolidated subsidiaries did not have any short-term debt outstanding, but had lines of credit with banks totaling $279 million. These lines of credit are available to provide liquidity support for commercial paper borrowings, and for NEP's Series R and T general and refunding mortgage bonds and other corporate purposes. Cash and temporary cash investments at December 31, 1991 were approximately $66 million.



New England Electric System and Subsidiaries
Selected Financial Data

Year ended December 31 (millions of dollars, except per share data)

	1991	1990	1989	1988	1987
Operating revenue:					
Electric sales (excluding fuel cost recovery)	$1,358	$1,282	$1,084	$ 996	$ 942
Fuel cost recovery	585	523	520	449	453
Other utility revenue	114	65	42	37	28
Oil and gas sales	37	39	59	59	46
Total operating revenue	$2,094	$1,909	$1,705	$1,541	$1,469
Net income (loss)	$ 180	$ 262*	$ 139	$ (54)*	$ 171
Average common shares	64,916,599	63,818,386	58,836,246	57,026,739	55,377,967
Per share data:					
Net income (loss)	$ 2.77	$ 4.11*	$ 2.36	$ (.94)*	$ 3.09
Dividends declared	$ 2.07	$ 2.04	$ 2.04	$ 2.04	$ 2.01
Return on average common equity	12.6%	20.5%	12.6%	N/A	14.9%
Total assets	$4,450	$4,408	$4,116	$3,718	$3,970
Capitalization:					
Common share equity	$1,441	$1,380	$1,212	$1,056	$1,191
Minority interests	63	62	54		
Cumulative preferred stock	162	162	162	162	162
Long term debt	1,548	1,680	1,639	1,434	1,387
Total capitalization	$3,214	$3,284	$3,067	$2,652	$2,740
Total electric sales (millions of kilowatthours)	23,502	22,561	23,069	21,487	20,206
Sales to ultimate customers (millions of kilowatthours)	20,470	20,727	20,665	20,113	18,990
Cost per KWH to ultimate customers (cents)	8.99	8.27	7.28	6.92	7.04
System maximum demand (megawatts)	4,250	4,059	4,225	4,124	3,798
Electric capability (MW net)—year end	5,645	5,627	5,480	5,268	4,921
Number of employees	5,533	5,666	5,580	5,478	5,256
Number of customers	1,257,213	1,256,656	1,253,425	1,233,519	1,204,189

*1990 and 1988 include $1.80 and $(3.14) per share, respectively, resulting from the 1988 rate settlement related to Seabrook 1 (Note C).

New England Electric System and Subsidiaries
Statements of Consolidated Income
Year ended December 31 (thousands of dollars)

	1991	1990	1989
Operating revenue	$2,094,378	$1,908,826	$1,705,488
Operating expenses:			
Fuel for generation	268,022	294,171	295,132
Purchased electric energy:			
Fossil and interchange	360,168	294,599	262,792
Nuclear entitlements	111,105	110,289	104,989
Other operation	428,652	385,148	299,532
Maintenance	148,266	137,117	121,582
Depreciation and amortization	278,126	259,115	256,681
Taxes, other than income taxes	105,332	92,596	83,156
Income taxes	103,702	81,920	40,286
Total operating expenses	1,803,373	1,654,955	1,463,350
Operating income	291,005	253,871	242,138
Other income:			
Allowance for equity funds used during construction	1,961	14,387	12,281
Equity in income of generating companies	10,370	6,836	6,288
Other income (expense)—net	16,020	(2,961)	(584)
Seabrook rate settlement adjustment (Note C)		153,590	
Federal and state taxes on Seabrook rate settlement adjustment (Note C)		(18,503)	
Operating and other income	319,356	387,220	260,123
Interest:			
Interest on long-term debt	118,846	116,565	110,535
Other interest	3,308	267	12,340
Allowance for borrowed funds used during construction	(2,330)	(17,486)	(17,465)
Total interest	119,824	106,346	105,410
Income after interest	199,532	280,874	154,713
Preferred dividends of subsidiaries	10,572	10,572	10,572
Minority interests	9,150	8,252	5,491
Net income (Note C)	$ 179,810	$ 262,050	$ 138,650
Average common shares	64,916,599	63,818,386	58,836,246
Per share data:			
Net income	$ 2.77	$ 4.11	$ 2.36
Dividends declared	$ 2.07	$ 2.04	$ 2.04

The accompanying notes are an integral part of these financial statements.

New England Electric System and Subsidiaries
Consolidated Balance Sheets
At December 31 (thousands of dollars)

		1991	1990
Assets	**Utility plant, at original cost**	$4,357,758	$4,211,315
	Less accumulated provisions for depreciation and amortization	1,344,465	1,246,501
		3,013,293	2,964,814
	Net investment in Seabrook 1 under rate settlement (Note C)	214,225	261,241
	Construction work in progress (Note F)	93,680	75,454
	Net utility plant	3,321,198	3,301,509
	Oil and gas properties, at full cost	1,179,883	1,217,761
	Less accumulated provision for amortization	694,750	670,494
	Net oil and gas properties	485,133	547,267
	Investments:		
	Nuclear power companies, at equity (Note D)	45,479	45,959
	Other subsidiaries, at equity	50,973	32,690
	Other investments, at cost	18,205	17,148
	Total investments	114,657	95,797
	Current assets:		
	Cash, including temporary cash investments of $63,300 and $19,100	66,133	23,208
	Accounts receivable, less reserves of $9,487 and $7,507	263,760	239,148
	Fuel, materials and supplies, at average cost	79,510	92,018
	Other current assets	10,050	8,496
	Total current assets	419,453	362,870
	Unamortized property losses (Note H)	23,298	28,529
	Deferred charges and other assets	86,338	71,542
		$4,450,077	$4,407,514
Capitalization and liabilities	**Capitalization** (see accompanying statements):		
	Common share equity	$1,440,421	$1,379,749
	Minority interests in consolidated subsidiaries	63,283	62,483
	Cumulative preferred stock	162,528	162,528
	Long-term debt	1,548,063	1,679,427
	Total capitalization	3,214,295	3,284,187
	Current liabilities:		
	Long-term debt due within one year	104,920	37,890
	Accounts payable	136,686	146,333
	Accrued taxes	8,423	8,120
	Accrued interest	26,284	35,454
	Dividends declared	37,986	35,167
	Other current liabilities	66,582	32,303
	Total current liabilities	380,881	295,267
	Deferred federal and state income taxes	610,034	592,583
	Unamortized investment tax credits	105,319	113,902
	Other reserves and deferred credits (Note F)	139,548	121,575
	Commitments and contingencies (Note F)		
		$4,450,077	$4,407,514

The accompanying notes are an integral part of these financial statements.

New England Electric System and Subsidiaries
Consolidated Statements of Cash Flows
Year ended December 31 (thousands of dollars)

		1991	1990	1989
Operating activities	Net income	$ 179,810	$ 262,050	$ 138,650
	Adjustments to reconcile net income to net cash provided by operating activities:			
	Depreciation and amortization	278,047	261,977	258,767
	Investment tax credits—net	(8,583)	(24,314)	(4,854)
	Deferred federal and state income taxes	17,451	36,484	(16,067)
	Seabrook rate settlement adjustment		(133,590)	
	Allowance for funds used during construction	(4,291)	(31,873)	(29,746)
	Minority interests	9,150	8,252	5,491
	Gain on sale of oil and gas properties	(7,099)		
	Decrease (increase) in accounts receivable, less reserves	(24,612)	(34,656)	(12,289)
	Decrease (increase) in fuel, materials and supplies	12,508	(18,628)	(6,635)
	Increase (decrease) in accounts payable	(9,647)	10,332	(20,091)
	Increase (decrease) in other current liabilities	25,412	(6,525)	11,034
	Other, net	(14,880)	(11,665)	(27,153)
	Net cash provided by operating activities	$ 453,266	$ 317,844	$ 297,107
Investing activities	Construction expenditures, excluding allowance for funds used during construction:			
	Hydro-Quebec Phase 2 project	$ (8,753)	$ (36,091)	$(319,197)
	Other projects	(183,985)	(182,249)	(212,710)
	Oil and gas exploration and development	(32,969)	(59,913)	(54,092)
	Proceeds from sale of oil and gas properties	22,954		
	(Increase) decrease in other investments	(18,731)	(13,515)	16,705
	Net cash provided by (used in) investing activities	$(221,484)	$(291,768)	$(569,294)
Financing activities	Proceeds from NEES common shares issued	$ 15,349	$ 36,346	$ 138,515
	Contributions to subsidiaries by minority interests			48,739
	Dividends paid to minority interests	(4,332)		
	Dividends paid on NEES common shares	(134,594)	(129,575)	(118,660)
	Long-term debt—issues	335,000	130,000	536,100
	Long-term debt—retirements	(400,280)	(51,629)	(381,241)
	Net cash provided by (used in) financing activities	$(188,857)	$ (14,858)	$ 273,453
	Net increase in cash and cash equivalents	$ 42,925	$ 11,218	$ 1,266
	Cash and cash equivalents at beginning of year	23,208	11,990	10,724
	Cash and cash equivalents at end of year	$ 66,133	$ 23,208	$ 11,990
Supplementary information	Interest paid less amounts capitalized	$ 125,780	$ 95,042	$ 94,974
	Federal and state income taxes paid	$ 99,917	$ 85,556	$ 61,860
	Dividends received from investments at equity	$ 12,434	$ 8,362	$ 6,959

The accompanying notes are an integral part of these financial statements.

New England Electric System and Subsidiaries
Statements of Consolidated Retained Earnings

Year ended December 31 (thousands of dollars)

	1991	1990	1989
Retained earnings at beginning of year	$ 592,807	$ 461,042	$ 443,798
Net income	179,810	262,050	138,650
Dividends declared on common shares	(134,487)	(130,285)	(121,406)
Retained earnings at end of year	$ 638,130	$ 592,807	$ 461,042

Consolidated Statements of Capitalization

At December 31 (thousands of dollars)

Common share equity	1991	1990
Common shares, par value $1 per share		
Authorized—150,000,000 shares		
Outstanding—64,969,652 and 64,371,600 shares	$ 64,970	$ 64,372
Paid-in capital	737,321	722,570
Retained earnings	638,130	592,807
Total common share equity	$1,440,421	$1,379,749

Cumulative preferred stock of subsidiaries				1991	1990
		Shares outstanding			
Company	Par value	1991	1990		
Massachusetts Electric Company					
4.44% Series	100	75,000	75,000	$ 7,500	$ 7,500
4.76% Series	100	75,000	75,000	7,500	7,500
7.80% Series	100	150,000	150,000	15,000	15,000
7.84% Series	100	200,000	200,000	20,000	20,000
The Narragansett Electric Company					
4½% Series	50	180,000	180,000	9,000	9,000
4.64% Series	50	150,000	150,000	7,500	7,500
8.00% Series	50	200,000	200,000	10,000	10,000
New England Power Company					
6.00%	100	80,140	80,140	8,014	8,014
4.56% Series	100	100,000	100,000	10,000	10,000
4.60% Series	100	80,140	80,140	8,014	8,014
4.64% Series	100	100,000	100,000	10,000	10,000
6.08% Series	100	100,000	100,000	10,000	10,000
7.24% Series	100	150,000	150,000	15,000	15,000
8.40% Series	100	150,000	150,000	15,000	15,000
8.68% Series	100	100,000	100,000	10,000	10,000
Total cumulative preferred stock of subsidiaries (annual dividend requirement of $10,572 for 1991 and 1990)		1,890,280	1,890,280	$162,528	$162,528

Long-term debt (Note K)	Company		Rate	Maturity	1991	1990
Notes	Granite State Electric Company		8.55%	1996	$ 5,000	$ 5,000
	Granite State Electric Company		12.55%	2000	3,600	4,000
	Granite State Electric Company		9.44%	2001	5,000	
	New England Energy Incorporated		variable	1998	300,000	318,000
	Hydro-Transmission Companies		various	2015	205,610	205,000
First mortgage bonds	Massachusetts Electric Company	Series F	5 %	1991		17,490
		Series G	4¾%	1992	60,000	60,000
		Series H	4⅝%	1993	10,000	10,000
		Series I	5¾%	1996	10,000	10,000
		Series J	7⅛%	1998	15,000	15,000
		Series K	7⅝%	1999	15,000	15,000
		Series M	7¾%	2002	20,000	20,000
		Series P	9¾%	2016	25,000	25,000
		Series Q	9⅞%	2018	50,000	50,000
		Series R	9¾%	2019	50,000	50,000
	The Narragansett Electric Company	Series R	8¾%	1992	20,000	20,000
		Series F	4⅝%	1994	4,600	4,600
		Series G	6¾%	1998	7,500	7,500
		Series I	7¾%	2002	7,500	7,500
		Series J	9 %	2004	9,700	9,700
		Series Q	9¾%	2014	25,000	25,000
		Series P	10¼%	2016		40,000
		Series S	9⅛%	2021	25,000	
		Series T	8⅞%	2021	40,000	
	New England Power Company	Series I	4⅝%	1991		20,000
		Series J	4⅜%	1992	12,000	12,000
		Series K	4½%	1993	10,000	10,000
		Series L	6⅜%	1996	10,000	10,000
		Series M	6⅞%	1997	15,000	15,000
		Series N	7⅛%	1998	20,000	20,000
		Series O	7⅜%	1998	20,000	20,000
		Series P	8⅜%	1999	15,000	15,000
		Series R	7⅝%	2002	25,000	25,000
		Series S	8⅝%	2003	40,000	40,000
		Series T	8⅜%	2003	40,000	40,000
General and refunding mortgage bonds	New England Power Company	Series N	8⅝%	1993		40,000
		Series A	8⅝%	2007	50,000	50,000
		Series B	9½%	2008		50,000
		Series D	9⅞%	2013	90,000	90,000
		Series G	9⅞%	2013	16,150	16,150
		Series I	10½%	2013	16,600	16,600
		Series J	10⅜%	2013	79,250	79,250
		Series K	7¼%	2015	38,500	38,500
		Series L	7.80%	2016	29,850	29,850
		Series M	9½%	2016	80,000	80,000
		Series R	variable	2020	85,850	85,850
		Series S	variable	2020	4,150	4,150
		Series T	variable	2020	50,000	
Unamortized discounts and premiums					(7,877)	(8,823)
Total long-term debt					1,652,983	1,717,317
Long-term debt due within one year					(104,920)	(37,890)
Long-term debt					$1,548,063	$1,679,427

The accompanying notes are an integral part of these financial statements.

Note A
Significant accounting policies

1. Basis of consolidation and system of accounts

The consolidated financial statements include the accounts of New England Electric System (NEES) and all subsidiaries except New England Electric Transmission Corporation (NEET), which is recorded at equity. Presentation of this subsidiary on the equity basis is not material to the consolidated financial statements. New England Power Company (NEP) has a minority interest in four regional nuclear generating companies (Yankees). Narragansett Energy Resources Company (Resources) has a 20 percent general partnership interest in the Ocean State Power project. NEP and Resources account for these ownership interests on the equity method.

NEES owns 50.4 percent of the outstanding common stock of both New England Hydro-Transmission Electric Company, Inc. and New England Hydro-Transmission Corporation (Hydro-Transmission companies). The consolidated financial statements include 100 percent of the assets, liabilities, and earnings of the Hydro-Transmission companies. Since NEES is the majority stockholder in these companies, the ownership interests of the other stockholders are called minority interests and have been separately disclosed on the NEES consolidated income statement and balance sheet. The "Minority interests" line on the "Statements of Consolidated Income" includes the minority interests' portion of the net earnings of the Hydro-Transmission companies.

The accounts of NEES and its utility subsidiaries are maintained in accordance with the Uniform System of Accounts prescribed by regulatory bodies having jurisdiction. All significant intercompany transactions between consolidated subsidiaries have been eliminated.

Prior to 1991, transactions with the New England Power Pool had been recorded on a net basis in purchased power expense. In 1991, the transactions were separately recorded in revenues and purchased power expense, therefore the consolidated financial statements for prior years have been reclassified to conform with the current year presentation.

2. Revenue

The utility subsidiaries record revenue as billed on a cycle billing basis. Accrued revenues are recorded related to rate adjustment mechanisms. No revenue is recorded for electricity that has been delivered but not billed.

3. Allowance for funds used during construction (AFDC)

The utility subsidiaries capitalize AFDC as part of construction costs, which represents the composite interest and equity costs of capital funds used to finance that portion of construction costs not eligible for inclusion in rate base. In 1991, an average of $15 million of construction work in progress (CWIP) was included in rate base. AFDC is capitalized in "Utility plant" with offsetting noncash credits to "Other income" and "Interest". This method is in accordance with an established rate-making practice under which a utility is permitted a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. The composite AFDC rates, excluding the Hydro-Transmission companies, were 8.9 percent, 9.1 percent, and 10.1 percent in 1991, 1990, and 1989, respectively. During the construction phase, the Hydro-Transmission companies capitalized all interest costs and a return on common equity.

4. Depreciation and amortization

The depreciation and amortization expense included in the "Statements of Consolidated Income" is composed of the following:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Depreciation	$136,443	$124,399	$109,488
Amortization:			
Oil and gas properties (Note A-6)	79,320	79,185	93,699
Investment in Seabrook 1 under rate settlement (Note C)	47,017	39,458	33,830
Property losses (Note H)	6,279	6,534	12,371
Oil conservation adjustment	9,067	9,539	7,493
Total depreciation and amortization expense	$278,126	$259,115	$256,881

Depreciation is provided annually on a straight-line basis. The provision for depreciation as a percentage of weighted average depreciable property, excluding the Hydro-Transmission companies, was 3.4 percent in 1991 and 3.3 percent in 1990 and 1989.

The Oil Conservation Adjustment (OCA) is designed to recover expenditures for coal conversion facilities at NEP's Salem Harbor Station by the mid-1990s. At December 31, 1991, unamortized coal conversion costs were $39,720,000.

5. Nuclear fuel disposal and nuclear plant decommissioning

The Nuclear Waste Policy Act of 1982 establishes that the federal government is responsible for the disposal of spent nuclear fuel. The federal government requires NEP to pay a fee based on its share of the net generation from the Millstone 3 and Seabrook 1 nuclear units. NEP is recovering this fee through its fuel clause. Similar costs are incurred by the Yankees. These costs are billed to NEP and recovered from customers through NEP's fuel clause.

Also, NEP is recovering its share of estimated decommissioning costs for Millstone 3 and Seabrook 1 through depreciation expense. NEP records decommissioning cost expense on its books consistent with its rate recovery. In addition, NEP is paying its portion of projected decommissioning costs for the four Yankees through purchased power expense. Such costs reflect estimates of total decommissioning costs approved by the Federal Energy Regulatory Commission (FERC).

There is no assurance that decommissioning costs actually incurred by the Yankees, Millstone 3 or Seabrook 1 will not substantially exceed these amounts. The absence of permanent repositories for both low-level and high-level nuclear waste makes it likely that estimates of decommissioning costs will continue to increase until such repositories are available. A 1988 Nuclear Regulatory Commission (NRC) rule sets forth formulas for determining the minimum funding levels that licensees must satisfy. To meet this requirement, licensees must provide reasonable assurance that funds will be available for decommissioning equal to the minimum funding level. Each of the nuclear units in which NEP has an ownership interest has filed the required assurance certification.

6. Oil and gas operations

New England Energy Incorporated (NEEI) participates in a rate-regulated domestic oil and gas exploration, development, and production program through a partnership with a non-affiliated oil company. This program consists of prospects acquired prior to December 31, 1983. No new prospects will be acquired under this program. However, NEEI continues to incur costs in connection with existing prospects. Savings and losses from this program are being passed on to NEP and ultimately to retail customers, under an intercompany pricing policy (Pricing Policy) approved by the Securities and Exchange Commission (SEC). NEEI has incurred operating losses since 1986, due to precipitate declines in oil and gas prices, and expects to incur substantial additional losses in the future. NEP's ability to pass such losses on to its customers was favorably resolved in NEP's 1988 FERC rate settlement. This settlement covered all costs incurred by or resulting from commitments made by NEEI through March 1, 1988.

Other subsequent costs incurred by NEEI are subject to normal regulatory review. NEEI follows the full cost method of accounting for its oil and gas operations, under which capitalized costs (including interest paid to banks) relating to wells and leases determined to be either commercial or non-commercial are amortized using the unit of production method. Due to the Pricing Policy, NEEI's rate-regulated program has not been subject to certain SEC accounting rules, applicable to non-rate-regulated companies, which limit the costs of oil and gas property that can be capitalized.

Prior to April 1991, NEEI participated in a non-rate-regulated program composed of prospects entered into after December 31, 1983. During 1990, NEEI sold a small share of its non-rate-regulated program and, in March 1991, sold substantially all of the remaining properties in the program. The sale of properties in March 1991 resulted in an after-tax gain of approximately $4.5 million. Profits and losses on the non-rate-regulated program were borne by shareholders.

NEEI incurred and capitalized the following costs in connection with its oil and gas exploration and development activities:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Leases	$ 1,775	$ 933	$ 907
Exploration	5,583	15,889	16,533
Development	1,304	4,390	(5,087)
Capitalized interest costs	21,770	28,322	33,362
Other	2,537	3,367	2,306
Non-rate-regulated program costs		7,012	6,071
Total	$32,969	$59,913	$54,092

7. Cash

NEES and its subsidiaries classify short-term investments with a maturity of 90 days or less as cash. Current banking arrangements do not require outstanding checks to be funded until actually presented for payment. Outstanding checks are, therefore, recorded in accounts payable until such time as the banks present them for payment.

Note B
Income taxes

Total income taxes in the "Statements of Consolidated Income" are as follows:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Income taxes charged to operations	$103,702	$ 81,920	$ 49,286
Income taxes charged (credited) to "Other income"	2,971	(428)	1,630
Income tax on rate settlement adjustments (Note C)		18,503	
Total income taxes	$106,673	$ 99,995	$ 50,916

Total income taxes, as shown above, consist of the following components:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Current income taxes	$ 97,806	$ 87,824	$ 72,133
Deferred income taxes	17,451	36,485	(16,363)
Investment tax credits—net	(8,584)	(24,314)	(4,854)
Total income taxes	$106,673	$ 99,995	$ 50,916

Total income taxes, as shown above, consist of federal and state components as follows:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Federal income taxes	$ 86,032	$ 73,830	$ 35,749
State income taxes	20,641	26,165	15,167
Total income taxes	$106,673	$ 99,995	$ 50,916

Investment tax credits of subsidiaries are deferred and amortized over the estimated lives of the property giving rise to the credits. Since the Tax Reform Act of 1986 generally eliminated investment tax credits, the amounts shown above principally reflect the amortization of investment tax credits generated in prior years. In addition, the investment tax credits—net for 1991 and 1990 reflect $1.7 million and $26 million, respectively, of tax credits recognized in income related to Seabrook 1 in accordance with a 1968 rate settlement agreement.

With regulatory approval, the subsidiaries have adopted comprehensive interperiod tax allocation (normalization) for most book/tax timing differences.

The following table details the components of the deferred income taxes of these subsidiaries:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Cost associated with utility plant retirements deducted for tax purposes	$ 5,144	$ 6,573	$ 4,538
Excess tax depreciation	21,213	12,572	2,157
Rate settlement adjustments (Note C)		37,330	
Property loss amortization	(2,495)	(2,703)	(4,877)
Unbilled revenue	(3,764)	(5,184)	(8,133)
Conservation costs capitalized (amortized)	(2,673)	(4,574)	7,247
Coal ship settlement			(7,538)
Oil and gas program	(19,942)	(11,981)	(7,434)
State income taxes	6,901	10,354	3,357
Other	13,067	(5,902)	(5,680)
Total deferred income taxes	$ 17,451	$ 36,485	$(16,363)

New accounting rules issued by the Financial Accounting Standards Board (FASB), which will be effective in 1993, will require all deferred tax balances to be restated at the current tax rate. Using the current 34 percent tax rate, the System would have excess reserves for deferred federal income taxes of approximately $38 million at December 31, 1991. Approximately $28 million of this excess relates to NEEI. Although the System has excess reserves for deferred federal income taxes, it has a deficiency in its net reserves for deferred state income taxes of approximately $8 million. It is expected that, through the regulatory process, net excess reserves for deferred income taxes will be passed back to ratepayers with no significant impact on net income. Accordingly, any excess will be reclassified from a deferred tax liability account to a customer-related liability account. Such pass-back commenced in 1987 with the reduction of the corporate federal income tax rate.

In addition, the new FASB rules will require utilities to establish new deferred tax reserves, including deferred taxes on the equity component of AFDC, NEP's OCA amortization and unamortized investment tax credits, which have not previously been considered subject to deferred tax accounting. These additional tax reserves will be offset by the establishment of regulatory assets or liabilities representing amounts ultimately expected to be recognized in rates. Therefore, the application of this new rule is not expected to have a significant impact on net income.

Total income taxes differ from the amounts computed by applying the statutory tax rate to income before taxes. The reasons for the differences are as follows:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Computed tax at statutory rate	$100,999	$126,690	$ 68,047
Increases (reductions) in tax resulting from:			
Allowance for equity funds used during construction	(667)	(4,892)	(4,176)
Rate settlement adjustments (Note C)		(5,652)	
Reversal of deferred taxes recorded at a higher rate	(6,339)	(6,414)	(12,343)
Amortization of investment tax credits	(7,015)	(31,365)	(8,510)
State income tax, net of federal income tax benefit	13,623	17,269	10,010
All other differences	6,072	4,359	(2,112)
Total income taxes	$106,673	$ 99,995	$ 50,916

Federal income tax returns for NEES and its subsidiaries have been examined and reported on by the Internal Revenue Service (IRS) through 1987. See Note F-2 for further information regarding the examination of the 1984 through 1987 tax returns.

Note C
Seabrook Nuclear Unit 1 and related rate settlements

NEP owns approximately 10 percent of Seabrook 1, a 1,150 MW nuclear generating unit, which entered commercial service on June 30, 1990.

NEP's rate recovery of its investment in Seabrook 1 has been resolved through two separate rate settlement agreements.

The first of these two settlements was a 1988 agreement. This agreement resolved all issues related to NEP's pre-1988 investment in the unit and settled a number of other rate issues outstanding at that time. The 1988 settlement initially limited NEP's recovery of its pre-1988 investment in Seabrook 1 to $61 million per year for seven years and five months, commencing in March 1988. Under the settlement, NEP was allowed to implement a $16.8 million rate increase for five years when the unit went into service on June 30, 1990.

The 1988 settlement also provided that if Seabrook 1 were cancelled, NEP would reduce the annual level of its rates by $12 million for a period of five years. In addition, if the unit had been cancelled, under the FERC's policy applicable to cancelled plants, NEP would have been allowed to collect only 50 percent of prudently incurred post-1987 costs.

As a result of the 1988 settlement agreement, NEP took a $170 million after-tax ($260 million before tax) write-down of its Seabrook 1 investment in 1988. The write-down assumed that the unit would be cancelled. However, after Seabrook 1 entered commercial service in 1990, NEP recorded adjustments in the third quarter of 1990 reversing a portion of the write-down taken in 1988. These adjustments increased income by $115 million after-tax ($134 million before tax) or $1.80 per share for the year ended December 31, 1990, and reflect the increased revenues resulting from achieving commercial operation, the reversal of certain reserves, and the immediate recognition of investment tax credits.

The second settlement agreement, approved by the FERC effective June 30, 1990, increased rates by $25.7 million annually. The rate increase allowed the recovery of (i) costs (not included in the 1988 rate settlement) associated with Seabrook 1 entering into service and (ii) NEP's investment in Seabrook 1 since January 1, 1988.

In February 1991, EUA Power Corporation (EUA Power), a 12 percent joint owner of Seabrook 1, filed for protection under Chapter 11 of the Bankruptcy Code. In August 1991, EUA Power failed to fund its share of monthly Seabrook 1 operating and capital costs. Subject to certain limitations, two joint

owners of Seabrook 1, that are not affiliated with NEP, have agreed to loan EUA Power up to $15 million to cover its monthly obligations to Seabrook 1. This sum is currently estimated to be sufficient to cover such obligations until the summer of 1992. At this time, no further arrangements have been made with respect to EUA Power's obligations.

On October 7, 1991, the U.S. Supreme Court declined to review the NRC's licensing of Seabrook 1. The only outstanding appeal of the license is pending before the NRC. It was brought by opponents of Seabrook 1 challenging an NRC Atomic Safety and Licensing Board decision that adequate provision had been made for sheltering persons who might be on the beach near Seabrook 1 at the time of an incident.

Because of the highly controversial nature of nuclear power in general, and the Seabrook plant in particular, many challenges to, and investigations of the safety of the design, construction, and operation of the plant have been raised in the past and are likely to continue to be raised in the future. NEP does not believe that the currently pending appeal will result in Seabrook 1 being permanently withdrawn from service or cancelled. However, if it were, either as a result of currently pending or unanticipated future events, NEP could be required to cease collecting revenue being collected under the 1988 settlement and/or make refunds and lower rates for five years, depending on the circumstances. A write-down could be required at that time.

The pre-1988 investment in Seabrook 1, net of amortization, is shown on a separate line on the balance sheet. Investments in Seabrook 1 since January 1, 1988 are included in the "Utility plant" line on the balance sheet.

Note D
Yankee Atomic Nuclear Power Station

NEP has a 30 percent ownership interest in Yankee Atomic Electric Company (Yankee), which owns and operates a 185 megawatt nuclear generating station in Rowe, Massachusetts. The station began commercial service in 1960. At December 31, 1991, NEP's investment in Yankee was approximately $6 million. On September 30, 1991, the NRC staff recommended to the NRC Commissioners that the Yankee facility be shut down, pending review of concerns as to the possible embrittlement of the facility's reactor vessel. Yankee began shutting down the facility the next day. On February 26, 1992, the Yankee board of directors decided to permanently cease power operation of the facility and, in time, decommission the facility.

Yankee intends to seek FERC authorization to collect, over the remaining term of the plant's present NRC operating license, the ongoing costs of maintaining and decommissioning the unit as well as previously unrecovered plant investment. The license extends through July 2000. Although these costs are substantial, they are expected to be less than the costs of continued operation. NEP believes that the FERC will continue to allow it to recover from its customers all costs billed to it by Yankee.

Note E
Early termination of purchased power contract

In August 1991, NEP and another utility agreed to an early termination of a contract which called for NEP to purchase power from that utility through April 1993. Under the agreement, NEP made a termination payment of $20 million in January 1992. NEP had recorded a liability for this buy-out amount, as well as an offsetting regulatory asset at December 31, 1991. Under a 1992 rate settlement agreement, which is subject to FERC approval, NEP is allowed rate recovery of this cost. Customers will realize savings in excess of the amount of the termination payment.

Note F
Commitments and contingencies

1. Construction expenditures

The utility subsidiaries' construction expenditures are estimated to be $300 million in 1992. The oil and gas subsidiary's expenditures for its exploration and development programs in 1992 are estimated to be $20 million, which are principally costs of capital (see Note A-6). At December 31, 1991, substantial commitments had been made relative to future planned expenditures.

2. Federal tax assessments

In connection with examinations of the System's tax returns, the IRS had taken the position that no abandonment of Seabrook Unit 2 took place in 1984 through 1987. Accordingly, the IRS disallowed the abandonment loss and related tax deductions claimed in the 1984 through 1987 returns, which resulted in substantial proposed tax deficiencies. The System appealed those disallowances. In December 1991, the System reached a settlement of this matter with the IRS which recognizes the abandonment loss in 1984 subject to certain adjustments to the amount of the tax loss claimed. Accordingly, the System was able to reverse $5.0 million of the total of $8.2 million of interest reserves established in prior years.

3. Franchise tax assessments

NEP paid assessments of additional Massachusetts franchise taxes totaling approximately $5.2 million (including interest) for the years 1983 through 1987. The assessments relate to the method of calculating the portion of NEP's income that is taxable in Massachusetts. NEP disagreed with the Massachusetts Department of Revenue's position and accordingly did not charge these amounts to expense. NEP initiated a refund suit for the assessment. In December 1991, the Massachusetts Supreme Court found in favor of NEP. In January 1992, NEP's payments were refunded in full as a result of this decision.

4. Natural gas pipeline capacity

In connection with NEP's efforts to reduce sulfur dioxide emissions and repower generating units, NEP has signed several contracts for natural gas pipeline capacity. These agreements will require minimum fixed payments, which began in late 1991. Such minimum payments have not been firmly established at this time but are currently estimated to be approximately $15 million in 1992, $30 million in 1993, $55 million in 1994, and $60 million each in 1995 and 1996.

5. Hazardous waste

The Federal Comprehensive Environmental Response, Compensation, and Liability Act, more commonly known as the "Superfund" law, imposes strict joint and several liability on persons identified as having caused or contributed to the release or threat of a release of hazardous wastes at a particular site requiring cleanup action. Parties liable include past and present site owners and operators, transporters that brought wastes to the site, and entities that generated or arranged for disposal or treatment of wastes ultimately disposed of at the site. A number of states, including Massachusetts, have enacted similar laws.

Federal and state environmental agencies, as well as private parties, have contacted or initiated legal proceedings against NEES or its utility subsidiaries regarding liability for cleanup of sites designated as containing hazardous waste. It is possible that, in the future, NEES and its subsidiaries will become involved in demands that they contribute payment to the cost of remediating additional hazardous waste sites.

One of the known sites is the Pine Street Canal Superfund site in Burlington, Vermont. Approximately 16 parties, including NEES, had been notified by the Environmental Protection Agency (EPA) that they were potentially responsible parties (PRPs) for cleanup of the site, which is contaminated by coal tar and other materials. The EPA had brought a lawsuit against NEES and two other parties to recover all of the EPA's past and future response costs at this site. In 1990, the litigation ended with the filing of a final consent decree with the court. Under the terms of the settlement, the EPA recovered its past removal costs. NEES recorded its share of these costs in 1989. NEES remains a PRP for the EPA's ongoing and future response costs at the Pine Street Canal site, which were not a subject of the settlement or consent decree.

The business activities of current and former subsidiaries of NEES have resulted and continue to result in the generation of material designated as hazardous waste. For example, NEES formerly owned gas subsidiaries that were engaged in gas manufacturing. Gas manufacturing processes generated some materials, since identified as hazardous waste, that were generally left on-site. During the early 1970s, NEES sold its gas subsidiaries to gas utilities in New England. Included in the sale were some properties where gas manufacturing facilities were located. Existing NEES subsidiaries also currently own some of these properties. One of the gas utilities that purchased several of the former NEES gas subsidiaries has indicated that it intends to seek recovery from NEES of any liability it may incur for cleanup of gas manufacturing sites that formerly were owned by NEES gas subsidiaries. With respect to one such site, that gas utility has filed a claim against NEES and Massachusetts Electric Company. NEES maintains that liability for cleanup of those sites was transferred to the gas utility when the subsidiaries were sold.

While NEES and its utility subsidiaries cannot estimate the costs which may result from potential liability for cleanup of the hazardous waste sites of which they are currently aware, they do not believe at this time that such costs would be material (ten percent of common equity) to NEES' financial position.

Although rate recovery may be sought for cleanup costs incurred, it is uncertain what portion, if any, would be allowed in rates, particularly in circumstances in which NEES, rather than one of its utility subsidiaries, incurs those costs.

6. Price-Anderson Act

The Price-Anderson Act limits the amount of liability claims that would have to be paid in the event of a single incident at a nuclear plant to $7.6 billion. The maximum amount of commercially available insurance coverage to pay such claims is only $200 million. The remaining $7.4 billion would be provided by an assessment of up to $66.2 million per incident levied on each of the nuclear units in the United States, subject to a maximum assessment of $10 million per incident per nuclear unit in any year. The maximum assessment, which was most recently calculated in 1988, is to be adjusted at least every five years to reflect inflationary changes. NEP's current interest in the Yankees, Millstone 3, and Seabrook 1 would subject NEP to a $68.2 million maximum assessment per incident. NEP's payment of any such assessment would be limited to a maximum of $10.3 million per incident per year.

7. Long-term contracts for the purchase of electricity

NEP purchases a portion of its electricity requirements pursuant to long-term contracts with owners of various generating units. Certain of these contracts require NEP to make minimum fixed payments to cover its proportionate share of the capital and fixed operating costs of these generating units. The majority of the payments are to the Yankees and Ocean State Power, entities in which NEES subsidiaries hold ownership interests. These costs are recovered in rates. The contracts also include variable costs which are also recovered through NEP's rates. The total cost of these contracts is included in the purchased electric energy lines in the "Statements of Consolidated Income"

The table below shows the minimum fixed payments expected to be made under these contracts for the years 1992 to 1996 including costs associated with the retired Yankee plant discussed in Note D

(millions of dollars)

	Ocean State and Yankees	All Other
1992	$200	$50
1993	200	50
1994	200	45
1995	200	35
1996	220	35

Note G
Retirement plans

The System's plans are noncontributory defined-benefit plans covering substantially all employees. The plans provide pension benefits based on the employee's compensation during the five years before retirement. The System's funding policy is to contribute each year, the net periodic pension cost for that year. However, the contribution for any year will not be less than the minimum required contribution under federal law or greater than the maximum tax deductible amount.

Total pension cost for 1991, 1990, and 1989 included the following components:

Year ended December 31 (thousands of dollars)	1991	1990	1989
Service cost—benefits earned during the period	$ 10,319	$ 10,229	$ 9,360
Plus (less):			
Interest cost on projected benefit obligation	43,602	40,806	38,479
Return on plan assets at expected long-term rate	(41,265)	(39,531)	(37,408)
Amortization	780	460	108
Total pension cost	$ 13,436	$ 11,964	$ 10,539
Assumptions used to determine pension cost were:			
Discount rate	8.5%	8.5%	8.5%
Average rate of increase in future compensation levels	6.7%	6.7%	6.7%
Expected long-term rate of return on assets	9.0%	9.0%	9.0%
Actual return on plan assets	$ 72,668	$ 13,060	$ 52,646

The following table sets forth the plans' funded status:

	December 31, 1991		December 31, 1990	
	Retirement Plans (In thousands)			
	Regular Plans	Supplemental Plans	Regular Plans	Supplemental Plans
Benefits earned				
Actuarial present value of accumulated benefit liability:				
Vested	$443,350	$32,057	$416,922	$27,519
Non-vested	23,781	223	21,258	209
Total	$467,131	$32,280	$438,180	$27,728
Reconciliation of funded status				
Actuarial present value of projected benefit liability	$544,901	$36,664	$510,282	$30,784
Unrecognized prior service costs	(14,581)	(5,007)	(11,526)	(4,386)
FAS 87 transition liability not yet recognized (amortized)	—	(6,504)	—	(7,155)
Net gain (loss) not yet recognized (amortized)	2,263	33	(27,291)	2,806
	532,583	25,186	471,465	22,049
Pension fund assets at fair value	552,629	—	488,723	—
FAS 87 transition asset not yet recognized (amortized)	(16,034)	—	(17,476)	—
	536,595	—	471,247	—
Accrued pension payments recorded on books	$ (4,012)	$25,186	$ 218	$22,049

Plan assets are composed primarily of corporate equity, guaranteed investment contracts, debt securities, and cash equivalents.

Certain health care and life insurance benefits are provided to substantially all retired employees. Such benefits are not funded by the System. The cost of these postretirement benefits is charged to expense when paid and was estimated to be $12 million in 1991, $11.8 million in 1990 and $10.1 million in 1989. New FASB accounting rules for such costs, which will be effective in 1993, will require the NEES subsidiaries to commence the establishment of a liability during the working years of employees for the expected cost of providing postretirement benefits to those employees. The impact of the new rules will result in a significant increase in annual cost. Had the new accounting rules for such costs been in effect in 1991, it is estimated that the accumulated postretirement benefit obligation would be approximately $400 million at December 31, 1991, and annual cost would have increased by approximately $50 million (before tax) in 1991. The NEES subsidiaries are seeking to recover these costs through rates.

Note H
Property losses

NEP is a joint owner of the cancelled Seabrook 2 nuclear generating unit. At December 31, 1987, NEP had expended approximately $69 million ($39 million after tax) on the unit. NEP has been allowed rate recovery of all such costs, but has not been allowed to earn a return on the unamortized balance during the recovery period. NEP has recorded this property loss at a discounted value and is amortizing and recovering it over a ten year period ending in 1996. The unamortized portion of these costs is included in the "Consolidated Balance Sheets" under "Unamortized property losses".

Note I
Short-term borrowing

At December 31, 1991, NEES and its consolidated subsidiaries did not have any short-term debt outstanding, but had lines of credit with banks totaling $279 million. These lines of credit are available to provide liquidity support for commercial paper borrowings and for NEP's Series R and T general and refunding mortgage bonds (see Note K) and other corporate purposes. There are no compensating balance arrangements. Fees are paid in lieu of compensating balances on most lines of credit.

Note J
Share capital of New England Electric System

NEES issued additional common shares, $1 par value, as follows:

Year ended December 31	1991		1990		1989	
(thousands of dollars)	Par	Paid-in capital	Par	Paid-in capital	Par	Paid-in capital
Public common share issuance					$4,000	$100,580
Dividend reinvestment and common share purchase plan	$212	$ 5,080	$ 773	$19,332	806	19,061
Employee share plans	386	9,671	621	15,620	576	13,492
	$598	$14,751	$1,394	$34,952	$5,382	$133,133

Note K
Long-term debt

Substantially all the properties of NEP and the retail subsidiaries are subject to the lien of mortgage indentures under which mortgage bonds have been issued.

The aggregate payments to retire maturing long-term debt and for sinking fund requirements are as follows:

	(thousands of dollars)				
	1992	1993	1994	1995	1996
Maturing long-term debt	$ 92,000	$20,000	$ 4,600		$ 20,000
Mandatory prepayments:					
Hydro-Transmission Companies	11,520	11,520	11,520	$11,520	11,520
Granite State Electric Company	1,400	1,400	1,400	1,400	1,400
NEEI			25,000	75,000	75,000
Other sinking fund requirements	6,670	5,750	5,500	5,500	5,400
	$111,590	$38,670	$48,020	$93,420	$113,320

Other sinking fund requirements may be satisfied in cash, bonds, or by evidencing additional property (credited at 60% of cost).

The terms of pollution control revenue bonds collateralized by NEP's variable rate bonds require NEP to reacquire the bonds under certain limited circumstances. At December 31, 1991, interest rates on NEP's variable rate bonds ranged from 4.10 to 6.20 percent. Also, at December 31, 1991, interest rates on NEEI's debt ranged from 5.31 to 6.125 percent.

In 1991, the Hydro-Transmission companies issued $215 million of long-term notes in three series with maturity dates ranging from 10 to 25 years and interest rates of 8.82 to 9.41 percent. The proceeds were used principally to repay outstanding borrowings under a previous revolving credit agreement.

Massachusetts Electric Company has agreed to sell $25 million of first mortgage bonds during the first quarter of 1992. These bonds will bear interest rates ranging from 5.875 to 8.55 percent.

Report of Management

The management of New England Electric System is responsible for the integrity of the consolidated financial statements included in this annual report. The financial statements were prepared in accordance with generally accepted accounting principles using management's informed best estimates and judgments where appropriate to fairly present the financial condition of the System and its results of operations. The information included elsewhere in this report is consistent with the financial statements.

The System maintains an accounting system and system of internal controls which is designed to provide reasonable assurance as to the reliability of the financial records, the protection of assets, and the prevention of any material misstatement of the financial statements. The System's accounting controls have been designed to provide reasonable assurance that errors or irregularities, which could be material to the financial statements, are prevented or detected by employees within a timely period as they perform their assigned functions. The System's internal auditing staff independently assesses the effectiveness of internal controls and recommends improvements when appropriate.

Coopers & Lybrand, the System's independent accountants, is engaged to audit and express their opinion on our financial statements. Their audit includes a review of internal controls to the extent required by generally accepted auditing standards.

The Board of Directors carries out its responsibility for the financial statements and the related financial data through its Audit Committee, which is composed solely of outside directors. The Audit Committee meets periodically with management, the internal auditor and the independent accountants to ensure that each is carrying out its responsibilities and to discuss auditing, internal accounting control and financial reporting matters. Both the internal auditor and the independent accountants have free access to the Audit Committee, without management present, to discuss the results of their audit work.

John W. Rowe
President and
Chief Executive Officer

Alfred D. Houston
Senior Vice President-Finance
and Chief Financial Officer

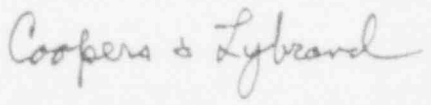
Report of Independent Accountants

To the Board of Directors and Shareholders of New England Electric System:

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of New England Electric System and subsidiaries (the Company) as of December 31, 1991 and 1990 and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1991. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 1991 and 1990, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1991, in conformity with generally accepted accounting principles.



Boston, Massachusetts
February 27, 1992

New England Electric System and Subsidiaries
Supplementary Information on Business Segments (unaudited)

The consolidated group operates in two principal domestic industry segments.

	(thousands of dollars)	Electric	Oil and gas	Consolidated
Year ended December 31, 1991	Operating revenue	$2,056,798	$ 37,580	$2,094,378
	Depreciation and amortization	198,806	79,320	278,126
	Other operating expenses	1,414,394	7,151	1,421,545
	Income taxes	126,111	(22,409)	103,702
	Operating income (loss)	317,487	(26,482)	291,005
	Interest expense	119,824		119,824
	Income from equity investments	11,803		11,803
	Other income (expense)—net	(7,696)	4,522	(3,174)
	Net income (loss)	$ 201,770	$ (21,960)	$ 179,810
	Total assets	$3,964,569	$485,508	$4,450,077
	Investments at equity	$ 96,452		$ 96,452
	Capital expenditures	$ 192,738	$ 32,969	$ 225,707
Year ended December 31, 1990	Operating revenue	$1,869,507	$ 39,319	$1,908,826
	Depreciation and amortization	179,930	79,185	259,115
	Other operating expenses	1,305,929	7,991	1,313,920
	Income taxes	103,915	(21,995)	81,920
	Operating income (loss)	279,733	(25,862)	253,871
	Interest expense	105,973	373	106,346
	Income from equity investments	5,808		5,808
	Other income—net	108,688	29	108,717
	Net income (loss)	$ 288,256	$ (26,206)	$ 262,050
	Total assets	$3,859,714	$547,800	$4,407,514
	Investments at equity	$ 78,649		$ 78,649
	Capital expenditures	$ 218,340	$ 59,913	$ 278,253
Year ended December 31, 1989	Operating revenue	$1,645,930	$ 59,558	$1,705,488
	Depreciation and amortization	163,182	93,699	256,881
	Other operating expenses	1,149,428	7,755	1,157,183
	Income taxes	72,607	(23,321)	49,286
	Operating income (loss)	260,713	(18,575)	242,138
	Interest expense	104,229	1,181	105,410
	Income from equity investments	8,444		8,444
	Other income (expense)—net	(6,523)	1	(6,522)
	Net income (loss)	$ 158,405	$ (19,755)	$ 138,650
	Total assets	$3,549,363	$566,996	$4,116,359
	Investments at equity	$ 64,478		$ 64,478
	Capital expenditures	$ 531,907	$ 54,092	$ 585,999

In 1985, the SEC granted approval to divide NEEI's oil and gas exploration and development activities into two programs: a rate-regulated program and a non-rate-regulated program. The net loss for 1991 of $22.0 million includes (a) a $4.0 million net profit on the non-rate-regulated program and (b) a $26.0 million loss on the rate-regulated program, which will be passed on to customers in 1992. The net loss for 1990 of $26.2 million includes (a) a $6.9 million loss on the non-rate-regulated program and (b) a $19.3 million loss on the rate-regulated program, which was passed on to customers in 1991. The net loss for 1989 of $19.8 million includes (a) a $3.6 million loss on the non-rate-regulated program and (b) a $16.2 million loss on the rate-regulated program, which was passed on to customers in 1990. See Note A-6 of "Notes to Financial Statements" for a more complete discussion of oil and gas operations.

New England Electric System and Subsidiaries
Supplementary Information on Oil and Gas Activities (unaudited)

The estimates of NEEI's proved reserves and proved-developed reserves of oil and gas, all located within the United States, and changes to the estimated proved reserves for 1989, 1990 and 1991 are as follows:

	Crude oil and condensate (thousands of Bbl)	Natural gas (thousands of MCF)
Proved reserves as of December 31, 1988	4,964	154,236
Revisions of previous estimates	(2,634)	2,657
Extensions, discoveries and other additions	219	11,250
Production	(436)	(23,620)
Proved reserves as of December 31, 1989	2,113	144,523
Revisions of previous estimates	77	(2,394)
Extensions, discoveries and other additions	113	5,248
Production	(421)	(17,368)
Proved reserves as of December 31, 1990	1,882	130,009
Revisions of previous estimates	(40)	(2,064)
Extensions, discoveries and other additions	530	1,731
Production	(425)	(17,559)
Proved reserves as of December 31, 1991	1,947	112,117

	Average selling price year ended December 31,		Proved-developed reserves at December 31,	
	Crude oil and condensate (per Bbl)	Natural gas (per MCF)	Crude oil and condensate (thousands of Bbl)	Natural gas (thousands of MCF)
1988	$15.44	$1.89	1,787	143,335
1989	$16.85	$1.84	2,015	130,792
1990	$20.56	$1.80	1,796	120,986
1991	$22.80	$1.61	1,402	100,596

Proved reserves are estimated quantities of crude oil, condensate and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known oil and gas reservoirs under existing economic and operating conditions. Proved-developed reserves are those proved reserves reasonably expected to be recovered through existing wells with existing equipment and operating methods. Included in the proved reserves and proved-developed reserves at December 31, 1990 and 1989 are approximately 221,000 Bbls and 147,000 Bbls respectively, of crude oil and condensate and 10,034,000 MCF and 10,443,000 MCF, respectively, of natural gas that relate to the non-rate-regulated program.

The following independent petroleum engineering consultants prepared estimates of NEEI's proved reserves and proved-developed reserves, and such estimates are included in reliance upon such consultants as experts: Paul M. Bennett and Associates of Dallas, Texas prepared the estimates for the majority of the 1991, 1990, and 1989 reserves and Bennett & Westerman, Inc. of Dallas, Texas prepared the estimates for 1988. The reserves are estimates only and should not be construed as exact quantities. Future conditions may affect the recovery of estimated reserves.

	1991			1990		
	Price range		Dividend	Price range		Dividend
	High	Low	declared	High	Low	declared
First quarter	$27 1/2	$24	$.51	$28 5/8	$26 3/8	$.51
Second quarter	$29 3/8	$26 7/8	$.52	$27 3/8	$24 3/4	$.51
Third quarter	$31 3/8	$27 3/4	$.52	$27 3/8	$22 1/2	$.51
Fourth quarter	$32 5/8	$30 1/4	$.52	$26	$23 1/2	$.51

The total number of shareholders at December 31, 1991 was 64,221.

(thousands of dollars)	First quarter	Second quarter	Third quarter	Fourth quarter
1991				
Operating revenue	$574,200	$475,011	$520,801	$524,366
Operating income	$ 98,632	$ 49,155	$ 77,625	$ 65,593
Net income	$ 73,552	$ 19,340	$ 44,489	$ 42,429
Net income per average share	$ 1.14	$ .29	$ .69	$ .65
1990				
Operating revenue	$494,066	$436,711	$486,729	$491,320
Operating income	$ 74,064	$ 39,661	$ 71,651	$ 68,495
Net income	$ 49,387	$ 17,290	$162,687	$ 32,686
Net income per average share	$ .78	$ .27	$ 2.55*	$ .51

*See Note C for a discussion of the rate settlement adjustments.

Information about shareholder records, quarterly dividend payments, direct deposit of dividends, seasonal address changes, dividend reinvestment, and optional cash payments may be obtained by contacting:

New England Electric System
Shareholder Services Department
Post Office Box 770
Westborough, Massachusetts 01581-0770

Shareholders may also direct questions to their shareholder services representative. The representatives listed to the right are assigned to accounts based on the first letter of each shareholder's last name.

(508) 366-9011
A–G Ruth Benjamin, extension 3177
H–N Judith Daggett, extension 2611
O–Z Karen Army, extension 2135

Dividends are generally payable on the first business day of January, April, July, and October.

Questions about the transfer of certificate shares should be directed to:

The First National Bank of Boston
Post Office Box 644, Mail Stop 45-02-09
Boston, Massachusetts 02102-0644
(617) 575-2900

New York Stock Exchange
Boston Stock Exchange

NES

The annual meeting of New England Electric System will be held at the New England Hall, 225 Clarendon Street, Boston, Massachusetts, on April 28, 1992, at 10:30 a.m.

Copies of the annual report on Form 10K to the Securities and Exchange Commission and a Statistical Report for 1991 can be obtained, free of charge, by writing to:

New England Electric System
Investor Relations
25 Research Drive
Westborough, Massachusetts 01582

As of January 1, 1992

W. Douglas Bell
Former Chairman and
Chief Executive Officer
State Mutual Life Assurance
Co. of America
Worcester, Massachusetts
Executive Committee

Joan T. Bok
Chairman
New England Electric System
Westborough, Massachusetts
Executive Committee

Paul L. Joskow
Professor of Economics
and Management
Massachusetts Institute
of Technology
Cambridge, Massachusetts
Audit Committee

John M. Kucharski
Chairman and
Chief Executive Officer
EG&G, Inc.
Wellesley, Massachusetts
Compensation Committee
Customer Service Committee

Edward H. Ladd
Chairman
Standish, Ayer & Wood, Inc.
Investment counselors
Boston, Massachusetts
Executive Committee

Joshua A. McClure
Former President
American Custom Kitchens, Inc.
Providence, Rhode Island
Audit Committee

Malcolm McLane
Vice President
Orr & Reno, P.A., Attorneys
Concord, New Hampshire
Audit Committee
Customer Service Committee

Felix A. Mirando, Jr.
Private investor
Osterville, Massachusetts
Compensation Committee

John W. Rowe
President and
Chief Executive Officer
New England Electric System
Westborough, Massachusetts
Executive Committee

George M. Sage
President
Bonanza Bus Lines, Inc.
Providence, Rhode Island
Executive Committee
Customer Service Committee

Anne Wexler
Chairman
The Wexler Group
Management consultants
Washington, D. C.
Executive Committee
Compensation Committee

James Q. Wilson
Professor of Management
The University of California
at Los Angeles
Audit Committee

James R. Winoker*
President
B. B. Greenberg Company
Jewelry Manufacturers
Providence, Rhode Island
Compensation Committee
Customer Service Committee

As of January 1, 1992

Joan T. Bok
Chairman

John W. Rowe
President and
Chief Executive Officer

Frederic E. Greenman
Senior Vice President,
General Counsel and
Secretary

Alfred D. Houston
Senior Vice President -
Finance and
Chief Financial Officer

Edward E. Mulligan
Vice President

John W. Newsham
Vice President

Glenn R. Schleede
Vice President

Richard P. Sergel
Vice President

Jeffrey D. Tranen
Vice President

Michael E. Jesanis
Treasurer

Massachusetts Electric Company
25 Research Drive
Westborough, Massachusetts 01582
John H. Dickson, President

The Narragansett Electric Company
280 Melrose Street
Providence, Rhode Island 02901
Robert L. McCabe, President

Granite State Electric Company
33 West Lebanon Road
Lebanon, New Hampshire 03766
Lydia M. Pastuszek, President

New England Power Company
25 Research Drive
Westborough, Massachusetts 01582

New England Energy Incorporated
25 Research Drive
Westborough, Massachusetts 01582

New England Electric Transmission Corporation
4 Park Street
Concord, New Hampshire 03301

New England Hydro-Transmission Corporation
4 Park Street
Concord, New Hampshire 03301

New England Hydro-Transmission Electric Company, Inc.
25 Research Drive
Westborough, Massachusetts 01582

Narragansett Energy Resources Company
280 Melrose Street
Providence, Rhode Island 02901

New England Power Service Company
25 Research Drive
Westborough, Massachusetts 01582

* James R. Winoker was elected to the NEES board of directors on August 27, 1991. He had served as a director of our Rhode Island retail subsidiary from 1990 to 1991. Mr. Winoker is a graduate of Brown University and Harvard University Graduate School of Business. He is Trustee Emeritus of Brown University and is a director of Original Bradford Soap Works Inc. and the Rhode Island Public Expenditure Council.

** Vice presidents Robert O. Bigelow, Robert C. Smith, and George P. Sasdi retired from NEES during 1991. Vice president Glenn R. Schleede retired from NEES in February 1992.