

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

FINANCIAL STATEMENTS

December 31, 2010 and 2009

With Independent Auditors' Report



INDEPENDENT AUDITORS' REPORT

The Board of Directors and Members
New Hampshire Electric Cooperative, Inc.

We have audited the accompanying balance sheets of New Hampshire Electric Cooperative, Inc. (the Cooperative) as of December 31, 2010 and 2009, and the related statements of operations, changes in equities (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and our audit of the December 31, 2010 financial statements in accordance with standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 financial position of New Hampshire Electric Cooperative, Inc. as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2011, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming opinions on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Berry, Dunn, McNeil & Parker

Portland, Maine
March 21, 2011

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Balance Sheets

December 31, 2010 and 2009

ASSETS

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|---|-----------------------|-----------------------|
| Utility plant | | |
| Distribution and transmission | \$ 251,761 | \$ 244,932 |
| General and other | 27,093 | 26,916 |
| Construction work in progress | <u>3,721</u> | <u>2,416</u> |
| Total utility plant | 282,575 | 274,264 |
| Less accumulated depreciation and amortization | <u>124,070</u> | <u>116,714</u> |
| Net utility plant | <u>158,505</u> | <u>157,550</u> |
| Other assets | | |
| Non-utility property, net | 318 | 171 |
| Investment in associated organizations, at cost | <u>11,796</u> | <u>11,603</u> |
| Total other assets | <u>12,114</u> | <u>11,774</u> |
| Current assets | | |
| Cash and cash equivalents | 76 | 1,273 |
| Special deposits | 1,103 | 1,102 |
| Receivables from members - energy sales, net of allowance for doubtful accounts of \$527 in 2010 and \$540 in 2009 | 13,110 | 12,276 |
| Other receivables, net of allowance for doubtful accounts of \$582 in 2010 and \$597 in 2009 | 1,288 | 1,271 |
| Materials and supplies | 2,125 | 1,823 |
| Prepayments and other current assets | <u>1,068</u> | <u>965</u> |
| Total current assets | <u>18,770</u> | <u>18,710</u> |
| Deferred debits and other assets | <u>15,933</u> | <u>27,375</u> |
| | <u>\$ 205,322</u> | <u>\$ 215,409</u> |

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

LIABILITIES AND EQUITIES

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|---|-----------------------|-----------------------|
| Equities | | |
| Patronage capital | | |
| Assigned | \$ 63,265 | \$ 58,179 |
| Assignable | 7,781 | 5,086 |
| Accumulated deficit | (3,091) | (4,135) |
| Other capital | <u>300</u> | <u>300</u> |
| Total equities | <u>68,255</u> | <u>59,430</u> |
| Commitments and contingencies (See Notes 2, 7, 8, and 14) | | |
| Current liabilities | | |
| Line of credit | 1,160 | 2,653 |
| Accounts payable | 6,697 | 7,230 |
| Accrued liabilities | 2,544 | 3,147 |
| Member deposits | 1,324 | 1,064 |
| Current portion of long-term obligations | <u>15,885</u> | <u>16,682</u> |
| Total current liabilities | <u>27,610</u> | <u>30,776</u> |
| Long-term obligations, excluding current portion | 96,414 | 107,581 |
| Deferred credits and other liabilities | <u>13,043</u> | <u>17,622</u> |
| | <u>\$ 205,322</u> | <u>\$ 215,409</u> |

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Statements of Operations

Years Ended December 31, 2010 and 2009

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|--|-----------------------|-----------------------|
| Operating revenues | \$ 130,023 | \$ 130,183 |
| Operating expenses | <u>117,270</u> | <u>120,022</u> |
| Operating margins before interest and other deductions | 12,753 | 10,161 |
| Interest and other deductions, net | <u>4,972</u> | <u>5,075</u> |
| Net operating margins | <u>7,781</u> | <u>5,086</u> |
| Nonoperating margins | | |
| Interest and patronage dividends | 872 | 783 |
| Other | <u>172</u> | <u>414</u> |
| Net nonoperating margins | <u>1,044</u> | <u>1,197</u> |
| Net margins | <u>\$ 8,825</u> | <u>\$ 6,283</u> |

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

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Statements of Changes in Equities (Deficit)

Years Ended December 31, 2010 and 2009

| | <u>Patronage Capital</u> | | <u>Accumulated</u> | <u>Other</u> | <u>Total</u> |
|---------------------------------|--------------------------|-------------------|--------------------|----------------|------------------|
| | <u>Assigned</u> | <u>Assignable</u> | <u>Deficit</u> | <u>Capital</u> | <u>Equities</u> |
| | (000s) | (000s) | (000s) | (000s) | (000s) |
| December 31, 2008 | \$ 53,729 | \$ 4,450 | \$ (5,332) | \$ 300 | \$ 53,147 |
| 2008 patronage capital assigned | 4,450 | (4,450) | - | - | - |
| Net operating margin | - | 5,086 | - | - | 5,086 |
| Net nonoperating margin | <u>-</u> | <u>-</u> | <u>1,197</u> | <u>-</u> | <u>1,197</u> |
| December 31, 2009 | 58,179 | 5,086 | (4,135) | 300 | 59,430 |
| 2009 patronage capital assigned | 5,086 | (5,086) | - | - | - |
| Net operating margin | - | 7,781 | - | - | 7,781 |
| Net nonoperating margin | <u>-</u> | <u>-</u> | <u>1,044</u> | <u>-</u> | <u>1,044</u> |
| December 31, 2010 | <u>\$ 63,265</u> | <u>\$ 7,781</u> | <u>\$ (3,091)</u> | <u>\$ 300</u> | <u>\$ 68,255</u> |

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

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Statements of Cash Flows

Years Ended December 31, 2010 and 2009

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|--|-----------------------|-----------------------|
| Cash flows from operating activities | | |
| Net margins | \$ 8,825 | \$ 6,283 |
| Adjustments to reconcile net margins to net cash provided by operating activities | | |
| Depreciation and amortization | 9,385 | 9,464 |
| Net gain on sale of utility assets | (39) | (248) |
| Noncash patronage capital dividends | (407) | (386) |
| Change in deferred credits | (3,187) | 562 |
| Change in deferred debits | 10,503 | 11,562 |
| (Increase) decrease in | | |
| Member and other accounts receivable | (851) | 3,375 |
| Special deposits | (1) | (1,102) |
| Materials and supplies | (302) | 45 |
| Prepayments and other current assets | (103) | (25) |
| Increase (decrease) in | | |
| Accounts payable | (535) | (3,312) |
| Accrued liabilities | (603) | (721) |
| Member deposits | 260 | 88 |
| | <u>22,945</u> | <u>25,585</u> |
| Net cash provided by operating activities | | |
| Cash flows from investing activities | | |
| Retirement of capital certificates | 214 | 205 |
| Construction and acquisition of plant | (10,266) | (9,530) |
| Proceeds from sales of utility assets | 40 | 464 |
| Removal costs of retirements, net of materials salvaged | (673) | (829) |
| Purchase of member equity investment | - | (1,000) |
| | <u>(10,685)</u> | <u>(10,690)</u> |
| Net cash used by investing activities | | |

(Continued next page)

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

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Statements of Cash Flows (Concluded)

Years Ended December 31, 2010 and 2009

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|---|-----------------------|-----------------------|
| Cash flows from financing activities | | |
| Net repayments on line of credit | \$ (1,493) | \$ (2,786) |
| Principal payments of long-term obligations | (16,964) | (16,658) |
| Proceeds from long-term obligations | <u>5,000</u> | <u>5,000</u> |
| Net cash used by financing activities | <u>(13,457)</u> | <u>(14,444)</u> |
| Net (decrease) increase in cash and cash equivalents | (1,197) | 451 |
| Cash and cash equivalents, beginning of year | <u>1,273</u> | <u>822</u> |
| Cash and cash equivalents, end of year | <u>\$ 76</u> | <u>\$ 1,273</u> |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the year for interest, net of capitalized interest | <u>\$ 6,317</u> | <u>\$ 7,084</u> |

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

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Organization and Purpose

New Hampshire Electric Cooperative, Inc. (NHEC or the Cooperative) is a rural electric cooperative utility established under the laws of the state of New Hampshire (NH). The Cooperative is subject to regulation by the Federal Energy Regulatory Commission (FERC) and the New Hampshire Public Utilities Commission (NHPUC) for certain rates and other matters. NHEC is a distribution cooperative, providing electric power to its members in certain areas of New Hampshire. NHEC serves more than 78,000 accounts, throughout nine of New Hampshire's ten counties.

1. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Regulatory Accounting

The Cooperative follows the accounting prescribed by the FERC Chart of Accounts, the NHPUC, and Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, *Regulated Operations*, for its regulated services. This accounting recognizes the economic effects of rate regulation by recording costs and a return on investment, as such amounts are recovered through rates authorized by regulating authorities. The Cooperative annually reviews the continued applicability of ASC 980 based on the current regulatory and competitive environment.

In accordance with New Hampshire statute, the Cooperative's members have the option to vote to reduce the level of NHPUC regulation that affects the Cooperative. The option to reduce NHPUC regulation was passed by a vote of the Cooperative's membership at its June 2000 annual meeting. Additional legislation became law during 2001 that further reduced the NHPUC's regulatory authority over the Cooperative such that its energy service (also known as "Co-op Power") is not subject to NHPUC regulation. The NHPUC retains regulatory control for all aspects of the Cooperative that pertain to the restructuring of the electric industry. Therefore, all regulatory assets and liabilities associated with stranded costs, default power service, energy efficiency, energy assistance and the restructuring efforts will continue to be regulated by the NHPUC. The Cooperative's Board of Directors regulates its other rate components.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Utility Plant and Depreciation

Utility plant is stated at cost including an allowance for funds used during construction. The provision for depreciation and amortization is computed on a straight line method at rates based upon the estimated service lives of the assets. Utility plant depreciation was approximately \$9,829,000 in 2010 and \$9,911,000 in 2009, a portion of which is capitalized.

Maintenance and repairs of utility plant are charged to operations as incurred. Replacements and betterments are capitalized. At the time units of utility plant are retired, the cost of the property retired and costs of removal, less salvage, are charged to the allowance for depreciation.

Allowance for Funds Used During Construction

The allowance for funds used during construction represents the cost of borrowed funds used for construction of utility plant. The allowance is capitalized as a component of the cost of utility plant. The Cooperative capitalized \$131,102 and \$181,540 of interest in 2010 and 2009, respectively.

Operating Revenues

The Cooperative extends credit to its members at standard terms after appropriate review. Operating revenues are based on rates, most of which are authorized by the NHEC Board of Directors and the remainder of which are authorized by NHPUC. The rates are applied to members' utilization of electricity, which NHEC bills its members on a cycle basis throughout the month. NHEC records revenues as it provides service to its members.

Purchased Power Costs

NHEC's "Co-op Power" energy service rates reflect estimates of the cost of purchased power, including contract power costs, spot market costs, cost of renewable energy credits, capacity costs, and the cost of ancillary services. Retail members who purchase their power from the Cooperative are billed a seasonally levelized power cost recovery charge based on projected data for the cost of wholesale power. NHEC's "Regional Access Charge" rates include estimates of transmission and distribution interconnection costs. These rates also reflect estimates of cost associated with services and administration necessary for members to access energy services from competitive suppliers. To the extent that cost estimates differ from actual charges incurred, the differences are deferred and refunded or charged to members through periodic rate adjustments as approved by NHEC's Board of Directors in accordance with New Hampshire Statutes.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Derivative Instruments

NHEC evaluates purchase power contracts, used to manage power costs over various periods, using guidance issued in FASB ASC 815, *Derivatives and Hedging*. For power contracts assessed as derivatives, NHEC has marked these contracts to fair market value. For all other purchase power contracts, NHEC applies the normal purchase and normal sales exception or lease exception.

Deferred Debits and Other Assets

Certain of the Cooperative's deferred debits and other assets have been designated as stranded costs. These costs are associated with the Cooperative's past purchased power and generation obligations for which the NHPUC has recognized the Cooperative's continued obligation. The deferred debits are related to the stranded cost debt. The interest and principal related to these obligations are reported in the financial statements as an amortization expense as approved by the NHPUC and are recoverable through a stranded cost charge. The NHPUC has also recognized that, as a member owned cooperative without shareholders to absorb stranded costs, the Cooperative requires full recovery of its non mitigated stranded costs. NHEC's retail rates reflect estimates of stranded costs. Retail members are billed a levelized stranded cost charge based on projected data for stranded costs. To the extent that cost estimates differ from actual charges incurred, the differences are deferred and refunded or charged to members through periodic rate adjustments under a tariff approved by the NHPUC.

Deferred Credits

NHEC establishes deferred credits for costs associated with the over recovery of certain tariff rates that are deferred and refunded to members through periodic rate adjustments. Deferred credits are regulatory in nature and are approved by either the Board of Directors or the NHPUC. Deferred credits also include amounts related to pension and regulatory liabilities that are amortized over a defined period established at the inception of the credit.

Other Regulated Rates

NHEC's tariff rates include an Energy Efficiency System Benefit Charge (EE SBC) and an Energy Assistance Program System Benefit Charge (EAP SBC) at rates set by the NHPUC for all New Hampshire jurisdictional utilities. The EE SBC recovers the costs of NHEC's energy efficiency program services it provides to its members in accordance with NHPUC approval. The funds collected through NHEC's EAP SBC are reconciled to the benefits provided to NHEC's income qualified members and any under or over recovery of benefits paid to members is received from or submitted to, respectively, the State of New Hampshire which administers the pooled funds of all jurisdictional utilities.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Materials and Supplies

Inventories of materials and supplies are stated at average cost.

Income Tax Status

NHEC is exempt from United States income taxes pursuant to §501(c)(12) of the Internal Revenue Code, which requires that at least 85% of a cooperative's income be collected from its members.

The Cooperative follows guidance for uncertainty in income taxes which is part of FASB ASC 740, *Income Taxes*. The guidance prescribes a recognition threshold and measurement attributes for financial statement recognition of a tax position taken or expected to be taken on a tax return.

As of December 31, 2010, tax years after 2006 remain subject to examination by the federal and State authorities.

Patronage Capital

The bylaws of the Cooperative provide that operating revenues from the furnishing of electric energy in excess of operating costs and expenses, referred to as operating margins, shall be allocated as patronage capital. All other amounts received in excess of other expenses, referred to as non operating margins, shall be used to offset any losses incurred during the current or any prior fiscal year and, to the extent not needed for that purpose, allocated to its patrons on the basis of their patronage, and any amount so allocated shall be included as part of the capital credited to the accounts of patrons.

NHEC may refund patronage capital within parameters set in the master loan agreement from the National Rural Utilities Cooperative Finance Corporation (CFC), its lender. In the event of the dissolution or liquidation of NHEC, after all outstanding indebtedness has been paid, outstanding capital credits shall be retired without priority on a pro rata basis.

Cash and Cash Equivalents

NHEC considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents that exclude Board approved special deposits. The Cooperative maintains cash in bank deposit accounts which may exceed federally insured limits. The Cooperative has not experienced losses in such accounts, and management does not believe that it is exposed to any significant risk on cash and cash equivalents.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Special Deposits

Special deposits are an investment/cash account used as collateral to meet financial assurance obligations with Independent System Operator New England (ISO NE). This account, along with Letters of Credit, provide financial assurance to ISO NE regarding NHEC's ability to meet its obligations to ISO NE. NHEC maintains control of the account, while ISO NE is the beneficiary of the account.

Receivables

Receivables are stated at the amount management expects to collect on outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance for doubtful accounts (allowance) based on its assessment of the collectibility of outstanding accounts. Individual accounts that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance and a credit to accounts receivable. Credit is extended without collateral.

Postretirement Benefit Plan

The Cooperative sponsors a defined benefit postretirement medical plan through National Rural Electric Cooperative Association (NRECA) that covers substantially all of its employees. The Cooperative has adopted FASB ASC 715, *Compensation-Retirement Benefits*. This pronouncement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Cooperative recognizes changes in the funded status using a regulatory liability or regulatory asset as allowed under ASC 980, because the changes in funded status will be recognized in future regulated rates.

Environmental Laws

The Cooperative has continuing requirements that must be met under environmental laws. Management believes that the Cooperative is in compliance with applicable laws in all material respects.

Taxes Collected from Consumers and Remitted to Governmental Authorities

The Cooperative reports certain taxes on a net basis. Accordingly, they are recorded as a liability when billed to consumers and excluded from revenue and expenses.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Reclassification

Certain amounts in the 2009 financial statements have been reclassified to conform to the current year's presentation.

2. Communication System Infrastructure/AMI Project and Funding

In 2009 the Cooperative submitted a proposal to the Department of Energy (DOE) for a Smart Grid Investment Grant (SGIG) funded by the American Recovery and Reinvestment Act of 2009. The SGIG project includes a new Communication System Infrastructure (CSI) component and Advanced Metering Infrastructure (AMI) component. The total estimated cost of the Project is \$35.1 million. In March 2010, the Cooperative executed a Financial Assistance Agreement with the DOE wherein the DOE agrees to contribute 45% of eligible Project costs and the Cooperative agrees to contribute the remaining 55%. The scheduled Project completion deadline date is March 28, 2013.

The CSI component of the project includes the deployment of a microwave and fiber optic cable-based end-to-end communications system that will be owned and operated by NHEC. The network will largely rely on microwave since the diversity, topography and geography of NHEC's service area, much of which is not adequately served by broadband technology, would otherwise yield a capital cost that is not feasible. This digital system will provide voice and data communications links between our operating headquarters, the power distribution system and substations. It will also serve as the backbone communication link for the AMI component of the project. The Cooperative will deploy advanced meters for all members. Installation of these meters will allow the Cooperative to reduce meter reading costs and more efficiently respond to thefts/losses, outages and/or meter failures.

This CSI/AMI project will improve NHEC's operations and enable the implementation of a more intelligent electric distribution network, including control, monitoring and metering infrastructure.

3. Nuclear Utility Plant

NHEC had a 2.17391% undivided ownership interest in the Seabrook Nuclear Plant (Seabrook) until November 1, 2002, when the Cooperative sold its interest. As part of the NHPUC's approval of NHEC's stranded costs, NHEC reduced the carrying value of the Seabrook plant to \$3,750,000 and classified the excess of the book value of Seabrook as the Seabrook Regulatory Asset in Deferred Debits and Other Assets. The regulatory asset includes an amount to recognize NHEC's total debt obligation relative to the Seabrook plant. The stranded cost charge has been approved by the NHPUC through 2011 which is the final year for stranded cost recovery. The Seabrook Regulatory Asset balance will be fully amortized by December 31, 2011.

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

4. Investment in Associated Organizations

At December 31, investments in associated organizations, which are not marketable and are carried at cost, consisted of the following:

| | <u>2010</u> <u>(000s)</u> | <u>2009</u> <u>(000s)</u> |
|---------------------------------|------------------------------|------------------------------|
| Capital term certificates - CFC | \$ 4,960 | \$ 5,168 |
| Patronage capital credits - CFC | 5,568 | 5,198 |
| Member equity investment - CFC | 1,000 | 1,000 |
| Other | <u>268</u> | <u>237</u> |
| Total | <u>\$ 11,796</u> | <u>\$ 11,603</u> |

These assets are considered for impairment annually. There are no identified events or changes in circumstances that may have a significant adverse effect on fair value.

5. Derivatives and Hedging

For power contracts assessed as derivatives, NHEC has designated these contracts as cash flow hedges. The Cooperative recognizes the gain or loss on a derivative instrument, as well as the offsetting loss or gain on these power contracts, as a regulatory asset or liability. The fair value of these contracts is recognized in the balance sheets and the contracts are accounted for using a mark to market (MTM) model. The Cooperative recognizes the MTM as a receivable from or a payable to members as allowed by ASC 980. For 2010 and 2009, the recognized fair market value of these power contracts on the balance sheet is \$7,307,000 and 7,994,000, respectively. According to FASB ASC 820, *Fair Value Measurements and Disclosures*, this is a Level 2 fair value measurement (as defined in Note 11).

6. Deferred Debits and Other Assets

Deferred debits and other assets at December 31, 2010 and 2009 were as follows:

| | <u>2010</u> <u>(000s)</u> | <u>2009</u> <u>(000s)</u> |
|--|------------------------------|------------------------------|
| Deferred debits | | |
| Deferred Recoveries (Note 1) | \$ 526 | \$ 751 |
| Renewable Energy Certificates | 210 | 353 |
| Termination Payment Regulatory Asset (Note 8) | 1,900 | 3,740 |
| Seabrook Regulatory Asset (Note 3) | 5,110 | 13,147 |
| Regulatory asset - derivative power contracts (Note 5) | 7,307 | 7,994 |
| Past Service Cost Recovery | 548 | 798 |
| Other assets | <u>332</u> | <u>592</u> |
| Total | <u>\$ 15,933</u> | <u>\$ 27,375</u> |

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

7. Long-Term Obligations

As of December 31, 2010 and 2009, long-term obligations were as follows:

| | <u>2010</u> <u>(000s)</u> | <u>2009</u> <u>(000s)</u> |
|--|------------------------------|------------------------------|
| General debt | | |
| 6% notes payable to CFC, payable in quarterly installments, including interest, through October 2012 | \$ 548 | \$ 798 |
| 4.55% - 5.79% notes payable to CFC, payable in quarterly installments, including interest, through November 2012 | 8,057 | 12,595 |
| 4.55% - 5.80% notes payable to CFC, payable in quarterly installments, including interest, through December 2012 | 1,407 | 1,217 |
| 5.98% - 6.85% notes payable to CFC, payable in quarterly installments, including interest, through November 2022 | 16,390 | 17,264 |
| 6.20% notes payable to CFC, payable in monthly installments, including interest, through November 2028 | 8,854 | 9,116 |
| 3.55% - 5.05% notes payable to CFC, payable in quarterly installments, including interest, through July 2030 | 14,094 | 14,518 |
| 4.55% - 6.15% notes payable to CFC, payable in quarterly installments, including interest, through January 2034 | 21,187 | 21,642 |
| 6.20% notes payable to CFC, payable in quarterly installments, including interest, through April 2035 | 5,828 | 5,927 |
| 6.75% notes payable to CFC, payable in quarterly installments, including interest, through October 2038 | 7,624 | 7,713 |
| 5.00% - 6.80% notes payable to CFC, payable in quarterly installments, including interest, through October 2039 | 19,880 | 15,060 |

NEW HAMPSHIRE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|---|-------------------------|--------------------------|
| Stranded cost related debt | | |
| 5.74% - 6.20% notes payable to CFC, payable in quarterly installments, including interest, through October 2011 | 1,675 | 3,250 |
| 5.66% - 6.55% notes payable to CFC, payable in quarterly installments, including interest, through October 2011 | 4,706 | 14,407 |
| Variable rate notes payable to CFC, payable in quarterly installments, interest only, principal due October 2011; interest rate varies monthly (4.95% at December 31, 2010) | <u>2,049</u> | <u>756</u> |
| Total long-term obligations | 112,299 | 124,263 |
| Less current portion | <u>15,885</u> | <u>16,682</u> |
| Total long-term obligations, excluding current portion | \$ <u>96,414</u> | \$ <u>107,581</u> |

The mortgage agreements provide that all outstanding obligations to CFC are collateralized by substantially all assets and the rents, income, revenues, proceeds and benefits derived, received or had for any and all such assets.

Interest expense for long term debt approximated \$6,298,000 in 2010 and \$7,071,000 in 2009. Based on an agreement reached in 2000 with the NHPUC regarding the termination payment (Note 8) and the Seabrook regulatory asset (Note 3), the Cooperative is classifying interest expense of approximately \$768,000 in 2010 and \$1.4 million in 2009 from certain CFC notes in operating expenses, which are recovered through stranded costs.

The Cooperative must also comply with certain covenants which include restrictions on the Cooperative's ability to borrow additional monies, enter into specified transactions or pay dividends or distribute patronage capital without first seeking the mortgagee's approval. Additional covenants address insurance coverage, the sale of assets and other non financial matters. CFC mortgage notes are subject to repricing periodically to reflect current market interest rates.

NHEC refinanced all its Rural Utilities Service debt through CFC in 1995 through 1997, resulting in discounts, net of refinancing fees, of approximately \$7,673,000. Accumulated amortization of these net discounts was approximately \$6,771,000 at December 31, 2010, and \$6,320,000 at December 31, 2009. The remaining unamortized discounts are reflected as deferred credits and are being amortized over the remaining life of the reacquired debt maturing in 2012.

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In 2004, NHEC signed an agreement with CFC for a four year work plan loan of approximately \$48.9 million. In May 2008, NHEC received an extension on this work plan to November 23, 2011. The interest rate will be determined based on the CFC market rates at the time of each advance, and principal will be paid over a period not to exceed 35 years through November 2039. NHEC had taken advances of \$34,490,000 through 2010, including \$5,000,000 in 2010.

The financing agreement with CFC requires NHEC to purchase loan capital term certificates (LCTC) in an amount not to exceed 12.5% of the total principal amount borrowed from CFC. CFC calculates the amount of LCTC that are required to be purchased at the time of each loan advance. In 2009 the Cooperative made a \$1 million investment in a CFC Member Equity Investment. CFC will review the need for additional LCTC purchases when needed, at its discretion. Since the Cooperative met its requirement for purchasing LCTC's, the Cooperative has not been required to purchase LCTC's in 2010 and 2009.

As a cooperative, CFC may pay capital dividends to its borrowers for their patronage. The total capital dividends NHEC received from CFC were \$741,000 during 2010 and \$682,000 in 2009, of which \$371,000 for 2010 and \$341,000 for 2009 was paid in cash with the remainder being patronage capital certificates in CFC to be retired at a later date.

The Cooperative has a perpetual revolving \$20 million line of credit from CFC. As of December 31, 2010, \$534,000 with interest at 4.25%, was outstanding on the line of credit. As of December 31, 2009, \$2,653,000 with interest at 4.25%, was outstanding on the line of credit. This line of credit is collateralized in the same manner as the other CFC debt obligations.

In June 2010, NHEC signed an agreement with National Cooperative Services Corporation for an unsecured five-year revolving line of credit of \$20 million for the CSI/AMI project. The outstanding balance as of December 31, 2010 is \$626,000 with interest rate of 2.50% using the seven-day London Interbank Offered Rate plus 225 basis points.

Principal payments to be made on long-term obligations, based on agreements currently in place, for the next five years are as follows:

| | <u>General</u> | (000s) <u>Stranded</u> <u>Costs</u> | <u>Total</u> |
|------|----------------|---|--------------|
| 2011 | \$ 7,455 | \$ 8,430 | \$ 15,885 |
| 2012 | 7,817 | - | 7,817 |
| 2013 | 2,970 | - | 2,970 |
| 2014 | 3,001 | - | 3,001 |
| 2015 | 3,173 | - | 3,173 |

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8. Long-Term Power Supply and Sale Agreements

Prior to January 1, 2000, NHEC had a contract agreement to purchase nearly all of its power supply from Public Service of New Hampshire (PSNH). In September 1999, NHEC negotiated an agreement with PSNH to terminate this contract. The agreement provided the Cooperative's members with the opportunity to purchase competitively supplied power at retail. The Cooperative made a termination payment to PSNH of \$18 million pursuant to the agreement, after borrowing the funds from CFC. NHEC established a deferred debit relating to this payment (Note 6). As part of the settlement agreement, NHEC will purchase interconnection and delivery service from PSNH pursuant to a long term contract which is FERC regulated, cost based, and cancelable by either party with a seven year notice.

Following termination of its requirements power supply agreement with PSNH for most of NHEC's wholesale requirements, NHEC terminated similar agreements with Central Vermont Public Service Company, New England Power Company, and Green Mountain Power Corp. which met NHEC's wholesale needs in isolated parts of NHEC's service territory.

NHEC procures wholesale energy, capacity, ancillary services and renewable energy credits (together, "bundled energy service") from a variety of resources in New England's deregulated competitive wholesale capacity, energy and renewable attributes markets to meet the needs of its members who elect, or default to, NHEC's "Co-op Power" bundled energy service option (rather than choosing to purchase bundled energy service from retail competitive suppliers).

NHEC's wholesale procurement arrangements include bilateral purchase agreements of various term lengths, with various suppliers, for various products or combinations of products. The contract terms run from a few months up to 20 years. Such products may include fixed-price or variable priced, daily, weekly, monthly, seasonal, or annual, on-peak and off-peak fixed volume or load following energy. Such products may be for physical delivery or financial settlement. Bilateral contract pricing may be fixed or indexed, and indexed contracts may include provisions to allow NHEC the option to swap future period index pricing for a fixed, capped or collared price. NHEC may also meet a portion of its wholesale requirements through contract arrangements tied to the output of specific generating plants or demand resources and may engage in ownership of such resources. NHEC uses competitive bidding and direct negotiation to establish terms, conditions and pricing of its bilateral wholesale procurements. NHEC may participate with other entities in joint or group procurement.

To the extent NHEC's wholesale requirements are not fully met through bilateral contract arrangements or ownership, they are met through NHEC's participation in the New England Power Pool residual markets administered by ISO NE, such as the day-ahead and real-time energy markets and the forward capacity market that imposes an obligation on load serving entities to provide or make payments for capacity.

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Should a significant number of NHEC's members choose to purchase competitively supplied power instead of purchasing power from the Cooperative, NHEC would still have the obligation to purchase some of the contracted power per these agreements. Management expects that NHEC would then sell any excess power in the marketplace. However, management expects that the likelihood of this happening is remote, as all but a small percentage of members currently purchase power from the Cooperative.

On January 1, 2008, an "Electric Renewable Portfolio Standard" (RPS) under New Hampshire Statute RSA 362 F:13 became effective. The law requires providers of electricity, including utilities and competitive providers, to acquire a specified percentage of their energy from four classes of renewable resources. By statute, some of the percentages increase over time. To facilitate the renewable energy production, the law implements a program of "renewable energy credits" (RECs) that allow for the trading of the renewable attributes of energy independent of the energy itself. Finally, the law establishes standards for alternative compliance payments made by electricity providers in lieu of REC acquisition in certain circumstances. The Cooperative has met its 2010 RPS obligations, and anticipates meeting its 2011 obligations, through unit contracts and REC purchases.

The Cooperative is purchasing Regional Network transmission service through ISO NE. NHEC is also purchasing unbundled Local Network transmission service from Northeast Utilities, PSNH's parent company, from Central Vermont Public Service Corporation, and from National Grid. All of these services are priced based on FERC regulated tariffs.

NHEC has executed agreements with CFC for the issuance by CFC of letters of credit as collateral for the Cooperative's performance under certain power supply agreements, ISO NE requirements and other agreements. The total authority under these facilities is \$80,000,000. At December 31, 2010 and 2009, there were ten letters of credit totaling \$22,050,000 outstanding under these facilities. Annual fee expenses for issuance of these letters are approximately \$443,000 for 2010 and \$460,000 for 2009, and are recovered through the power cost rate.

9. Deferred Credits and Other Liabilities

Deferred credits and other liabilities at December 31, 2010 and 2009 were as follows:

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|--|-----------------------|-----------------------|
| Deferred credits | | |
| Regulatory liability - Seabrook (Note 3) | \$ 1,550 | \$ 3,403 |
| Co-op power and regional access over-recovery (Note 1) | - | 2,199 |
| Unamortized discounts on refinanced debt (Note 7) | 902 | 1,353 |
| Regulatory liability - postretirement benefits (Note 11) | 1,485 | 1,822 |
| Other deferred credits and recoveries | 1,799 | 851 |
| Other liabilities - derivative contracts (Note 5) | <u>7,307</u> | <u>7,994</u> |
| Total | <u>\$ 13,043</u> | <u>\$ 17,622</u> |

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10. Pension and 401(k) Savings Plan

Substantially all of the employees of the Cooperative participate in the Electric Cooperative NRECA Retirement and Security Program, a multi employer defined benefit pension plan. The Cooperative funds accrued pension costs on an annual basis. Pension costs totaled \$2,398,000 and \$1,936,000 for 2010 and 2009, respectively. Under the Program, accumulated benefits and net asset information are not determined or allocated separately by individual employer.

The Cooperative has established a tax qualified 401(k) savings plan for the benefit of its employees and their beneficiaries. During 2010, the Cooperative matched contributions by those participating employees who are part of the collective bargaining unit, International Brotherhood of Electrical Workers Local 1837, up to 4.5% of annual base pay. The Cooperative also provided a one-time contribution of 4.0% of annual base pay for employees who are not part of the collective bargaining unit. The Cooperative's contribution was approximately \$469,000 and \$552,000 for 2010 and 2009, respectively.

11. Postretirement Benefit Plan

The Cooperative sponsors a defined benefit postretirement medical and life insurance plan. The plan is contributory, with contributions set as a percent of benefit costs plus deductibles and coinsurance. Retiree contributions were not significant in 2010 and 2009. The Cooperative established an irrevocable trust to fund the plan as was required by the NHPUC. The Cooperative plans to fund future pay-as-you go expenses from this trust and not provide additional funds to the trust. The Cooperative expects the pay-as-you go expenses will be approximately equal to the income from the trust for the next several years.

ASC 715 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. As allowed by ASC 980, the Cooperative reports the accumulated change as a regulatory liability. The statement requires that an employer recognize the funded status of a benefit plan, measured as the difference between plan assets at fair value and the benefit obligation, in its balance sheet. For a postretirement benefit plan, the benefit obligation is the accumulated postretirement benefit obligation.

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December 31, 2010 and 2009

The following sets forth the plan's funded status and amounts reported in the Cooperative's financial statements at December 31, 2010 and 2009, and for the years then ended:

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|--|-----------------------|-----------------------|
| <u>Benefit obligation and funded status</u> | | |
| Benefit obligation at December 31 | \$ (1,099) | \$ (745) |
| Fair value of plan assets at December 31 | <u>1,221</u> | <u>1,120</u> |
| Funded status of the plans | <u>\$ 122</u> | <u>\$ 375</u> |
| <u>Amounts recognized in the balance sheet</u> | | |
| Plan assets included in other assets | \$ 122 | \$ 375 |
| Regulatory liability-postretirement benefits | (1,485) | (1,822) |

At December 31, 2010 and 2009, the regulatory liability postretirement benefits was comprised of approximately \$1,434,000 and \$1,735,000 actuarial gain and \$51,000 and \$87,000 of unrecognized prior service credits, respectively. The Cooperative expects to amortize approximately \$92,000 of the actuarial gain and \$36,000 of the prior service costs into income in 2011.

| | <u>2010</u> (000s) | <u>2009</u> (000s) |
|---------------|-----------------------|-----------------------|
| Benefit cost | \$ 34 | \$ 26 |
| Benefits paid | \$ 96 | \$ 50 |

Weighted-average assumptions as of and for years ended December 31:

| | <u>2010</u> | <u>2009</u> |
|---|-------------|-------------|
| Discount rate to determine net periodic benefit costs | 6.50 % | 6.50 % |
| Discount rate to determine benefit obligation | 6.00 % | 6.50 % |
| Expected return on plan assets | 4.10 % | 6.25 % |

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Estimated future benefit payments for the next ten years are as follows:

| | <u>(000s)</u> |
|-------------|---------------|
| 2011 | \$ 116 |
| 2012 | 98 |
| 2013 | 91 |
| 2014 | 81 |
| 2015 | 109 |
| 2016 - 2020 | 391 |

For measurement purposes, a 9.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2010. The rate was assumed to decrease gradually to 5.0% per year by 2018 and remain level thereafter.

Plan Assets

Fund assets are managed in a manner which seeks to achieve the following long term investment objectives:

- Exceed Inflation - Achieve investment returns that average in excess of the annualized inflation rate, defined as the average annualized compound rate of the Consumer Price Index.
- Meet Actuarial Assumptions - Realize a long-term rate of return that meets or exceeds the assumed actuarial rate as stated in the plan's actuarial report.
- Perform in Line with Benchmark Returns - Realize a long-term rate of return that is in line with appropriate benchmark returns on a risk-adjusted basis for each of the asset classes/funds.
- Fund Plan Operating Needs - Provide sufficient income and liquidity to pay monthly retiree benefits and other liquidity needs.

To develop the expected long term rate of return on assets assumption, the Cooperative considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocations to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 4.10% assumption for fiscal 2010.

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Notes to Financial Statements

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Asset allocation as of December 31 is as follows:

| | <u>2010</u> | <u>2009</u> |
|-------------|-------------|-------------|
| Bond funds | 57.0 % | 59.4 % |
| Stock funds | 43.0 | 40.6 |

Investment Strategy

The Trustees of NHEC's postretirement plan assets meet semi-annually to review the performance of the funds. The overall objective is to maintain a balance of 60% in bond funds and 40% in stock funds with investments in a high quality portfolio which:

- Preserves the principal value of the investment portfolio
- Maintains liquidity to meet anticipated cash flows
- Achieves the best available yields consistent with capital preservation and liquidity requirements
- Avoids inappropriate concentrations of investments through diversification

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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Notes to Financial Statements

December 31, 2010 and 2009

Assets that are measured at fair value on a recurring basis are summarized below:

| | <u>Fair Value Measurements at December 31, 2010, Using:</u> | |
|-------------------------------------|---|------------------|
| | <u>2010</u> | <u>(Level 1)</u> |
| | (000s) | (000s) |
| Postretirement plan assets: | | |
| Bond Funds: | | |
| Short-term Gov. Securities Fund (a) | \$ 227 | \$ 227 |
| Short-term Bond Fund (b) | 470 | 470 |
| Stock Funds: | | |
| Stock Index Fund (c) | 127 | 127 |
| Value Fund (d) | 258 | 258 |
| Small-Company Stock Fund (e) | 82 | 82 |
| International Value Fund (f) | <u>57</u> | <u>57</u> |
| Total | <u>\$ 1,221</u> | <u>\$ 1,221</u> |

| | <u>Fair Value Measurements at December 31, 2009, Using:</u> | |
|-------------------------------------|---|------------------|
| | <u>2009</u> | <u>(Level 1)</u> |
| | (000s) | (000s) |
| Postretirement plan assets: | | |
| Bond Funds: | | |
| Short-term Gov. Securities Fund (a) | \$ 221 | \$ 221 |
| Short-term Bond Fund (b) | 445 | 445 |
| Stock Funds: | | |
| Stock Index Fund (c) | 111 | 111 |
| Value Fund (d) | 228 | 228 |
| Small-Company Stock Fund (e) | 61 | 61 |
| International Value Fund (f) | <u>54</u> | <u>54</u> |
| Total | <u>\$ 1,120</u> | <u>\$ 1,120</u> |

All of the funds listed are managed by NRECA's Homestead Funds Inc.

- (a) 80% of the assets in this category are invested in fixed-income securities whose principal and interest payments are guaranteed by the U.S. Government.
- (b) At least 80% of assets are invested in the three highest credit categories as ranked by a nationally recognized statistical rating organization (NRSRO) – for example, securities rated AAA, AA, and A by S&P Corp.
- (c) This fund invests all of its assets in the S&P 500 Index Master Portfolio.
- (d) The Value Fund seeks capital growth over the long-term and secondarily, income. Investments are in stocks of established companies.
- (e) The Small-Company Fund seeks capital growth over the long-term by investing in stocks of small companies that advisors believe are undervalued with market capitalization similar to companies represented by the Russell 2000 Index.
- (f) The International Value Fund seeks long-term capital appreciation by investing primarily in equity securities traded principally on markets outside the U.S.

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12. Fair Value of Financial Instruments

The Cooperative's financial instruments consist of cash and cash equivalents, short term trade receivables and payables, investments in non traded stock, lines of credit, and long term debt. The carrying values of all instruments, except long-term debt, approximates their fair value. Based on borrowing rates currently available to the Cooperative for loans with similar terms and average maturities, the fair value of long term debt was approximately \$112,492,000 and \$121,509,000 as of December 31, 2010 and 2009, respectively. These estimates are not necessarily indicative of the amounts that the Cooperative could realize in the current market and different methodologies may have a material effect on the estimated fair value amounts.

13. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date, but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date, but arose after that date. Management has evaluated subsequent events through March 21, 2011, the date the December 31, 2010 financial statements were available for issuance, and no subsequent events occurred requiring recognition or disclosure.

14. Commitments and Contingencies

The Cooperative is involved in various legal proceedings incidental to the conduct of its normal business operations. In the opinion of management, these proceedings will not have a material adverse impact on the financial condition of the Cooperative.

New Hampshire Electric Cooperative, Inc.

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2010

| <u>Grantor/Program Title</u> | <u>Federal CFDA Number</u> | <u>Federal Expenditures</u> |
|--|------------------------------------|---------------------------------|
| U.S. Department of Energy ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis - Smart Grid Investment Grant Program | 81.122 | \$ 1,450,279 |
| U.S. Department of Homeland Security Disaster Grants - Public Assistance (Presidentially Declared Disasters) | 97.036 | \$ 2,473,656 |

Note to Schedule of Expenditures of Federal Awards - Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of New Hampshire Electric Cooperative, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.