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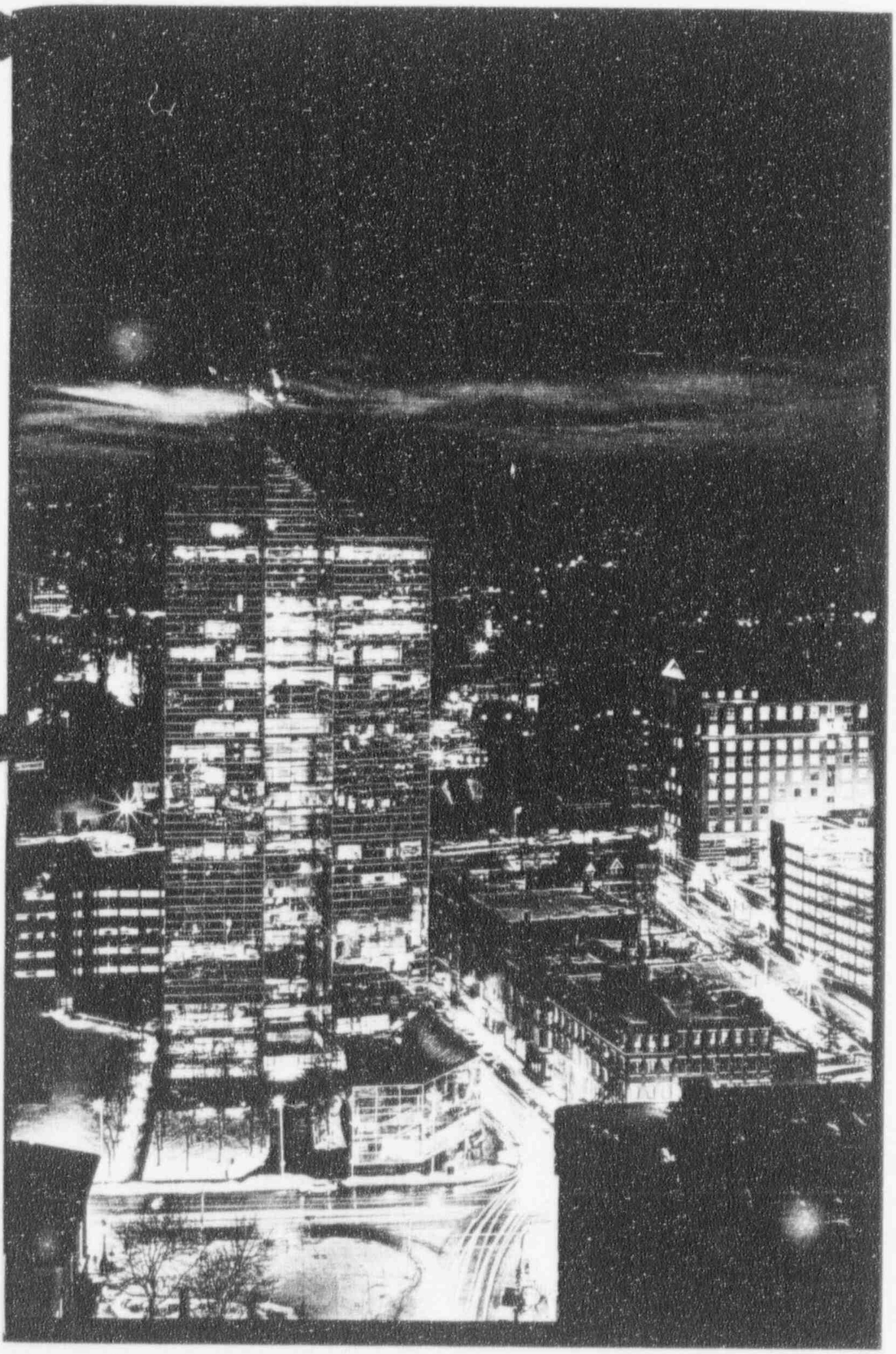

1993 ANNUAL REPORT

Route

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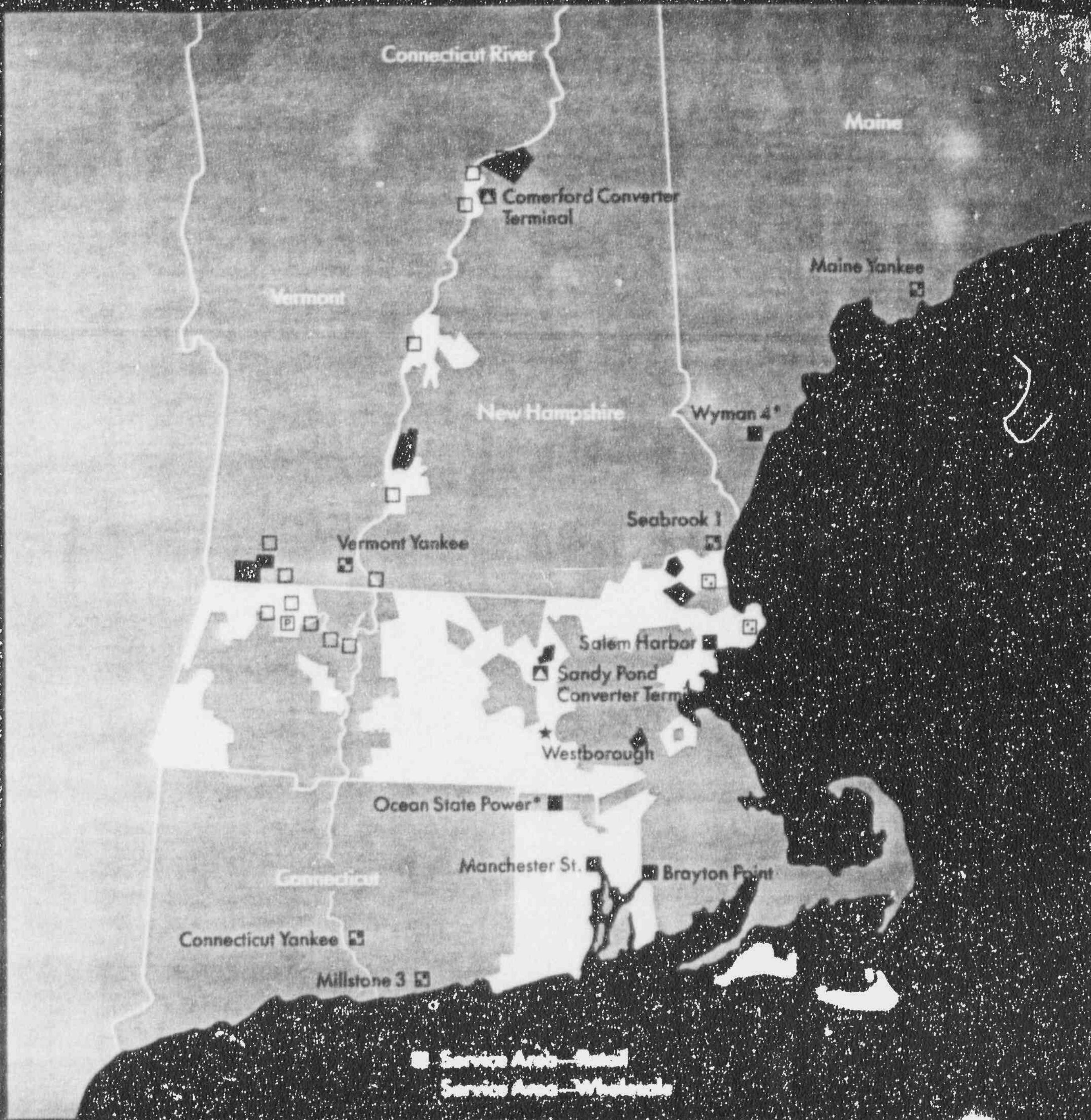
New England Electric System

New England Electric System



About the cover:
With a population [illegible]

FINANCIAL HIGHLIGHTS

	1993	1992
Earnings per average share	$ 2.93	$ 2.85
Dividends declared per share	$ 2.22	$ 2.14
Book value per share—year end	$23.55	$22.88
Market price per share—year end	$39⅛	$38½
Growth in kilowatthour (KWH) sales billed to ultimate customers	1.4%	0.4%
Cost per KWH to ultimate customers (cents)	9.50	9.43

New England Electric System is a public utility holding company headquartered in Westborough, Massachusetts. Subsidiaries include three retail electric companies—Massachusetts Electric Company, which serves 930,000 customers in 149 Massachusetts communities; The Narragansett Electric Company, which serves 323,000 customers in 27 Rhode Island communities; and Granite State Electric Company, which serves 35,000 customers in 21 New Hampshire communities. Other subsidiaries include two wholesale electric generating companies: New England Power Company, which operates 20 generating stations, and Narragansett Energy Resources Company, which owns 20 percent of the Ocean State Power generating station; an oil and gas exploration and development company, New England Energy Incorporated; three electric transmission companies: New England Electric Transmission Corporation, New England Hydro-Transmission Corporation, and New England Hydro-Transmission Electric Company, Inc.; an international operations and management consulting services company, New England Electric Resources, Inc.; and a service company, New England Power Service Company.

Contents

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

To Our Fellow Shareholders:

1993 was a year marked by continued strong financial performance and new signs that the lingering recession is easing in the Northeast. It was a year in which our company made important progress in its efforts to stay a step ahead of the competition that is emerging in our industry. And it was a year of further actions to enhance your investment in New England Electric System (NEES) and to shape an even stronger enterprise.

Among our accomplishments:

- Earnings for 1993 increased to $2.93 per share compared with $2.85 in 1992;
- Return on equity was 12.6 percent, which places us in the top third of major electric utilities in the Northeast for the fifth consecutive year;
- In May, the NEES board of directors raised your annual dividend by 3.7 percent to $2.24 per share;
- In addition to meeting return on equity and dividend growth goals, we achieved our three other key financial goals as shown on the report card on page 3.
- As part of 1993 cost-cutting efforts, we renegotiated purchased power contracts and sold capacity, which will provide long-term savings of more than $150 million. We also refinanced debt, which will provide approximately $10 million in savings annually. Since 1991, we have reduced the average interest rate on our debt from 8 percent to less than 6 percent.

Among other 1993 achievements, we obtained approval of an important rate agreement, completed a corporate reorganization, and developed our latest and most far-reaching resource plan, NEESPLAN 4. Here are details on these accomplishments.

We reduced rates in Massachusetts while resolving responsibility for gas wastes

During the fourth quarter, a rate agreement among our retail subsidiary Massachusetts Electric,

the Massachusetts Attorney General, and two groups of large commercial and industrial customers was approved by the state's Department of Public Utilities. This important agreement resolves the question of how environmental remediation costs for Massachusetts sites contaminated by manufactured gas wastes will be funded and recovered in rates.

As part of the settlement, NEES made a $30 million contribution to a fund for remediation costs at locations operated by gas utilities that NEES once owned. This contribution is well within the reserves we had already set aside. Each year, $3 million will be added to the fund and is recoverable in Massachusetts Electric's rates.

The agreement also provides our Massachusetts Electric customers with a one-time rate reduction of $26 million and offers discounts to large industrial and commercial customers who make a commitment to long-term service.

NEES' Key Financial Goals—1993 Results

- ✓ **Total Return** in top one-third of major electric utilities on rolling 5-year average
- ✓ **Dividend Growth** exceeds average of electric utilities on rolling 5-year average
- ✓ **Return on Equity** in top one-third of major New York and New England utilities
- ✓ **Cash Flow** coverage of dividends in top one-third of major electric utilities
- ✓ **Investment Quality** Auditors' reports not qualified and bond ratings A+

We reorganized and downsized to meet competition

A more competitive business environment is taking shape for energy suppliers. Independent producers challenge the economics of utility power plants, and widely available natural gas supplies provide energy alternatives for many customers. For an electric utility to succeed and prosper, it must understand that this new marketplace is customer-driven and that customer expectations for price, reliability, and service must be met. To better meet these demands, NEES undertook a major review of its entire organization. In spring 1993, we realigned into two strategic business units (supported by an administrative and legal group). This structure will help us to focus simultaneously on the needs of our industrial, commercial, and residential customers at the retail level and on the needs of our own retail affiliates and other electric utilities at the wholesale level.

Richard P. Sergel, who has served as a NEES vice president since 1992 and was NEES treasurer from 1990 until 1992, was selected to lead the System's retail business unit. Jeffrey D. Tranen, who has served as NEES vice president since 1991 and was vice president of our wholesale generating subsidiary from 1984 to 1991, was selected to head the wholesale business unit.

Our strategic objectives for these two business units reflect the different customer expectations and competitive forces that prevail in each market. But our overall goals are the same: to sharpen our competitive edge and remain the electricity supplier of choice.

In 1993, through a voluntary early retirement program and a special severance program for

Peter Greenberg (left), national accounts manager for the NEES retail companies, discusses energy-efficiency improvements with William Card, manager of financial analysis for Papa Gino's restaurants. Our company is working closely with the restaurant chain to pilot-test electrotechnologies for baking, grilling, frying, and other restaurant support purposes.

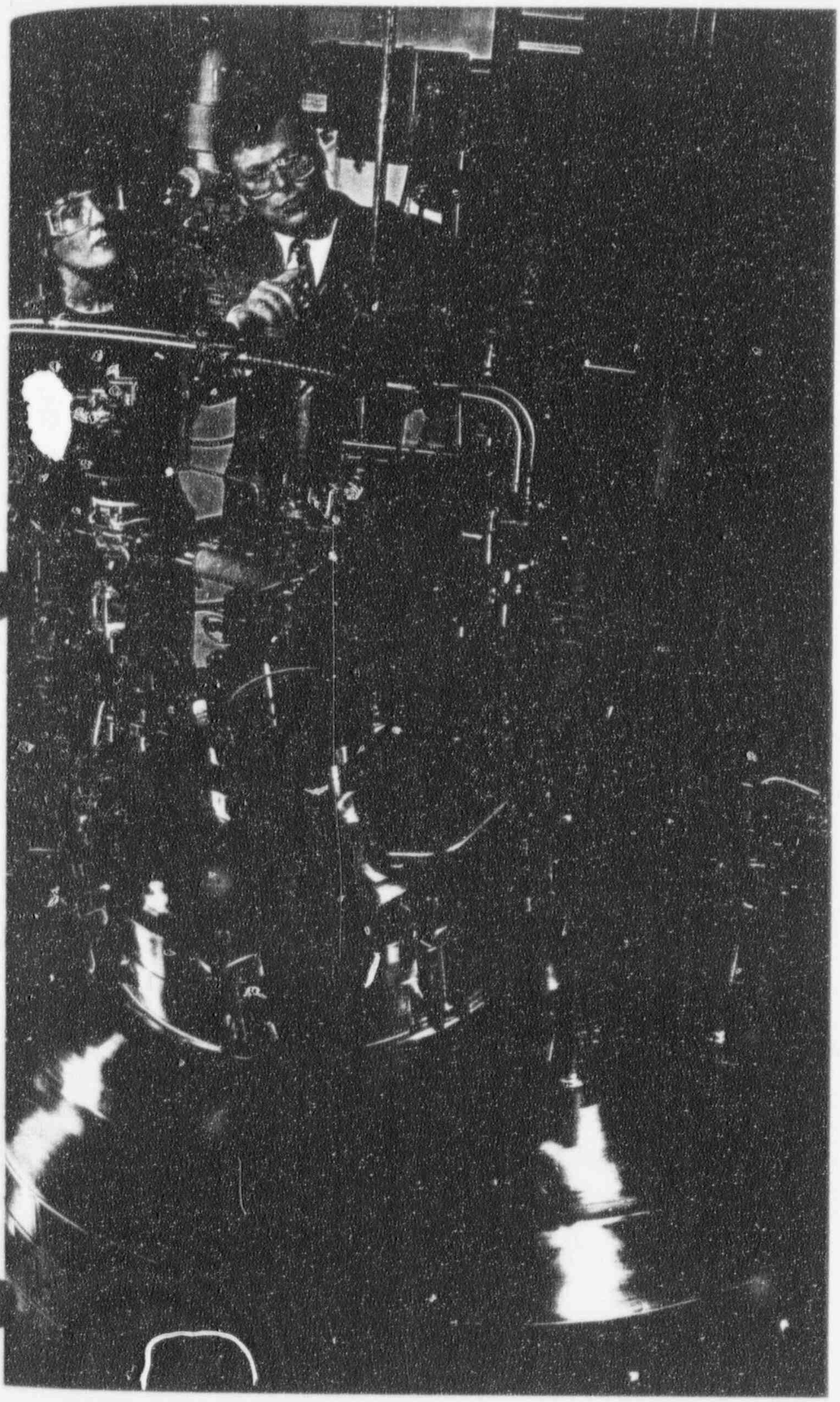
non-union employees, we reduced layers of management and created a smaller, more responsive organization. We estimate savings to be approximately $20 million per year. Many functions and job assignments were redesigned to give our employees more opportunities to be creative and effective. The downsizing created real anguish within our organization, but our employees, as always, have risen to the challenge. For example, during this difficult transition period, they continued to stress safety and set a record low of 30 lost-time accidents.

We added more value to our retail service

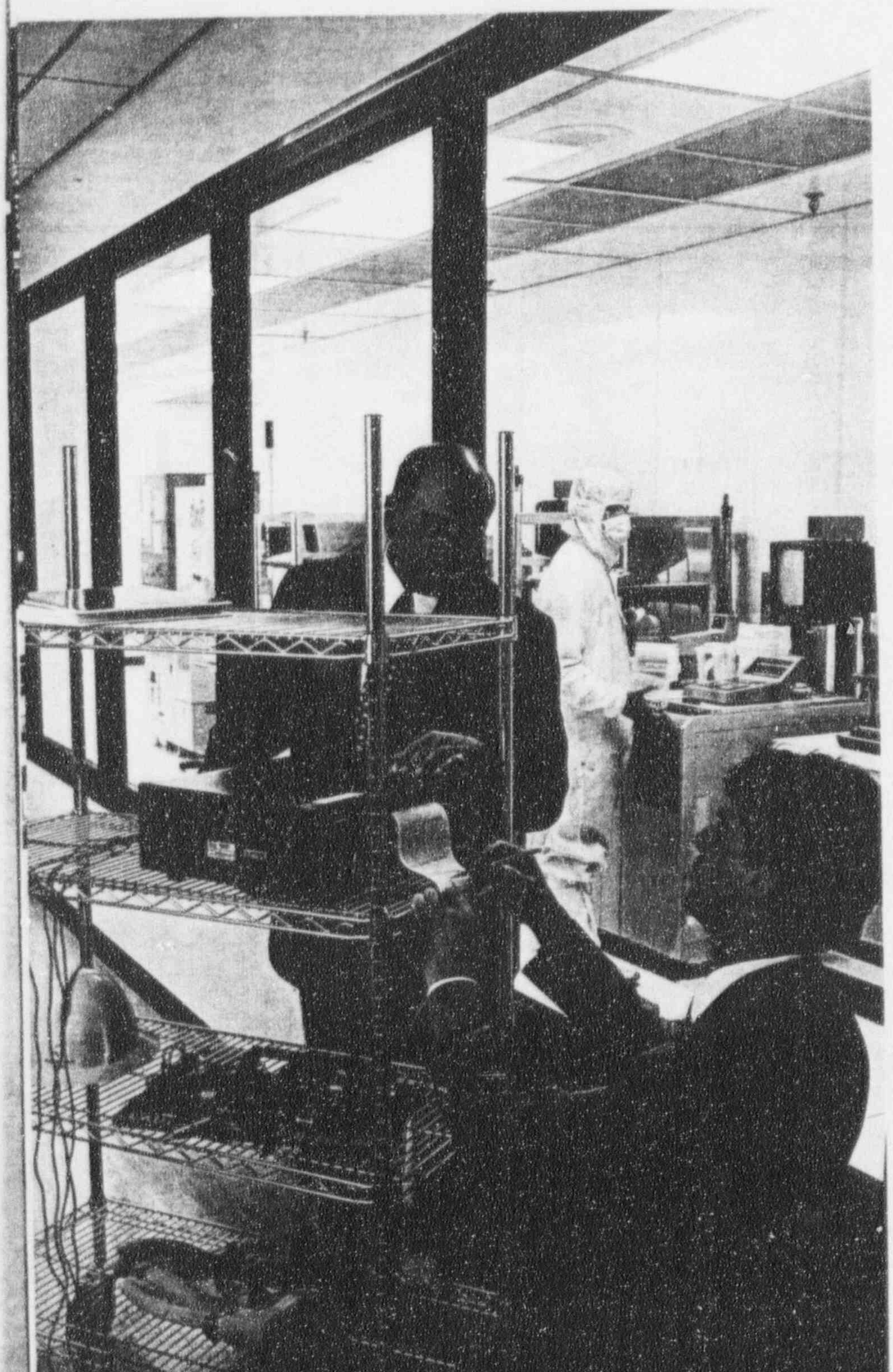
The first prerequisites of good customer service are reliability and cost control. During 1993, our reliability index continued to improve and our average cost per kilowatthour rose by less than 1 percent. Massachusetts Electric customers received a small rate reduction in December 1993, and that company began to offer large commercial and industrial customers a discount if they sign agreements for long-term service. The early response to this offer has been most encouraging.

Energy conservation programs have become a mainstay of the relationship between New England Electric and its customers. For the past six years, the NEES companies have developed and implemented one of the nation's largest and most comprehensive energy conservation, or demand-side management (DSM), programs. We have become leaders in evaluating actual customer experience to measure the effectiveness of DSM technologies. We have encouraged and helped thousands of our customers to increase operating efficiency and reduce costs. Through incentives approved by regulators in each of the three states we serve, DSM programs have also benefitted our shareholders, adding seven cents to earnings per average common share in 1993.

As our customers look for new ways to reduce costs and make their operations more efficient and competitive, the quality of electric service is becoming more important. During 1993, NEES' retail business



Rita Moran, Massachusetts Electric account manager, examines a process tank at the BASF Bioresearch Corporation facility at Biotechnology Park in Worcester, Mass. with Peter Moesta, BASF's vice president of operations. Energy-efficient lighting, storage cooling, and premium efficiency motors are among the features incorporated into the new building through our DSM programs.



Timothy Roughan (right), Massachusetts Electric account manager, monitors power quality at the Allegro MicroSystems, Inc. plant in Worcester, Mass. with James McKeon of the facility's engineering staff. Allegro MicroSystems, Inc. seeks disturbance-free power for the manufacturing of integrated circuits for consumer electronics.

Abraham Gladstone (left), Massachusetts Electric account manager, confers with executives Marc Villa and Neil Dawson of Hardwick Kilns, Inc. a company that dries hardwood lumber for export. Hardwick Kilns, Inc. is the first participant in Project Impact, a program that targets DSM for economic development and is jointly funded by the state government and Massachusetts Electric.

unit responded by developing an expanded menu of customer services that we call *EnergyFIT*, which will be introduced with at least 20 large commercial and industrial customers in 1994.

EnergyFIT includes, but goes well beyond, opportunities for conservation of electricity. It addresses the customer's usage of all forms of energy and offers integrated solutions to help the customer remain competitive. Customized services include assisting in compliance with environmental regulations, advising on the best use of new electrotechnologies, and helping the customer decide whether or not to generate its own electricity.

EnergyFIT includes an expanded power quality program, to address the growing needs of our larger commercial and industrial customers for steady, undistorted electric energy to power their computers and other electronic equipment. In addition to making ongoing improvements to our generation and transmission facilities, we are conducting workshops and providing advanced training for customers and our field service staff to help them meet power quality requirements.

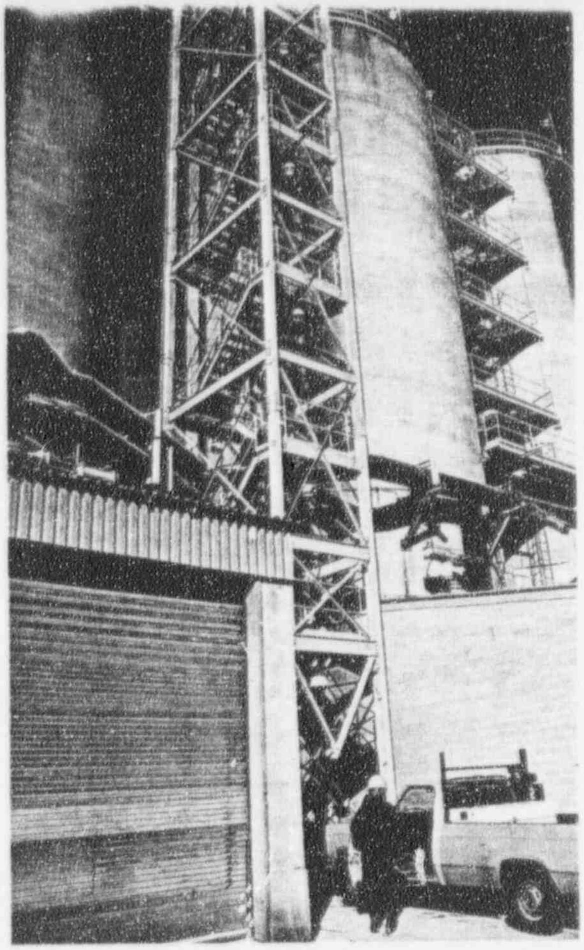
For nearly 27 years, Malden Catholic High School had operated this cogeneration equipment to meet its electricity needs. In 1993, the school agreed to instead purchase its electric service from Massachusetts Electric on a long-term basis for cost, power quality, and environmental advantages. Pictured with Brother Richard Cook (center), school headmaster, are Massachusetts Electric's Jack Meeker, account manager, and Thomas Donahue, account representative.

With residential customers, we are exploring promising technologies such as ground-source heat pumps and cordless electric lawn mowers, and are continuing our successful DSM efforts in such areas as residential lighting and space heating. We are also establishing a team of customer representatives trained to analyze bills, offer savings advice, and recommend appropriate rates and services.

We began to use portfolio management techniques to provide greater flexibility in resource selection

Our rates continue to be among the lowest in New England. However, as the marketplace changes for electric utilities, we are constantly reminded that the best way to prepare for increased competition is not only to keep rates low, but also improve service and add value. We are committed to maintaining real price stability for the long term while also achieving public policy goals for continuous environmental improvement.

Meeting both price and environmental goals will require the development of more creative planning approaches. Forecasting future loads has been a source of significant uncertainty for utilities. Commitments for new generating capacity often must be made well before the forecasted load occurs.



At Brayton Point and Salem Harbor stations, ash produced by the burning of coal is stored in silos prior to disposal or recycling. We have set a goal of recycling 100 percent of our coal ash by the year 2000.

In our new approach to planning, we are basing our commitments on a process designed to more closely match supply to demand. We will make long-term commitments only to match forecasted customer loads that are highly certain to occur, and these commitments will employ a wide range of fuel sources. We will meet needs that are less certain by developing resources or purchasing options on resources that can be made available quickly, without long construction lead times. The short lead-time options may include DSM programs, efficiency improvements at our generating stations and on our power delivery system, and power purchases from renewable energy projects as well as more conventional gas turbines.

As market conditions and customer needs change, we will adjust our resource mix to achieve the best balance of cost and flexibility. In essence, we intend to manage our resources as a portfolio of options, much as an investor manages a portfolio of stocks and bonds to provide flexibility and minimize risk.

As part of this portfolio approach to resource planning, we are continuing to relicense our hydro-electric facilities as the current federal licenses expire. These facilities generated nearly 6 percent of our energy needs in 1993. In another ongoing initiative, we are on schedule and under budget in repowering our Manchester Street Station in Providence, R.I. Scheduled for completion in late 1995, the 489-megawatt facility will be fueled by natural gas and will offer high efficiency. The result will be a better balance of fuels in our energy mix and substantially lower emissions.

We are also making long-term plans for the most cost-effective and timely phaseout of our existing oil-fired and coal-fired generating units, recognizing that new technologies will eventually make them obsolete. A gradual rather than premature phaseout of these units will avoid significant rate shock for customers while enabling us to take advantage of newer technologies as they become available.

In 1993, the state regulatory commissions of Massachusetts, Rhode Island, and New Hampshire approved a first-of-its-kind resource planning agreement in which our demand forecasts and resource plans will be filed and reviewed in all three

Donald Turner, supervisor with our Manchester Street Station repowering team, helps oversee construction work at the Providence site. The project will result in a modern, gas-fired generating station that is competitive into the next century.

John Rowe, NEES president and chief executive officer, was one of three public representatives invited to speak at an October 19, 1993 White House ceremony in which the Clinton Administration announced its Global Climate Action Plan

states at the same time. This will expedite approvals, insure consistency, and reduce the need for additional federal oversight.

Through NEESPLAN 4, we expanded our environmental commitment

Our latest resource plan, NEESPLAN 4, was developed in close collaboration with the Conservation Law Foundation to assure a cutting edge approach to environmental improvement. Our commitment to reducing emissions and wastes from our operations is reinforced and enhanced as part of NEESPLAN 4. As one example, the NEES companies will take a leading role in the development of renewable energy sources that minimize greenhouse gas emissions. In 1993, we contracted with seven projects using energy sources such as wind power, methane gas extracted from landfills, municipal solid waste, and waste heat to

Allen Sload (right), engineer at our Salem Harbor Station, discusses technology that has dramatically reduced the plant's nitrogen oxides emissions with Cheung-fai Lui, environmental protection officer from Wanchai, Hong Kong, and Joseph Su and Edward Braczyk of the Massachusetts Department of Environmental Protection.

Bruce Dyas, research engineer with our R&D department, and Lina Morales, director of process engineering for Separation Technologies, Inc., inspect a sample of coal ash from our Salem Harbor Station. We are working with this firm to solve the problem of unburned carbon in coal ash—an important barrier to recycling coal ash as a cement substitute.

generate 36 megawatts of electricity. We are also seeking to develop a biomass gasification project.

NEESPLAN 4 expands our commitment to reducing emissons that contribute to summer smog and acid rain. It does this by setting ambitious goals for nitrogen oxides and sulfur dioxide emissions—a 60 percent reduction of each by the year 2000 compared with 1990 levels.

The plan continues our program of demonstrating new technologies to reduce emissions at our facilities. It also includes efforts to "offset" our greenhouse gas emissions through measures at other locations that achieve emission reductions at less cost than equivalent reductions at our plants. For example, we are working with a timber firm in Malaysia to improve harvesting practices in the rain forest so that more unharvested trees survive to absorb carbon dioxide. Harvesting in test areas began in 1993 and early results are encouraging. This effort is estimated to economically offset a total of 300,000 to 600,000 tons of carbon dioxide emissions from our power plants.

We have begun a program to account for all types of wastes associated with producing electricity and delivering it to our customers. This will include measurement of solid wastes, liquid effluents, air emissions, and waste heat released to the environment. The data will be used to establish new targets for reducing, reusing, or recycling the wastes.

Ash from burning coal and oil represents the largest volume of solid wastes produced by our generating facilities. NEESPLAN 4 has set a goal of recycling 100 percent of our coal ash into raw material or higher-value products by the year 2000. In line with this goal, our subsidiary New England Power Company is working with a Massachusetts firm on commercial development of a new process to remove carbon from coal ash so the ash can be used more readily for processes such as making cement. The extracted carbon can then be recycled as a boiler fuel.

Our positive results in 1993 and preparations for the future owe a great deal to the perseverance and creativity of our employees, who are striving to do more with fewer resources. As the electric utility industry continues to change and tougher competition continues to challenge us to improve our products and our services, we can count on our people to respond.

We greatly appreciate your continued interest and investment in NEES.

Joan T Bok

Joan T. Bok
Chairman of the Board

John W Rowe

John W. Rowe
President and Chief Executive Officer

FEBRUARY 25, 1994

Financial Review

Overview

Earnings in 1993 were $2.93 per average share compared with $2.85 and $2.77 per share in 1992 and 1991, respectively. The return on common equity was 12.64 percent.

The increase in 1993 earnings was primarily the result of an increase in kilowatthour (KWH) sales billed to ultimate customers, the effects of an October 1992 rate increase and an October 1993 rate agreement involving Massachusetts Electric Company (Massachusetts Electric), reduced interest costs achieved through debt refinancings, and lower costs of scheduled overhauls at thermal generating units. These increases were partially offset by a first quarter charge of $.27 per share associated with an early retirement offer and a special severance program undertaken by New England Electric System (NEES) subsidiaries as part of an organizational review (see 1993 Early retirement and special severance programs section), as well as a second quarter charge of $.21 per share related to potential response costs for wastes associated with a number of manufactured gas locations operated by Massachusetts gas utilities once owned by NEES (see Hazardous waste section). The increase in earnings in 1992 over 1991 primarily reflects wholesale and retail rate changes as well as incentives recorded on the retail companies' demand-side management (DSM) programs. In addition, New England Power Company (NEP) rate adjustment mechanisms reduced earnings in 1991.

KWH sales billed to ultimate customers in 1993 increased by 1.4 percent over 1992. A return to more normal weather conditions in 1993 was largely offset by the fact that 1992 included an extra day for leap year. KWH sales billed to ultimate customers increased 0.4 percent in 1992. NEES' retail subsidiaries currently forecast an increase in KWH sales of 1 percent in 1994.

The annual dividend rate was raised by 3.7 percent or $.08 per share in May 1993 and is now $2.24 on an annual basis. In 1992, the annual dividend rate was increased by 3.8 percent or $.08 per share. The market price of NEES common shares at year end 1993 was $39 1/8 per share, compared with $38 1/2 per share and $32 1/8 per share at the end of 1992 and 1991, respectively.

In November 1993, the Massachusetts Department of Public Utilities (MDPU) approved a rate agreement filed by Massachusetts Electric, the Massachusetts Attorney General, and two groups of large commercial and industrial customers.

Under the agreement, Massachusetts Electric began implementing an 11 month general rate decrease effective December 1, 1993 of $26 million (annual basis), from the level of rates then in effect. This rate reduction will continue in effect until October 31, 1994, after which rates will increase to the previously approved levels. The agreement also provided for rate discounts of up to $4 million available for the period ending October 31, 1994 for large commercial and industrial customers who agree to give a five year notice to Massachusetts Electric before they purchase power from another supplier or generate any additional power themselves. These discounts will increase after October 31, 1994 to a level of $11 million per year if all eligible customers participate. Massachusetts Electric also agreed not to increase its base rates before October 1, 1995. The decrease in revenues will be offset by the recognition for accounting purposes of revenues for electricity delivered but not yet billed. At December 31, 1993, Massachusetts Electric recorded on its balance sheet approximately $43 million of unbilled revenues, of which $11 million was recognized as 1993 revenues with the balance deferred for recognition monthly through December 1994, pursuant to the rate agreement. The net effect of these revenue provisions increased fourth quarter earnings by $.09 per share.

The agreement also resolved all issues associated with providing funds and securing rate recovery for environmental cleanup costs of Massachusetts manufactured gas waste sites formerly owned by Massachusetts Electric and its affiliates, as well as certain other Massachusetts Electric environmental cleanup costs (see Hazardous waste section). The rate agreement allows for these costs to be met by establishing a special interest bearing fund on Massachusetts Electric's books. The fund's initial balance of $30 million comes from previously recorded environmental reserves and is not recoverable from customers. Annual contributions of $3 million, adjusted for inflation, will be added to the fund by Massachusetts Electric and will be recoverable in rates. In addition, any shortfalls in the fund will be paid

by Massachusetts Electric and be recovered through rates over seven years, without interest. Since the previously established reserves against earnings exceeded the initial $30 million balance in the fund, resolution of the issue of rate recovery resulted in a one-time increase in fourth quarter earnings of $.11 per share.

Lastly, the agreement provided for the rate recovery of $8 million of certain storm restoration and other costs previously charged to expense which added $.08 per share to fourth quarter earnings.

Effective October 1992, the MDPU authorized a $45.6 million annual increase in rates for Massachusetts Electric. This general rate increase included $2.5 million representing the first step of a four year phase-in of Massachusetts Electric's tax deductible costs associated with postretirement benefits other than pensions (PBOPs). A second $2.5 million increase took effect October 1, 1993.

Effective May 1992, the Rhode Island Public Utilities Commission (RIPUC) authorized a $3.5 million annual increase in rates for The Narragansett Electric Company (Narragansett). In addition, effective January 1993, the RIPUC approved a $1.5 million increase in rates for Narragansett, representing the first step of a three year phase-in of Narragansett's recovery of costs associated with PBOPs. A second $1.5 million increase took effect in January 1994.

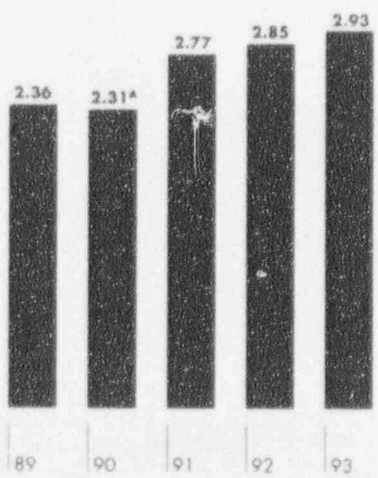
Effective March 1993, the New Hampshire Public Utilities Commission (NHPUC) authorized a $2.0 million rate increase for Granite State Electric Company (Granite), with a retroactive adjustment to September 15, 1992 to reflect the difference between the authorized amount and the $1.4 million Granite had been collecting on an interim basis since September 15, 1992. Effective July 1, 1993, the NHPUC approved a $0.8 million increase in rates for Granite to recover costs associated with PBOPs.

In May 1992, the Federal Energy Regulatory Commission (FERC) approved a settlement of NEP's W-92 rate case under which base rates were increased by $39.7 million, effective March 1992. The entire increase was attributable to costs associated with the commercial operation of Unit 2 of the Ocean State Power (OSP) generating facility. These costs had been collected through NEP's fuel clause since the unit entered service in late 1991. The settlement also incorporated new depreciation rates proposed in NEP's filing, which reduced NEP's overall revenue requirement by $18 million.

No general wholesale rate cases were filed with the FERC during 1993.

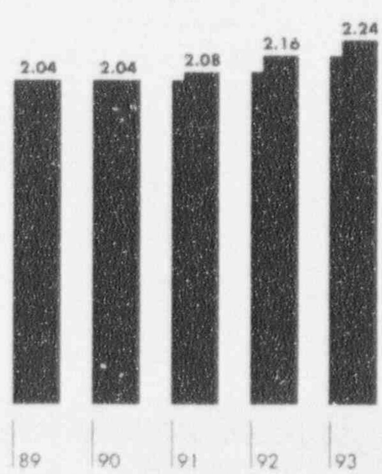
In February 1993, NEES subsidiary companies offered a voluntary early retirement program to non-union employees who were at least 55 years old with 10 years of service. This program was part of an organizational review with the goal of streamlining operations and reducing the work force. The early retirement offer was accepted by 344 employees. A special severance program was also announced for employees affected by the organizational review, but who were not eligible for, or did not accept, the

Earnings Per Average Share ($)



A Before reversal of a portion of 1988 write-down related to the Seabrook 1 Nuclear Power Plant, $4.11 after reversal.

Dividends Declared Per Share –Annual Rate ($)



early retirement offer. NEES subsidiaries recorded in the first quarter a one-time charge to 1993 earnings of approximately $18 million, after tax ($28 million, before tax), to reflect the cost of the early retirement and special severance programs, which consisted principally of pension benefits. Estimated annual savings of $20 million, before tax, are anticipated as a result of the work force reduction.

New England Energy Incorporated (NEEI) participates in a rate-regulated domestic oil and gas exploration, development, and production program consisting of prospects acquired prior to December 31, 1983. NEEI is not acquiring any new prospects. Due to precipitate declines in oil and gas prices, NEEI has incurred operating losses since 1986, 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 is allowed to recover these losses from its customers under NEP's 1988 FERC rate settlement, which 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.

The retail companies file their conservation and load management programs, also referred to in the industry as demand-side management (DSM) programs, regularly with their respective regulatory agencies and have received approval to recover in rates estimated DSM expenditures on a current basis. The rates provide for reconciling estimated expenditures to actual DSM expenditures, with interest. Expenditures subject to the reconciliation mechanism were $62 million, $58 million, and $77 million in 1993, 1992, and 1991, respectively. Since 1990, the retail companies have been allowed to earn incentives based on the results of their DSM programs. The retail companies must be able to demonstrate the electricity savings produced by their DSM programs to their respective state regulatory agencies before incentives are recorded. The retail companies recorded before-tax incentives of $7.3 million, $10.5 million, and $7.3 million in 1993, 1992, and 1991, respectively. The retail companies have received regulatory approvals that will give them the opportunity to continue to earn incentives based on 1994 DSM program results.

Operating revenue increased by $52 million in 1993 primarily due to KWH sales growth, retail rate increases, and beginning in the fourth quarter of 1993, the recognition by Massachusetts Electric of revenues from electric energy delivered to customers but not yet billed (i.e. unbilled revenues). KWH sales billed to ultimate customers in 1993 increased 1.4 percent over 1992. A return to more normal weather conditions in 1993 was largely offset by the fact that 1992 included an extra day for leap year. Rate increases, principally Massachusetts Electric's $45.6 million increase in late 1992, contributed approximately $36 million to the overall increase in operating revenue. In addition, in connection with its 1993 rate agreement, Massachusetts Electric commenced the recognition, for accounting purposes, of revenues from electricity delivered but not billed. At December 31, 1993, Massachusetts Electric recorded on its balance sheet approximately $43 million of unbilled revenues, of which $11 million was recognized as 1993 revenues with the balance to be deferred for recognition monthly through December 1994, pursuant to the rate agreement.

In 1992, operating revenue increased by $87 million principally due to rate changes for NEP and the retail subsidiaries. In addition, NEP recorded decreases in revenue during 1991 in connection with various rate adjustment mechanisms then in effect.

Total operating expenses increased by $55 million in 1993 primarily reflecting a $28 million one-time charge in connection with early retirement and special severance programs, $10 million associated with the adoption of two new accounting standards for postemployment benefits, increased computer systems development costs, and general increases in other areas. (See 1993 Early retirement and special severance programs and New accounting standards sections.) These increases were partially offset by a $10 million decrease in generating plant maintenance costs and reduced winter storm related costs.

Depreciation and amortization decreased $6 million in 1993 primarily reflecting reduced amortization of oil and gas properties as the result of a reduced level of oil and gas production. NEP's depreciation expense also declined as a result of new lower depreciation rates established in NEP's last rate case, which went into effect in March 1992. These decreases were partially offset by increased amortization of Seabrook 1 as part of NEP's 1988 rate settlement and increased depreciation on new plant expenditures.

Taxes charged to operations in 1993 increased by approximately $17 million primarily reflecting increased municipal property taxes and increased income taxes. The increase in income taxes includes the effects of the increase in the federal income tax rate in 1993 from 34 percent to 35 percent.

In 1992, total operating expenses increased by $73 million. Expenditures for purchased energy excluding fuel increased by $30 million, reflecting increased purchases in connection with the commercial operation of OSP Unit 2 beginning in October 1991 as well as increased costs billed to NEP associated with scheduled refueling and maintenance shutdowns by nuclear power suppliers. Other operation and maintenance expenses increased by $9 million during 1992, reflecting increased maintenance costs associated with scheduled overhauls at thermal generating units, the costs associated with a severe winter storm, and general increases in other areas. These increases were partially offset by a decrease in DSM costs.

Depreciation and amortization expense increased by $24 million during 1992, principally reflecting increased amortization of oil and gas properties, increased amortization of Seabrook 1 as part of the 1988 rate settlement, increased coal conversion amortization, and increased depreciation resulting from new construction. The increase in oil and gas amortization resulted from an increase in the level of oil and gas production. These increases were partially offset by a decrease in NEP's depreciation as a result of new depreciation rates established in the W-92 rate case.

Taxes charged to operations increased approximately $16 million in 1992, primarily reflecting increased taxes on increased income and increased municipal property taxes.

In 1992, the decrease in "Other income (expense)—net" principally reflects decreased interest income in 1992 and the 1991 gain on the sale of NEEI's unregulated oil and gas operations.

Interest expense decreased $9 million in 1993 primarily due to significant refinancings of corporate debt at lower interest rates during 1993 and 1992 (see Liquidity and capital resources section).

The Federal Comprehensive Environmental Response, Compensation and Liability Act, more commonly known as the "Superfund" law, imposes strict, joint and several liability, regardless of fault, for remediation of property contaminated with hazardous substances. 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.

The electric utility industry typically utilizes and/or generates in its operations a range of potentially hazardous products and by-products. These products or by-products may not have previously been considered hazardous, and may not currently be considered hazardous, but may be identified as such by federal, state, or local authorities in the future. NEES subsidiaries currently have in place an environmental audit program intended to enhance compliance with existing federal, state, and local requirements regarding the handling of potentially hazardous products and by-products.

Federal and state environmental agencies, as well as private parties, have contacted or initiated legal proceedings against NEES and certain subsidiaries regarding liability for cleanup of sites alleged to contain hazardous waste or substances. NEES and/or its subsidiaries have been named as a potentially responsible party (PRP) by either the U.S. Environmental Protection Agency (EPA) or the Massachusetts Department of Environmental Protection (DEP) for 18 sites at which hazardous waste is alleged to have been disposed. NEES and its subsidiaries are also aware of other sites which they may be held responsible for remediating and it is likely that, in the future, NEES and its subsidiaries

will become involved in additional proceedings demanding contribution for the cost of remediating additional hazardous waste sites.

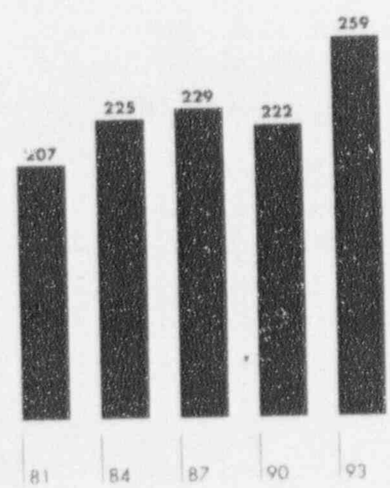
The most prevalent types of hazardous waste sites that NEES and its subsidiaries have been connected with are former manufactured gas locations. Until the early 1970s, NEES was a combined electric and gas holding company system. Gas was manufactured from coal and oil until the early 1970s to supply areas in which natural gas was not yet available or for peaking purposes. Among the waste by-products of that process were coal and oil tars. NEES is currently aware of approximately 40 locations (including one of the 18 locations for which NEES is a PRP) at which gas may have been manufactured and/or stored. Of the manufactured gas locations, 17 have been listed for investigation by the DEP. Two manufactured gas plant locations that have been the subject of extensive litigation are discussed in more detail below: the Pine Street Canal Superfund site in Burlington, Vermont and a site located in Lynn, Massachusetts.

Approximately 18 parties, including NEES, have been notified by the EPA that they are PRPs for cleanup of the Pine Street Canal site, at which coal tar and other materials were deposited. Between 1931 and 1951, NEES and its predecessor owned all of the common stock of Green Mountain Power Corporation. Prior to, during, and after that time, gas was manufactured at the Pine Street Canal site. The EPA had brought a lawsuit against NEES and 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, to which 14 entities were party, the EPA recovered its past response costs. NEES recorded its share of these costs in 1989. NEES remains a PRP for ongoing and future response costs. In November 1992, the EPA proposed a cleanup plan estimated by the EPA to cost $50 million. In June 1993, the EPA withdrew this cleanup plan in response to public concern about the plan and the cost. It is not known at this time what the ultimate cleanup plan will be, how much it will cost, or what portion NEES will have to pay.

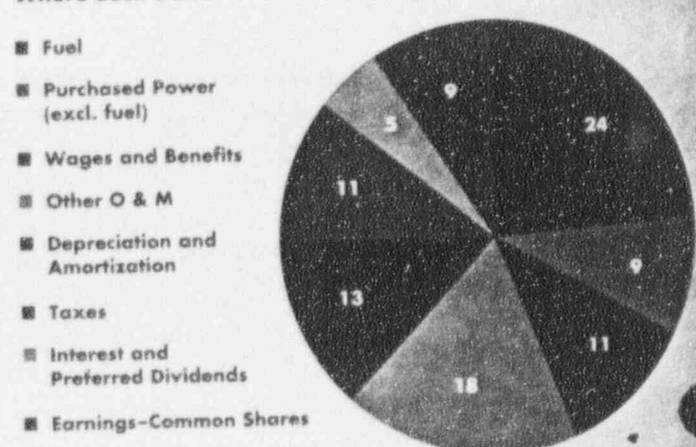
On May 26, 1993, the United States Court of Appeals for the First Circuit affirmed on appeal an earlier adverse decision against NEES and two of its subsidiaries, Massachusetts Electric and New England Power Service Company, with respect to the Lynn, Massachusetts site which was once owned by a gas utility formerly owned by NEES. The decision held NEES and these subsidiaries liable for cleanup of the properties involved in the case. Although the circumstances differ from location to location, the Court of Appeals opinion has adverse implications for the potential liability of NEES and its subsidiaries with respect to other gas manufacturing locations operated by gas utilities once owned by NEES.

In November 1993, the MDPU approved a rate agreement filed by Massachusetts Electric (see Massachusetts Electric 1993 rate agreement section) that resolved all rate recovery issues related to Massachusetts manufactured gas sites as well as certain other Massachusetts hazardous waste sites. The agreement allows Massachusetts Electric to establish a fund on its books of $30 million from previously

Customers Served Per Employee



Where Each Dollar of 1993 Revenue Went (%)



recorded environmental reserves. NEES had previously established approximately $40 million of reserves related to Massachusetts manufactured gas locations earlier in 1993 and in prior years. The agreement also provides that contributions of $3 million, adjusted for inflation, be added to the fund each year and be recoverable in rates. Under the agreement, any shortfalls in the fund will be paid by Massachusetts Electric and be recovered through rates over seven years, without interest.

Predicting the potential costs to investigate and remediate hazardous waste sites continues to be difficult. Factors such as the evolving nature of remediation technology and regulatory requirements and the particular characteristics of each site, including, for example, the size of the site, the nature and amount of waste disposed at the site, and the surrounding geography and land use, make precise estimates difficult. There are also significant uncertainties as to the portion, if any, of the investigation and remediation costs of any particular hazardous waste site that may ultimately be borne by NEES or its subsidiaries. At year end 1993, NEES had total reserves for environmental response costs of $56 million and a related regulatory asset of $19 million.

NEES believes that hazardous waste liabilities for all sites of which it is aware, and which are not covered by a rate agreement, will not be material (10 percent of common equity) to its financial position. Where appropriate, the NEES companies intend to seek recovery from their insurers and from other PRPs, but it is uncertain whether, and to what extent, such efforts would be successful.

In recent years, concerns have been raised about whether 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 companies), have been conducted and are continuing. Some of the studies have suggested associations between certain EMF and various types of cancer, while other studies have not substantiated such associations. In February 1993, the EPA called for significant additional research on EMF. It is impossible to predict the ultimate impact on NEES subsidiaries and the electric 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.

Several state courts have recognized a cause of action for damage to property values in transmission line condemnation cases based on the fear that power lines cause cancer. It is difficult to predict what impact there would be on the NEES companies if this cause of action is recognized in the states in which NEES companies operate and in contexts other than condemnation cases.

Bills have been introduced in the Rhode Island legislature to require that transmission lines be placed underground. In July 1993, two bills passed by the legislature restricting the construction of overhead transmission lines were vetoed by the governor. EMF-related legislation has also been introduced in Massachusetts.

NEP produces approximately 50 percent of its electricity at eight older thermal generating units. The 1990 amendments to the federal Clean Air Act require a significant reduction in the nation's sulfur dioxide (SO_2) and nitrogen oxide (NO_x) emissions by the year 2000. Under the amendments, NEP is not subject to Phase 1 of the acid rain provisions of the federal law that will become effective in 1995. However, NEP is subject to the Massachusetts SO_2 acid rain law that will become effective in 1995. Phase 2 of the federal acid rain requirements, effective in 2000, will apply to NEP and its units.

Under the federal Clean Air Act, state environmental agencies in ozone non-attainment areas were required to develop regulations (also known as Reasonably Available Control Technology requirements, or RACT) that will become effective in 1995 to address the first phase of ozone air quality attainment. These regulations were adopted in Massachusetts in September 1993. The RACT regulations require control technologies (such as low NO_x burners) to reduce NO_x emissions, an ozone precursor. Additional control measures may be necessary to ensure attainment of the ozone standard. These measures would have to be developed by the states in 1994 and fully implemented no later than 1999. The extent of these additional control measures is unknown at this time, but could range from minor additions to the RACT requirements to extensive emission reduction requirements, such as costly add-on controls or fuel

switching. Should the 1999 ozone attainment requirements be extensive or additional Clean Air Act or other environmental requirements be imposed, continued operation of certain existing generating units beyond 1999 could be uneconomical. NEP believes that premature retirement of substantially all of its older thermal generating units would cause substantial rate increases.

To date, NEP has expended $6.5 million of one-time operation and maintenance costs and $50 million of capital costs in connection with Massachusetts and federal Clean Air Act compliance requirements. NEP expects to incur additional one-time operation and maintenance costs of approximately $18 million and capital costs of approximately $70 million in 1994 and 1995 to comply with the federal and state clean air requirements that will become effective in 1995. In addition, as a result of federal and state clean air requirements, NEP will begin incurring increased fuel costs which are estimated to reach an annual level of $13 million by 1995.

The generation of electricity from fossil fuels may emit trace amounts of hazardous air pollutants as defined in the Clean Air Act Amendments of 1990. The Act mandates a study of the potential dangers of hazardous air pollutant emissions from electric utility plants. Such research is currently under way and is expected to be complete in 1995. The study conclusions could result in new emission standards and the need for additional costly controls on NEP plants. At this time, NEES and its subsidiaries cannot estimate the impact that findings of this research might have on operations.

In 1993, the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions" (PBOPs) went into effect. The NEES subsidiaries provide health care and life insurance coverage to eligible retired employees. Eligibility is based on certain age and length of service requirements and in some cases retirees must contribute to the cost of their coverage. This new accounting standard requires employers to establish a liability during the working years of employees for the expected cost of providing PBOPs instead of recording such costs when paid. This new standard increased total 1993 costs by $40 million, approximately $10 million of which was capitalized as a construction overhead.

Each of the NEES subsidiaries has received regulatory approval to recover PBOP costs on a current and/or deferred basis, which are expected to at least equal the amounts calculated in accordance with the new standard. In a statement of policy applicable to NEP and all other utilities subject to its ratemaking jurisdiction, the FERC stated that the increased costs resulting from this new standard could be deferred, pending the next rate filing so long as such filings occur before the end of 1995. Accordingly, the NEES subsidiaries recovered $5 million in rates in 1993 and deferred a total of approximately $25 million of PBOP costs as of December 31, 1993. Thus, there was no significant impact on net income as a result of adopting this standard.

The FASB issued SFAS No. 109, "Accounting for Income Taxes", which became effective in 1993. The new standard requires all deferred tax reserve balances to be restated at the currently enacted tax rates and requires the establishment of certain new deferred tax reserves. The new deferred tax reserve balances have resulted in the establishment of regulatory assets or liabilities representing amounts ultimately expected to be recognized in rates. Therefore, the application of this new standard did not have a significant impact on net income. The increase in deferred tax reserve balances at December 31, 1993, at the current statutory rates, and the corresponding net regulatory asset each amounted to approximately $74 million.

On January 1, 1994, SFAS No. 112, "Employer's Accounting for Postemployment Benefits" became effective. The statement requires recognition of the postemployment benefit obligation when earned by employees. The most significant types of postemployment benefits offered by NEES subsidiaries include income continuance while on long-term disability, workers' compensation, and continuation of health and life insurance coverage during disability. The NEES subsidiaries adopted this standard in 1993 and recorded a charge to earnings in the fourth quarter of $5 million representing the cumulative effect of adopting the new standard.

The electric utility business is being subjected to increasing competitive pressures, stemming from a combination of increasing electric rates, improved technologies, and new regulations and legislation intended to foster competition. Recently, this competition has been most prominent in the bulk power market in which non-utility generating sources have noticeably increased their market share. For example, in 1984, less than 1 percent of NEP's capacity was supplied by non-utility generation sources. By the end of 1993, non-utility power purchases accounted for 380 megawatts (MW) or 7 percent of NEP's total capacity. In addition to competition from non-utility generators, the presence of excess generating capacity in New England has resulted in the sale of bulk power by utilities at prices less than the total costs of owning and operating such generating capacity.

Electric utilities are also facing increased competition in the retail market. Currently, retail competition comes from alternative fuel suppliers (principally natural gas companies) for heating and cooling, customer-owned generation to displace purchases from electric utilities, and direct competition among electric utilities to attract major new manufacturing facilities to their service territories. In the future, the potential exists for electric utilities and non-utility generators to sell electricity to retail customers of other electric utilities.

The NEES companies are responding to current and anticipated competitive pressures in a variety of ways including cost control and a corporate reorganization into separate retail and wholesale business units. The wholesale business unit is positioning itself for increased competition through such means as terminating certain purchased power contracts, past and future shutdowns of uneconomic generating stations, and rapid amortization of certain plant assets. NEP's rates currently include approximately $100 million per year associated with the recovery of certain Seabrook 1 costs under a 1988 rate settlement and coal conversion expenditures at NEP's Salem Harbor Station. The recovery of these costs will be completed prior to the end of 1995. The retail business unit's response to competition includes the development of value-added services for customers and the offering of economic development rates to encourage businesses to locate in our service territory. In its recent rate settlement, Massachusetts Electric was able to change the standard terms under which it offers service to commercial and industrial customers to extend the notice period a customer must give before purchasing electricity from others or generating any additional electricity for the customer's own use from one year to two. In addition, Massachusetts Electric began offering a discount from base rates in return for a contract requiring the customer to provide five years written notice before purchasing electricity from others or generating any additional electricity for the customer's own use. The discount is available to customers with average monthly peak demands over 500 kilowatts.

Electric utility rates are generally based on a utility's costs. Therefore, electric utilities are subject to certain accounting standards that are not applicable to other business enterprises in general. These accounting rules allow regulated entities, in appropriate circumstances, to establish regulatory assets and to defer the income statement impact of certain costs that are expected to be recovered in future rates. The effects of competition could ultimately cause the operations of the NEES companies, or a portion thereof, to cease meeting the criteria for application of these accounting rules. While the NEES companies do not expect to cease meeting these criteria in the near future, if this were to occur, accounting standards of enterprises in general would apply and immediate recognition of any previously deferred costs would be necessary in the year in which these criteria were no longer applicable.

Capital requirements for 1993 and projections for 1994 are shown below:

Year ended December 31 (millions of dollars)	**1993**	1994
Cash expenditures for utility plant:		
Manchester Street repowering project	**$104**	$200
All other	**201**	225
Oil and gas exploration and development	**19**	20
Total capital expenditures	**$324**	$445
Cash from operations excluding dividends	**$367**	$360

The funds necessary for utility plant expenditures in 1993 were primarily provided by net cash from operating activities after the payment of dividends. Funds for Narragansett utility plant expenditures were also provided from the proceeds of long-term debt and preferred stock issues that were not used to refinance long-term debt or redeem preferred stock.

The financing activities of the NEES subsidiaries for 1993 are summarized as follows:

	Long-term debt		Preferred stock	
(millions of dollars)	Issues	Retirements	Issues	Retirements
NEP	$224	$224		$25
Massachusetts Electric	116	117	$35	35
Narragansett	28	15	20	10
Granite	5	1		
Hydro-Transmission Companies		12		
NEEI		27		
	$373	$396	$55	$70

Interest rates on the new long-term debt issues shown above (excluding $134 million of NEP variable rate mortgage bonds) range from 5.06 percent to 8.15 percent. Dividend rates on the new cumulative preferred stock issues shown above range from 6.84 percent to 6.99 percent.

Internally generated funds are expected to meet approximately 65 percent of the 1994 capital expenditure requirements for utility plant. NEP and the retail subsidiaries plan to issue $140 million of long-term debt in 1994.

Net cash from operating activities provided all of the funds necessary for oil and gas expenditures. NEEI's 1993 oil and gas exploration and development costs include $9 million of capitalized interest costs.

Since April 1991, NEES has been meeting all of the requirements of its dividend reinvestment and common share purchase plan and employee share plans through open market purchases.

The NEES subsidiaries' major construction project is the repowering of Manchester Street Station, a 140 MW electric generating station in Providence, Rhode Island. Repowering will more than triple the power generation capacity of Manchester Street Station and substantially increase the plant's thermal efficiency. NEP owns a 90 percent interest and Narragansett owns a 10 percent interest in Manchester Street Station. The total cost for the generating station, scheduled for completion in late 1995, is estimated to be approximately $525 million, including allowance for funds used during construction (AFDC). In addition, related transmission work, which is the sole responsibility of Narragansett, is estimated to cost approximately $75 million and is scheduled for completion in late 1994. At December 31, 1993, $161 million, including AFDC, had been spent on the project which includes the related transmission work. Substantial commitments have been made relative to future planned expenditures for this project.

At December 31, 1993, NEES and its consolidated subsidiaries had $72 million of short-term debt outstanding in the form of commercial paper borrowings. At December 31, 1993, these companies had lines of credit with banks totaling $446 million which are available to provide liquidity support for commercial paper borrowings and for $252 million of NEP's outstanding variable rate mortgage bonds in commercial paper mode and for other corporate purposes. There were no borrowings under these lines of credit at December 31, 1993. There are no compensating balance arrangements. Fees are paid in lieu of compensating balances on most lines of credit. Cash at December 31, 1993 was approximately $3 million.

New England Electric System and Subsidiaries
Selected Financial Data

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

	1993	1992	1991	1990	1989
Operating revenue:					
Electric sales (excluding fuel cost recovery)	**$1,488**	$1,424	$1,358	$1,282	$1,084
Fuel cost recovery	**582**	597	585	523	520
Other utility revenue	**117**	118	114	65	42
Oil and gas sales	**47**	43	37	39	59
Total operating revenue	**$2,234**	$2,182	$2,094	$1,909	$1,705
Net income	**$ 190**	$ 185	$ 180	$ 262*	$ 139
Average common shares outstanding	**64,969,652**	64,969,652	64,916,599	63,818,386	58,836,246
Per share data:					
Net income	**$ 2.93**	$ 2.85	$ 2.77	$ 4.11*	$ 2.36
Dividends declared	**$ 2.22**	$ 2.14	$ 2.07	$ 2.04	$ 2.04
Return on average common equity	**12.64%**	12.58%	12.64%	20.52%	12.62%
Total assets	**$4,796**	$4,585	$4,450	$4,408	$4,116
Capitalization:					
Common share equity	**$1,530**	$1,487	$1,441	$1,380	$1,212
Minority interests	**56**	61	63	62	54
Cumulative preferred stock	**147**	162	162	162	162
Long-term debt	**1,512**	1,533	1,548	1,680	1,639
Total capitalization	**$3,245**	$3,243	$3,214	$3,284	$3,067
Total electric sales billed (millions of KWH)	**22,790**	22,679	23,502	22,561	23,069
Sales billed to ultimate customers (millions of KWH)	**20,832**	20,554	20,470	20,727	20,665
Cost per KWH to ultimate customers (cents)	**9.50**	9.43	8.99	8.27	7.28
System maximum demand (MW)	**4,081**	3,964	4,250	4,059	4,225
Electric capability (MW net)—year end	**5,362**	5,479	5,645	5,627	5,480
Number of employees	**4,969**	5,415	5,533	5,666	5,580
Number of customers	**1,288,184**	1,277,281	1,257,213	1,256,656	1,253,425

*1990 includes $1.80 per share, resulting from a rate settlement related to Seabrook 1.

New England Electric System and Subsidiaries
Statements of Consolidated Income

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

	1993	1992	1991
Operating revenue	**$2,233,978**	$2,181,676	$2,094,378
Operating expenses:			
Fuel for generation	**227,182**	237,161	268,022
Purchased electric energy	**527,307**	525,655	471,273
Other operation	**492,079**	423,330	428,652
Maintenance	**146,219**	162,974	148,266
Depreciation and amortization	**296,631**	302,217	278,126
Taxes, other than income taxes	**120,493**	114,027	105,332
Income taxes	**121,124**	110,761	103,702
Total operating expenses	**1,931,035**	1,876,125	1,803,373
Operating income	**302,943**	305,551	291,005
Other income:			
Allowance for equity funds used during construction	**3,795**	2,732	1,961
Equity in income of generating companies	**11,016**	13,052	10,370
Other income (expense)—net	**(1,154)**	936	16,020
Operating and other income	**316,600**	322,271	319,356
Interest:			
Interest on long-term debt	**100,777**	114,182	118,846
Other interest	**9,809**	5,420	3,308
Allowance for borrowed funds used during construction	**(2,816)**	(2,204)	(2,330)
Total interest	**107,770**	117,398	119,824
Income after interest	**208,830**	204,873	199,532
Preferred dividends of subsidiaries	**10,585**	10,572	10,572
Minority interests	**8,022**	9,264	9,150
Net income	**$ 190,223**	$ 185,037	$ 179,810
Average common shares outstanding	**64,969,652**	64,969,652	64,916,599
Per share data:			
Net income	**$ 2.93**	$ 2.85	$ 2.77
Dividends declared	**$ 2.22**	$ 2.14	$ 2.07

Statements of Consolidated Retained Earnings

Year ended December 31 (thousands of dollars)

	1993	1992	1991
Retained earnings at beginning of year	**$ 684,132**	$ 638,130	$ 592,807
Net income	**190,223**	185,037	179,810
Dividends declared on common shares	**(144,233)**	(139,035)	(134,487)
Premium on redemption of preferred stock of subsidiaries	**(2,047)**		
Retained earnings at end of year	**$ 728,075**	$ 684,132	$ 638,13[illegible]

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)

		1993	1992
Assets	**Utility plant, at original cost**	$4,661,612	$4,518,475
	Less accumulated provisions for depreciation and amortization	1,511,271	1,415,204
		3,150,341	3,103,271
	Net investment in Seabrook 1 under rate settlement (Note C)	103,344	161,781
	Construction work in progress	228,816	110,219
	Net utility plant	3,482,501	3,375,271
	Oil and gas properties, at full cost	1,220,110	1,201,145
	Less accumulated provision for amortization	884,837	794,438
	Net oil and gas properties	335,273	406,707
	Investments:		
	Nuclear power companies, at equity (Note D)	46,342	45,799
	Other subsidiaries, at equity	44,676	47,266
	Other investments, at cost	28,836	25,813
	Total investments	119,854	118,878
	Current assets:		
	Cash	2,876	2,768
	Accounts receivable, less reserves of $14,551 and $12,052	275,020	290,917
	Unbilled revenues (Note A)	43,400	
	Fuel, materials, and supplies, at average cost	74,314	88,100
	Prepaid and other current assets (Note F)	69,004	74,908
	Total current assets	464,614	456,693
	Accrued Yankee Atomic costs (Note D)	103,501	120,685
	Deferred charges and other assets (Note A)	290,135	106,562
		$4,795,878	$4,584,796
Capitalization and liabilities	**Capitalization** (see accompanying statements):		
	Common share equity	$1,529,868	$1,486,423
	Minority interests in consolidated subsidiaries	55,855	60,626
	Cumulative preferred stock of subsidiaries	147,528	162,528
	Long-term debt	1,511,589	1,533,165
	Total capitalization	3,244,840	3,242,742
	Current liabilities:		
	Long-term debt due within one year	12,920	12,920
	Short-term debt	71,775	42,250
	Accounts payable	128,342	171,309
	Accrued taxes	10,332	12,207
	Accrued interest	23,278	20,575
	Dividends payable	36,950	32,829
	Other current liabilities (Note A)	153,812	66,060
	Total current liabilities	437,409	358,150
	Deferred federal and state income taxes	705,026	623,509
	Unamortized investment tax credits	99,355	103,007
	Accrued Yankee Atomic costs (Note D)	103,501	120,685
	Other reserves and deferred credits	205,747	136,703
	Commitments and contingencies (Note E)		
		$4,795,878	$4,584,796

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)

		1993	1992	1991
Operating activities	Net income	$ 190,223	$ 185,037	$ 179,810
	Adjustments to reconcile net income to net cash provided by operating activities:			
	Depreciation and amortization	300,444	305,046	278,047
	Deferred income taxes and investment tax credits—net	4,105	11,163	8,868
	Allowance for funds used during construction	(6,611)	(4,936)	(4,291)
	Minority interests	8,022	9,264	9,150
	Early retirement program	23,922		
	Gain on sale of oil and gas properties			(7,099)
	Decrease (increase) in accounts receivable, net and unbilled revenues	(27,503)	(27,157)	(24,612)
	Decrease (increase) in fuel, materials, and supplies	13,786	(8,590)	12,508
	Decrease (increase) in prepaid and other current assets	5,904	(64,858)	(1,554)
	Increase (decrease) in accounts payable	(42,967)	34,623	(9,647)
	Increase (decrease) in other current liabilities	64,658	(2,447)	25,412
	Other, net	(35,332)	(2,146)	8,070
	Net cash provided by operating activities	$ 498,651	$ 434,999	$ 474,662
Investing activities	Plant expenditures, excluding allowance for funds used during construction	$(304,659)	$(241,872)	$(209,674)
	Oil and gas exploration and development	(18,965)	(21,262)	(32,969)
	Proceeds from sale of oil and gas properties			22,95[illegible]
	Other investing activities	(107)	2,388	(18,731)
	Net cash provided by (used in) investing activities	$(323,731)	$(260,746)	$(238,420)
Financing activities	Proceeds from NEES common shares issued			$ 15,349
	Dividends paid to minority interests	$ (10,622)	$ (15,939)	(4,332)
	Dividends paid on NEES common shares	(142,352)	(140,174)	(134,594)
	Short-term debt	29,525	42,250	
	Long-term debt—issues	372,500	477,500	335,000
	Long-term debt—retirements	(395,820)	(585,120)	(400,280)
	Preferred stock—issues	55,000		
	Preferred stock—retirements	(70,000)		
	Premium on reacquisition of long-term debt	(10,996)	(16,135)	(4,460)
	Premium on redemption of preferred stock	(2,047)		
	Net cash provided by (used in) financing activities	$(174,812)	$(237,618)	$(193,317)
	Net increase (decrease) in cash and cash equivalents	$ 108	$ (63,365)	$ 42,925
	Cash and cash equivalents at beginning of year	2,768	66,133	23,208
	Cash and cash equivalents at end of year	$ 2,876	$ 2,768	$ 66,133
Supplementary information	Interest paid less amounts capitalized	$ 97.518	$ 119,146	$ 125,78[illegible]
	Federal and state income taxes paid	$ 124,853	$ 99,935	$ 99,91[illegible]
	Dividends received from investments at equity	$ 14,404	$ 18,405	$ 12,434

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

New England Electric System and Subsidiaries
Consolidated Statements of Capitalization

At December 31 (thousands of dollars)

Common share equity	**1993**	1992
Common shares, par value $1 per share		
Authorized—150,000,000 shares		
Outstanding—64,969,652 shares	**$ 64,970**	$ 64,970
Paid-in capital	**736,823**	737,321
Retained earnings	**728,075**	684,132
Total common share equity	**$1,529,868**	$1,486,423

Cumulative preferred stock of subsidiaries	Shares outstanding **1993**	Shares outstanding 1992	**1993**	1992
$100 Par value—				
4.44% to 4.76%	**430,140**	430,140	**$ 43,014**	$ 43,014
6.00% to 7.24%	**530,140**	330,140	**53,014**	33,014
7.80% to 8.68%		600,000		60,000
$50 Par value—				
4.50% to 6.95%	**730,000**	330,000	**36,500**	16,500
8.00%		200,000		10,000
$25 Par value—				
6.84%	**600,000**		**15,000**	
Total cumulative preferred stock of subsidiaries (annual dividend requirement of $8,720 for 1993 and $10,572 for 1992)	**2,290,280**	1,890,280	**$147,528**	$162,528

Long-term debt (Note I)	Maturity	Rate	**1993**	1992
Mortgage bonds*	1994 through 1996	4.625%-6.375%	**$ 45,000**	$ 49,600
	1997 through 1998	5.700%-7.375%	**122,500**	127,500
	1999 through 2002	6.310%-7.830%	**95,000**	142,500
	2003 through 2008	6.110%-7.090%	**112,500**	
	2013	9.875%-10.625%		112,000
	2015 through 2016	7.250%-7.800%	**68,350**	68,350
	2018 through 2019	9.750%-9.875%		97,000
	2021 through 2022	8.000%-9.125%	**252,200**	255,000
	2023	7.050%-8.150%	**56,000**	
	2018 through 2022	Variable	**342,000**	230,000
Notes				
Granite State Electric Company	1996 through 2023	7.370%-12.550%	**15,800**	12,200
New England Energy Incorporated	1998	Variable	**238,000**	265,000
Hydro-Transmission Companies	2001 through 2015	8.820%-9.410%	**182,570**	194,090
Unamortized discounts and premiums, net			**(5,411)**	(7,155)
Total long-term debt			**1,524,509**	1,546,085
Long-term debt due within year			**(12,920)**	(12,920)
			$1,511,589	$1,533,165

*Includes $410,350 issued to secure pollution control and solid waste disposal revenue bonds issued by state agencies on behalf of New England Power Company.

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

New England Electric System and Subsidiaries
Notes to 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, 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 generating facility. 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 statements and balance sheets. The ''Minority interests'' line on the statements of consolidated income includes the minority interests' portion of the net earnings of the Hydro-Transmission companies.

NEP is also a 12 percent and 10 percent joint owner, respectively, of the Millstone 3 and Seabrook 1 nuclear generating units, each 1,150 megawatts. NEP's net investment in Millstone 3, included in net utility plant, is approximately $400 million (see Note C for a discussion of Seabrook 1). NEP's share of the related expenses for these units is included in ''Operating expenses''.

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.

2. Revenue

Under a rate agreement approved in November 1993, Massachusetts Electric Company (Massachusetts Electric) began recognizing, for accounting purposes, revenues for electricity delivered but not yet billed. At December 31, 1993, Massachusetts Electric recorded on its balance sheet approximately $43 million of unbilled revenues, of which $11 million was recognized in income in the fourth quarter of 1993, with the balance to be deferred for recognition monthly through December 1994, pursuant to this rate agreement. All other NEES subsidiaries record revenue as billed on a cycle billing basis, and no revenue is recorded for electricity that has been delivered but not yet billed. Accrued revenues are recorded in accordance with rate adjustment mechanisms.

3. Allowance for funds used during construction (AFDC)

The utility subsidiaries capitalize AFDC as part of construction costs. AFDC 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 1993, an average of $30 million of construction work in progress was included in rate base, all of which was attributable to the Manchester Street Station repowering project. 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 were 7.4 percent, 8.6 percent, and 8.9 percent, in 1993, 1992, and 1991, respectively.

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)	1993	1992	1991
Depreciation	**$129,379**	$132,545	$136,443
Amortization:			
Oil and gas properties (Note A-6)	**90,399**	99,687	79,320
Investment in Seabrook 1 nuclear unit under rate settlement (Note C)	**58,437**	52,443	47,017
Oil Conservation Adjustment	**12,137**	11,263	9,067
Property losses	**6,279**	6,279	6,279
Total depreciation and amortization expense	**$296,631**	$302,217	$278,126

Depreciation is provided annually on a straight-line basis. The provision for depreciation as a percentage of weighted average depreciable property was 3.0 percent in 1993, 3.2 percent in 1992, and 3.4 percent in 1991.

The Oil Conservation Adjustment is designed to recover expenditures for coal conversion facilities at NEP's Salem Harbor Station by 1995. At December 31, 1993, such unamortized coal conversion costs included in utility plant were $16,321,000.

5. Nuclear plant decommissioning and nuclear fuel disposal

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 all of the Yankees through purchased power expense. Such costs reflect estimates of total decommissioning costs approved by the Federal Energy Regulatory Commission (FERC).

Each of the operating nuclear units in which NEP has an ownership interest has established decommissioning trust funds or escrow funds into which payments are being made to meet the projected costs of decommissioning its plant. If any of the units were shut down prior to the end of its operating license, the funds collected for decommissioning to that point would be insufficient. Listed below is NEP's ownership share of each nuclear plant, its share of the estimated decommissioning costs, current fund balances, and the expiration date of the operating license for each plant. (See Note D for a discussion of Yankee Atomic Nuclear Power Station decommissioning.)

		NEP's share of (millions of dollars)		
Unit	Ownership Interest	Estimated Total Cost (in 1993 $)	Fund Balances*	License Expiration
Connecticut Yankee	15%	49	18	2007
Maine Yankee**	20%	63	19	2008
Vermont Yankee	20%	57	20	2012
Millstone 3	12%	50	10	2025
Seabrook 1	10%	36	3	2026

* Certain additional amounts are anticipated to be available through tax deductions.

** A Maine statute provides that if both Maine Yankee and its decommissioning trust fund have insufficient assets to pay for the plant decommissioning, the owners of Maine Yankee are jointly and severally liable for the shortfall.

There is no assurance that decommissioning costs actually incurred by the Yankees, Millstone 3, or Seabrook 1 will not substantially exceed these amounts. For example, current decommissioning cost estimates assume the availability of permanent repositories for both low-level and high-level nuclear waste which do not currently exist. 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. (See Note D for a discussion of Yankee Atomic Nuclear Power Station 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 cc ts are incurred by Connecticut Yankee, Maine Yankee, and Vermont Yankee. These costs are billed to NEP and recovered from customers through NEP's fuel clause.

The Energy Policy Act of 1992 assesses the domestic nuclear power industry for a portion of costs associated with the decontamination and decommissioning of the Department of Energy's (DOE) uranium enrichment facilities. An annual assessment of $150 million (escalated for inflation) on the domestic nuclear power industry will be allocated to each plant based upon the amount of DOE uranium enrichment services utilized in the past. The total DOE assessment, which began in October 1992, will remain in place for up to 15 years and will amount to $2.25 billion (escalated). The Yankees, Millstone 3, and Seabrook have been assessed and initial billings indicate NEP's obligation for such costs over the next 14 years will be approximately $29 million. In accordance with the provisions of the Energy Policy Act, these costs are being recovered through NEP's fuel clause.

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. The Pricing Policy has allowed NEEI to capitalize all costs incurred in connection with fuel exploration activities of its rate-regulated program, including interest paid to banks of which $9 million, $14 million, and $22 million was capitalized in 1993, 1992, and 1991, respectively. In the absence of the Pricing Policy, the SEC's full cost "ceiling test" rule requires non-rate-regulated companies to write down capitalized costs to a level which approximates the present value of their proved oil and gas reserves. Based on NEEI's 1993 average oil and gas selling prices and NEEI's proved reserves at December 31, 1993, if this test were applied, it would have resulted in a write-down of approximately $138 million after tax.

A summary of NEEI's operating revenue, results of operations and assets is as follows:

Year ended December 31 (thousands of dollars)	**1993**	1992	1991
Operating revenue	**$ 46,938**	$ 43,374	$ 37,580
Pre-tax loss passed on to customers	**$ (46,355)**	$ (54,607)	$ (39,303)
Total assets	**$335,226**	$407,015	$485,508
Capital expenditures	**$ 18,965**	$ 21,262	$ 32,969

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.

8. Deferred charges and other assets

The components of deferred charges and other assets are detailed below. These amounts primarily represent costs which have been deferred for later recovery from customers in accordance with either rate-making policies of regulatory jurisdictions or specific rate agreements entered into by NEES subsidiaries.

Year ended December 31	**1993**	1992
Unamortized losses on reacquired debt	**$ 60,333**	$ 49,154
Deferred SFAS No. 106 costs (see Note F-2)	**24,563**	
Deferred SFAS No. 109 costs (see Note B)	**73,760**	
Purchased power termination costs (see Note E-5)	**28,400**	4,000
Deferred gas pipeline charges (see Note E-2)	**13,187**	3,556
Environmental response costs (see Note E-3)	**18,752**	
Deferred storm costs	**14,774**	10,619
Unamortized property losses	**12,745**	18,233
Intangible asset-pensions (see Note F-1)	**15,103**	
Other	**28,518**	21,000
	$290,135	$106,562

9. Other current liabilities

The components of other current liabilities are as follows:

Year ended December 31	**1993**	1992
Accrued wages and benefits	**$ 39,756**	$15,239
Deferred unbilled revenues	**32,300**	
Rate adjustment mechanisms	**31,237**	26,944
Accrued purchased power termination costs	**21,900**	
Customer deposits	**12,336**	12,243
Other	**16,283**	11,634
	$153,812	$66,060

Note B
Income taxes

Total income taxes in the statements of consolidated income are as follows:

Year ended December 31 (thousands of dollars)	1993	1992	1991
Income taxes charged to operations	**$121,124**	$110,761	$103,702
Income taxes charged to "Other income"	**3,147**	3,192	2,971
Total income taxes	**$124,271**	$113,953	$106,673

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

Year ended December 31 (thousands of dollars)	1993	1992	1991
Current income taxes	**$120,167**	$102,790	$ 97,806
Deferred income taxes	**7,756**	13,475	17,451
Investment tax credits—net	**(3,652)**	(2,312)	(8,584)
Total income taxes	**$124,271**	$113,953	$106,673

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

Year ended December 31 (thousands of dollars)	1993	1992	1991
Federal income taxes	**$ 98,529**	$ 92,647	$ 86,032
State income taxes	**25,742**	21,306	20,641
Total income taxes	**$124,271**	$113,953	$106,673

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.

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

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

Year ended December 31 (thousands of dollars)	1993	1992	1991
Cost associated with utility plant retirements deducted for tax purposes	**$ 9,684**	$ 8,115	$ 5,750
Excess tax depreciation	**18,351**	21,168	24,380
Early retirement program (Note F)	**(9,005)**		
Other postretirement benefits (Note F-2)	**7,762**	17,430	
Rate adjustments	**(1,857)**	(6,322)	4,867
Operating reserves	**(2,853)**	(5,349)	908
Loss on reacquired debt	**4,460**	6,889	1,710
Oil and gas program	**(27,117)**	(30,807)	(19,942)
Other	**8,331**	2,351	(222)
Total deferred income taxes	**$ 7,756**	$ 13,475	$ 17,451

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

Year ended December 31 (thousands of dollars)	1993	1992	1991
Computed tax at statutory rate	**$113,778**	$105,251	$100,999
Increases (reductions) in tax resulting from:			
Reversal of deferred taxes recorded at a higher rate	**(5,099)**	(7,175)	(6,339)
Amortization of investment tax credits	**(4,697)**	(5,384)	(7,015)
State income tax, net of federal income tax benefit	**16,732**	14,062	13,623
All other differences	**3,557**	7,199	5,405
Total income taxes	**$124,271**	$113,953	$106,673

The Financial Accounting Standards Board established Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes" which became effective in 1993. In conjunction with the new standard, NEES has recorded additional deferred taxes and a corresponding net regulatory asset of approximately $74 million at December 31, 1993. This amount primarily reflects additional deferred taxes related to the equity component of AFDC and other book versus tax plant items not previously normalized, offset by deferred taxes on unamortized investment tax credits and reduced deferred income tax reserves resulting from the reduction in the federal income tax rate from 46 percent in 1986 to the currently enacted rate of 35 percent. The application of this new standard did not have a significant impact on 1993 net income.

The following table identifies the major components of total deferred income taxes at December 31, 1993:

	(millions of dollars)
Deferred tax asset:	
Plant related	$ 99
Investment tax credits	40
All other	129
	268
Deferred tax liability:	
Plant related	(758)
Equity AFDC	(57)
All other	(158)
	(973)
Net deferred tax liability	$(705)

There were no valuation allowances for deferred tax assets deemed necessary.

Federal income tax returns for NEES and its subsidiaries have been examined and reported on by the Internal Revenue Service (IRS) through 1989. The IRS is currently auditing the returns for 1990 and 1991.

Note C
Seabrook Nuclear Unit 1 (Seabrook 1)

NEP owns approximately 10 percent of Seabrook 1, a 1,150 megawatt (MW) nuclear generating unit that entered commercial service on June 30, 1990. NEP's rate recovery of its investment in Seabrook 1 was resolved through two separate rate settlement agreements. The pre-1988 portion of NEP's investment is being recovered over a period of seven years and five months ending in July 1995. This investment, net of amortization, is shown on a separate line on the consolidated balance sheets. NEP's

investment in Seabrook 1 since January 1, 1988, which amounts to approximately $50 million at December 31, 1993, is included under the caption "Utility plant" on the consolidated balance sheets and is being recovered over its useful life.

Note D
Yankee Atomic Nuclear Power Station

NEP has a 30 percent ownership interest in Yankee Atomic Electric Company (Yankee Atomic), which owns a 185 MW nuclear generating station in Rowe, Massachusetts. The station began commercial service in 1960. At December 31, 1993, NEP's investment in Yankee Atomic was approximately $7 million. In February 1992, the Yankee Atomic board of directors decided to permanently cease power operation of, and in time decommission, the facility.

In March 1993, the FERC approved a settlement agreement that allows Yankee Atomic to recover all but $3 million of its approximately $50 million remaining investment in the plant over the period extending to July 2000, when the plant's NRC operating license would have expired. Yankee Atomic recorded the $3 million before-tax write-down in 1992. The settlement agreement also allows Yankee Atomic to earn a return on the unrecovered balance during the recovery period and to recover other costs, including an increased level of decommissioning costs, over this same period. Decommissioning cost recovery increased from $6 million per year to $27 million per year for the period 1993 to 1995. This level of recovery is subject to review in 1996.

NEP has recorded an estimate of its entire future payment obligations to Yankee Atomic as a liability on its balance sheet and an offsetting regulatory asset reflecting its expected future rate recovery of such costs. This liability and related regulatory asset amounted to approximately $104 million each at December 31, 1993, and are included on separate lines in the consolidated balance sheet.

Note E
Commitments and contingencies

1. Plant expenditures

The subsidiaries' utility plant expenditures are estimated to be $425 million in 1994. At December 31, 1993, substantial commitments had been made relative to future planned expenditures.

2. 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 and gas supply. These agreements require minimum fixed payments. NEP's minimum net payments are currently estimated to be approximately $45 million in 1994, $65 million in 1995, and $70 million each in 1996, 1997, and 1998.

As part of its W-12 rate settlement, NEP is recovering 50 percent of the fixed pipeline capacity payments through its current fuel clause and deferring the recovery of the remaining 50 percent until the Manchester Street repowering project is completed. NEP has deferred payments of approximately $13 million as of December 31, 1993 (see Note A-8).

3. Hazardous waste

The Federal Comprehensive Environmental Response, Compensation and Liability Act, more commonly known as the "Superfund" law, imposes strict, joint and several liability, regardless of fault, for remediation of property contaminated with hazardous substances. 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.

The electric utility industry typically utilizes and/or generates in its operations a range of potentially hazardous products and by-products. These products or by-products may not have previously been considered hazardous, and may not currently be considered hazardous, but may be identified as such by federal, state, or local authorities in the future. NEES subsidiaries currently have in place an environmental audit program intended to enhance compliance with existing federal, state, and local requirements regarding the handling of potentially hazardous products and by-products.

Federal and state environmental agencies, as well as private parties, have contacted or initiated legal proceedings against NEES and certain subsidiaries regarding liability for cleanup of sites alleged to contain hazardous waste or substances. NEES and/or its subsidiaries have been named as a potentially responsible party (PRP) by either the U.S. Environmental Protection Agency (EPA) or the Massachusetts Department of Environmental Protection (DEP) for 18 sites at which hazardous waste is alleged to have been disposed. NEES and its subsidiaries are also aware of other sites which they may be held responsible for remediating and it is likely that, in the future, NEES and its subsidiaries will become involved in additional proceedings demanding contribution for the cost of remediating additional hazardous waste sites.

The most prevalent types of hazardous waste sites that NEES and its subsidiaries have been connected with are former manufactured gas locations. Until the early 1970s, NEES was a combined electric and gas holding company system. Gas was manufactured from coal and oil until the early 1970s to supply areas in which natural gas was not yet available or for peaking purposes. Among the waste by-products of that process were coal and oil tars. NEES is currently aware of approximately 40 locations (including one of the 18 locations for which NEES is a PRP) at which gas may have been manufactured and/or stored. Of the manufactured gas locations, 17 have been listed for investigation by the DEP. Two manufactured gas plant locations that have been the subject of extensive litigation are discussed in more detail below: the Pine Street Canal Superfund site in Burlington, Vermont and a site located in Lynn, Massachusetts.

Approximately 18 parties, including NEES, have been notified by the EPA that they are PRPs for cleanup of the Pine Street Canal site, at which coal tar and other materials were deposited. Between 1931 and 1951, NEES and its predecessor owned all of the common stock of Green Mountain Power Corporation. Prior to, during, and after that time, gas was manufactured at the Pine Street Canal site. The EPA had brought a lawsuit against NEES and 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, to which 14 entities were party, the EPA recovered its past response costs. NEES recorded its share of these costs in 1989. NEES remains a PRP for ongoing and future response costs. In November 1992, the EPA proposed a cleanup plan estimated by the EPA to cost $50 million. In June 1993, the EPA withdrew this cleanup plan in response to public concern about the plan and the cost. It is not known at this time what the ultimate cleanup plan will be, how much it will cost, or what portion NEES will have to pay.

On May 26, 1993, the United States Court of Appeals for the First Circuit affirmed on appeal an earlier adverse decision against NEES and two of its subsidiaries, Massachusetts Electric and New England Power Service Company, with respect to the Lynn, Massachusetts site which was once owned by a gas utility formerly owned by NEES. The decision held NEES and these subsidiaries liable for cleanup of the properties involved in the case. Although the circumstances differ from location to location, the Court of Appeals opinion has adverse implications for the potential liability of NEES and its subsidiaries with respect to other gas manufacturing locations operated by gas utilities once owned by NEES.

In November 1993, the Massachusetts Department of Public Utilities approved a rate agreement filed by Massachusetts Electric that resolved all rate recovery issues related to Massachusetts manufactured gas sites as well as certain other Massachusetts hazardous waste sites. The rate agreement allows for environmental cleanup costs for such sites to be met by establishing a special interest bearing fund on Massachusetts Electric's books. The fund's initial balance of $30 million has come from previously recorded reserves and is not recoverable from customers. NEES had previously established approximately $40 million of reserves related to Massachusetts manufactured gas locations earlier in 1993 and in prior years. The resolution of the issue of rate recovery resulted in a one-time increase to fourth quarter earnings of $11 million. Annual contributions of $3 million, adjusted for inflation, will be added to the fund by Massachusetts Electric and be recoverable in rates. Under the agreement, any shortfalls in the fund will be paid by Massachusetts Electric and be recovered through rates over seven years, without interest.

Predicting the potential costs to investigate and remediate hazardous waste sites continues to be

difficult. Factors such as the evolving nature of remediation technology and regulatory requirements and the particular characteristics of each site, including, for example, the size of the site, the nature and amount of waste disposed at the site, and the surrounding geography and land use, make precise estimates difficult. There are also significant uncertainties as to the portion, if any, of the investigation and remediation costs of any particular hazardous waste site that may ultimately be borne by NEES or its subsidiaries. At year end 1993, NEES had total reserves for environmental response costs of $56 million (included in Other reserves and deferred credits) and a related regulatory asset of $19 million.

NEES believes that hazardous waste liabilities for all sites of which it is aware, and which are not covered by a rate agreement, will not be material (10 percent of common equity) to its financial position. Where appropriate, the NEES companies intend to seek recovery from their insurers and from other PRPs, but it is uncertain whether, and to what extent, such efforts would be successful.

4. 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 $9.2 billion (based upon 114 licensed reactors). The maximum amount of commercially available insurance coverage to pay such claims is only $200 million. The remaining $9.0 billion would be provided by an assessment of up to $79.3 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 1993, 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 an $81.8 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. As a result of the permanent cessation of power operation of the Yankee Atomic Plant, Yankee Atomic has petitioned the NRC for an exemption from obligations under the Price-Anderson Act.

5. 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. These contracts expire in various years from 1995 to 2029.

Certain of these contracts require NEP to make minimum fixed payments, even when the supplier is unable to deliver power, to cover NEP's proportionate share of the capital and fixed operating costs of these generating units. The majority of the payments under these contracts are to the Yankees (excluding Yankee Atomic—See Note D) and Ocean State Power, entities in which NEES subsidiaries hold ownership interests. These contracts have minimum fixed payment requirements of $210 million in 1994 and 1995, $195 million in 1996, and $185 million in 1997 and 1998.

NEP's other contracts, principally with non-utility generators, require NEP to make payments only if power supply capacity and energy are deliverable from such suppliers. NEP's payments under these contracts amounted to $210 million, $200 million, and $190 million in 1993, 1992, and 1991 respectively.

NEP has also incurred certain purchased power contract termination costs which it expects to recover in future rates pursuant to a rate settlement agreement. (See Note A-8).

Note F
Employee benefits

1. Pension plans

The System's retirement 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 1993, 1992, and 1991 included the following components:

Year ended December 31 (thousands of dollars)	**1993**	1992	1991
Service cost—benefits earned during the period	**$ 11,160**	$ 10,984	$ 10,319
Plus (less):			
Interest cost on projected benefit obligation	**49,346**	46,171	43,602
Return on plan assets at expected long-term rate	**(45,032)**	(43,877)	(41,265)
Amortization	**1,364**	1,239	780
Total pension cost	**$ 16,838**	$ 14,517	$ 13,436
Assumptions used to determine pension cost were:			
Discount rate	**8.3%**	8.5%	8.5%
Average rate of increase in future compensation levels	**5.4%**	6.7%	6.7%
Expected long-term rate of return on assets	**8.8%**	9.0%	9.0%
Actual return on plan assets	**$ 69,208**	$ 38,489	$ 72,668

Service cost does not reflect costs incurred in connection with an early retirement program offered by the NEES subsidiaries in 1993 (see Note F-4).

The following table sets forth the plans' funded status:

	Retirement Plans (millions of dollars)					
	December 31, 1993			December 31, 1992		
	Union Employee Plans	Non-Union Employee Plans	Supplemental Plans	Union Employee Plans	Non-Union Employee Plans	Supplemental Plans
Benefits earned						
Actuarial present value of accumulated benefit liability:						
Vested	$251	$333	$40	$217	$267	$36
Non-vested	20	6	—	17	7	—
Total	$271	$339	$40	$234	$274	$36
Reconciliation of funded status						
Actuarial present value of projected benefit liability	$310	$383	$44	$268	$309	$40
Unrecognized prior service costs	(8)	(6)	(4)	(11)	(6)	(5)
SFAS No. 87 transition liability not yet recognized (amortized)	—	(1)	(5)	—	(2)	(6)
Net gain (loss) not yet recognized (amortized)	(11)	(45)	(2)	6	(9)	(1)
Additional minimum liability recognized	—	8	7	—	—	—
	291	339	40	263	292	28
Pension fund assets at fair value	302	318	—	280	295	—
SFAS No. 87 transition asset not yet recognized (amortized)	(14)	—	—	(16)	—	—
	288	318	—	264	295	—
Accrued pension/(prepaid) payments recorded on books	$ 3	$ 21	$40	$ (1)	$ (3)	$28

The assumptions used to calculate pension cost changed effective January 1, 1994 to 7.3 percent, 4.4 percent, and 8.8 percent for the discount rate, the average rate of increase in future compensation levels, and the expected long-term rate of return on assets, respectively. These rates were used to calculate the plans' funded status at December 31, 1993.

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

2 Postretirement benefit plans other than pensions

In 1993, SFAS No. 106, "Employer's Accounting for Postretirement Benefits Other than Pensions" went into effect. The NEES subsidiaries provide health care and life insurance coverage to eligible retired employees. Eligibility is based on certain age and length of service requirements and in some cases retirees must contribute to the cost of their coverage. This new standard requires employers to establish a liability during the working years of employees for the expected cost of providing postretirement benefits other than pensions (PBOPs) instead of recording such costs when paid.

The total cost of PBOPs for 1993 includes the following components:

(thousands of dollars)	
Service cost—benefits earned during the period	$ 8,160
Plus (less):	
Interest cost on the accumulated benefit obligation	30,457
Return on plan assets at expected long-term rate	(5,089)
Amortization	18,418
Total postretirement benefit cost	$ 51,946
Assumptions used to determine postretirement benefit cost were:	
Discount rate	8.25%
Health care cost rate—near-term	12.00%
Health care cost rate—long-term	7.25%
Expected long-term rate of return on assets	8.50%
Actual return on plan assets	$ 5,249

The following table sets forth benefits earned and the plan's funded status:

	December 31, 1993	January 1, 1993
Accumulated postretirement benefit obligation:		
Retirees	$249	$196
Fully eligible active plan participants	23	47
Other active plan participants	130	125
Total benefits earned	402	368
Unrecognized transition obligation	(350)	(368)
Net loss not yet recognized	(7)	—
	45	—
Plan assets at fair value	86	48
Prepaid postretirement benefit costs recorded on books	$ 41	$ 48

The assumptions used to calculate postretirement benefit cost changed effective January 1, 1994 to 7.25 percent, 11 percent, and 6.25 percent for the discount rate, the health care cost rate for 1994, and the health care cost rate for years 2005 and beyond, respectively. These rates were used to calculate the plan's funded status at December 31, 1993. The prepaid postretirement benefit cost shown in the funded status at January 1, 1993 consists of contributions made in 1992 in advance of adoption of the new standard.

The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed rates by 1 percent in each year would increase the accumulated postretirement benefit obligation as of December 31, 1993 by approximately $60 million and the net periodic cost for the year 1993 by approximately $7 million.

The NEES subsidiaries fund the annual tax deductible contributions. These plan assets are invested in equity and debt securities and cash equivalents.

Prior to 1993, NEES subsidiaries recorded the cost of PBOPs when paid. These costs amounted to approximately $13 million in 1992 and $12 million in 1991. Each of the NEES subsidiaries has been permitted to recover amounts on either a current and/or deferred basis, which are expected to at least equal the amounts calculated in accordance with this new accounting standard. In a statement of policy applicable to NEP and all other utilities subject to its rate-making jurisdiction, the FERC stated that the increased costs resulting from this new standard could be deferred pending the next rate filing so long as such filings occur before the end of 1995. This new standard increased total 1993 costs by $40 million, approximately $10 million of which was capitalized as a construction overhead. Of the remaining $30 million, $5 million was recovered in rates in 1993 and $25 million was deferred for later recovery. Therefore, adoption of this new standard did not have a significant impact on net income.

3. Postemployment benefits

On January 1, 1994, SFAS No. 112, "Employer's Accounting for Postemployment Benefits" became effective. The statement requires recognition of the postemployment benefit obligation when earned by employees. The most significant types of postemployment benefits offered by NEES subsidiaries include income continuance while on long-term disability, workers' compensation, and continuation of health and life insurance coverage during disability. The NEES subsidiaries adopted this standard in 1993 and recorded a charge to earnings in the fourth quarter of $5 million representing the cumulative effect of adopting the new standard.

4. 1993 Early retirement and special severance programs

In February 1993, NEES subsidiary companies offered a voluntary early retirement program to non-union employees who were at least 55 years old with 10 years of service. This program was part of an organizational review with the goal of streamlining operations and reducing the work force. The early retirement offer was accepted by 344 employees. A special severance program was also announced in February 1993 for employees affected by the organizational review, but who were not eligible for, or did not accept, the early retirement offer. NEES subsidiaries recorded in the first quarter a one-time charge to 1993 earnings of approximately $18 million, after tax ($28 million, before tax), to reflect the cost of the early retirement and special severance programs which consisted principally of pension benefits.

Note G
Short-term borrowings

At December 31, 1993, NEES and its consolidated subsidiaries had $72 million of short-term debt outstanding in the form of commercial paper borrowings. At December 31, 1993, these companies had lines of credit with banks totaling $446 million which are available to provide liquidity support for commercial paper borrowings and for $252 million of NEP's outstanding variable rate mortgage bonds in commercial paper mode (see Note I) and for other corporate purposes. There were no borrowings under these lines of credit at December 31, 1993. There are no compensating balance arrangements. Fees are paid in lieu of compensating balances on most lines of credit.

Note H
Share capital of New England Electric System

NEES did not issue new shares of its common stock in 1993 or 1992. NEES issued additional common shares, $1 par value, in 1991 as follows:

(thousands of dollars)	Par	Paid-in capital
Dividend reinvestment and common share purchase plan	$212	$ 5,080
Employee share plans	386	9,671
	$598	$14,751

Note I
Long-term debt

Substantially all the properties of NEP, Massachusetts Electric, and The Narragansett Electric Company (Narragansett) are subject to the lien of mortgage indentures under which mortgage bonds have been issued.

The aggregate payments to retire maturing long-term debt are as follows:

(thousands of dollars)	1994	1995	1996	1997	1998
Maturing long-term debt		$35,000	$10,000	$ 62,500	$ 60,000
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	400	400
NEEI		38,000	75,000	75,000	50,000
Total	$12,920	$85,920	$97,920	$149,420	$121,920

The terms of $342 million of variable rate pollution control revenue bonds collateralized by NEP mortgage bonds require NEP to reacquire the bonds under certain limited circumstances. At December 31, 1993, interest rates on NEP's variable rate bonds ranged from 2.20 percent to 3.40 percent. Also, at December 31, 1993, interest rates on NEEI's debt ranged from 3.5625 to 3.875 percent.

At December 31, 1993, NEES subsidiaries' long-term debt had a carrying value of $1,524,509,000 and had a fair value of approximately $1,625,000,000. To estimate fair value, the carrying amount was used for debt that reprices frequently at market rates because the carrying amount is a reasonable estimate of fair value. For all other debt, the fair market value of the NEES subsidiaries' long-term debt was estimated based on the quoted prices for similar issues or on the current rates offered to the System for debt of the same remaining maturity. The fair value of the NEES subsidiaries' short-term debt approximates carrying value.

Note J
Redemption of preferred stock

During 1993, all of NEP's 8.68 percent Series and 8.40 percent Series of cumulative preferred stock, all of Massachusetts Electric's 7.80 percent Series and 7.84 percent Series of cumulative preferred stock and all of Narragansett's 8.00 percent Series of cumulative preferred stock were redeemed. Total premiums of $2 million in connection with these redemptions were charged to retained earnings in 1993.

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 are 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, are 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 Audit Committee, composed solely of outside directors, 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
John W. Rowe
President and
Chief Executive Officer

Alfred D. Houston
Alfred D. Houston
Executive Vice President
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, 1993 and 1992 and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1993. 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, 1993 and 1992, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1993, in conformity with generally accepted accounting principles.

Boston, Massachusetts
February 25, 1994

Coopers & Lybrand

	1993			1992		
	Price range		Dividend declared	Price range		Dividend declared
	High	Low		High	Low	
First quarter	$42 1/4	$36 7/8	$.54	$32 3/8	$29 1/4	$.52
Second quarter	$42 7/8	$39 3/8	$.56	$33	$29 3/8	$.54
Third quarter	$43 3/8	$40 3/4	$.56	$37 3/8	$32 3/8	$.54
Fourth quarter	$42	$37	$.56	$39	$34	$.54

The total number of shareholders at December 31, 1993 was 57,667.

(thousands of dollars)	First quarter	Second quarter	Third quarter	Fourth quarter*
1993				
Operating revenue	$579,490	$518,136	$576,644	$559,708
Operating income	$ 80,711	$ 46,046	$ 82,498	$ 93,688
Net income	$ 53,586	$ 19,146	$ 55,531	$ 61,960
Net income per average share	$ .82	$ .30	$ .85	$ .96
1992				
Operating revenue	$574,664	$499,306	$540,929	$566,777
Operating income	$ 91,865	$ 58,168	$ 79,776	$ 75,742
Net income	$ 64,388	$ 30,173	$ 48,447	$ 42,029
Net income per average share	$ .99	$ .47	$ .74	$ .65

*See Notes A-2 and E-3 for discussion of items that increased fourth quarter earnings.

Shareholders may direct questions or acquire additional information about shareholder records, quarterly dividend payments, or address changes by contacting a shareholder services representative. The following services are available to shareholders who have shares registered in their own name: direct deposit of dividends, automatic investments, dividend reinvestment, and safekeeping of certificated shares.

New England Electric System
Shareholder Services Department
Post Office Box 770
Westborough, Massachusetts 01581-0770
Toll-Free No: 1-800-466-7215
Local No: 508-389-2699

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:

Bank of Boston, Transfer Processing
Post Office Box 644, Mail Stop 45-01-05
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 Mechanics Hall, Worcester, Massachusetts, on April 26, 1994, at 10:30 a.m.

Copies of the annual report on Form 10K to the Securities and Exchange Commission and a Statistical Report for 1993 can be obtained, free of charge, by writing to:

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

System Directors

System Officers

System Subsidiaries

New England Electric System
25 Research Drive
Westborough, Massachusetts 01582-0001
Telephone: (508) 366-9011

Bulk Rate
U.S. Postage
PAID
New England Electric

TED C FEIGENBAUM
NEW HAMPSHIRE YANKEE
PO BOX 300
SEABROOK, NH 03874-0300

4575773

System Directors

System Officers

System Subsidiaries