Orange and Rockland Utilities, Inc.
2006 Annual Financial Statements and Notes

Financial Statements

Report of Independent Registered Public Accounting Firm

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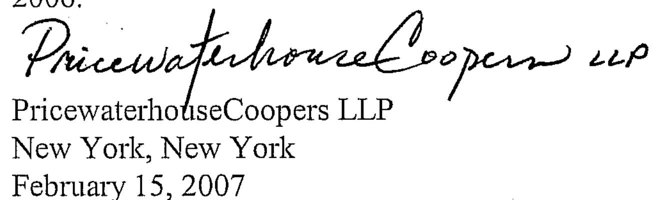
Report of Independent Registered Public Accounting Firm

To the Stockholder and Board of Directors of Orange and Rockland Utilities, Inc.:

In our opinion, the accompanying consolidated balance sheet and statement of capitalization and the related consolidated statements of income, of comprehensive income, of common shareholder's equity and of cash flows present fairly, in all material respects, the financial position of Orange and Rockland Utilities, Inc. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with the standards of the Public Company Accounting Oversight Board (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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes E and F to the consolidated financial statements, the Company changed its method of accounting for defined benefit pension and other postretirement benefit plans in 2006.



PricewaterhouseCoopers LLP
New York, New York
February 15, 2007

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2006	December 31, 2005
	(Millions of Dollars)	
ASSETS		
UTILITY PLANT, AT ORIGINAL COST (Note A)		
Electric	$ 903	$ 846
Gas	385	361
General	125	123
Total	1,413	1,330
Less: Accumulated depreciation	409	395
Net	1,004	935
Construction work in progress	39	32
NET UTILITY PLANT	1,043	967
CURRENT ASSETS		
Cash and temporary cash investments (Note A)	21	9
Restricted cash	2	2
Accounts receivable - customers, less allowance for uncollectible accounts of $2 in 2006 and 2005	48	61
Accrued unbilled revenue (Note A)	36	29
Other receivables, less allowance for uncollectible accounts of $1 and $2 in 2006 and 2005, respectively	43	39
Accounts receivable from affiliated companies	5	30
Gas in storage, at average cost	57	62
Materials and supplies, at average cost	7	6
Prepayments	10	11
Fair value of derivative assets	2	50
Deferred derivative losses	24	-
Recoverable energy costs (Notes A and B)	22	29
TOTAL CURRENT ASSETS	277	328
INVESTMENTS (Note A)	11	11
DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS		
Regulatory assets (Note B)	412	244
Other deferred charges and noncurrent assets	25	38
TOTAL DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS	437	282
TOTAL ASSETS	$ 1,768	$ 1,588

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2006	December 31, 2005
	(Millions of Dollars)	
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION		
Common shareholder's equity (See Statement of Common Shareholder's Equity)	$ 360	$ 369
Long-term debt (See Statement of Capitalization)	436	384
TOTAL CAPITALIZATION	796	753
NONCURRENT LIABILITIES		
Provision for injuries and damages (Note G)	6	6
Pensions and retiree benefits	299	101
Superfund and other environmental costs (Note G)	49	53
Hedges on variable rate long-term debt (Note N)	12	14
TOTAL NONCURRENT LIABILITIES	366	174
CURRENT LIABILITIES		
Long-term debt due within one year	22	2
Notes payable	34	101
Accounts payable	77	81
Accounts payable to affiliated companies	68	33
Customer deposits	14	14
Accrued taxes	5	4
Accrued interest	10	6
Deferred derivative gains (Note B)	1	54
Deferred income taxes - recoverable energy costs (Note K)	9	12
Other current liabilities	30	12
TOTAL CURRENT LIABILITIES	270	319
DEFERRED CREDITS AND REGULATORY LIABILITIES		
Deferred income taxes and investment tax credits (Notes A and K)	199	194
Regulatory liabilities (Note B)	120	138
Other deferred credits	17	10
TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES	336	342
TOTAL CAPITALIZATION AND LIABILITIES	$ 1,768	$ 1,588

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED INCOME STATEMENT

	For the Years Ended December 31,		
	2006	2005	2004
	(Millions of Dollars)		
OPERATING REVENUES (Note A)			
Electric	$ 582	$ 596	$ 499
Gas	236	228	204
TOTAL OPERATING REVENUES	818	824	703
OPERATING EXPENSES			
Purchased power	307	319	246
Gas purchased for resale	150	143	120
Other operations and maintenance	185	177	174
Depreciation and amortization (Note A)	35	34	33
Taxes, other than income taxes	47	47	48
Income taxes (Notes A and K)	25	31	17
TOTAL OPERATING EXPENSES	749	751	638
OPERATING INCOME	69	73	65
OTHER INCOME (DEDUCTIONS)			
Investment and other income (Note A)	5	2	1
Income taxes (Notes A and K)	(1)	-	-
Other deductions	-	(1)	-
TOTAL OTHER INCOME (DEDUCTIONS)	4	1	1
INTEREST EXPENSE			
Interest on long-term debt	23	21	19
Other interest	5	3	1
NET INTEREST EXPENSE	28	24	20
NET INCOME	$ 45	$ 50	$ 46

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2006	2005	2004
	(Millions of Dollars)		
NET INCOME	$ 45	$ 50	$ 46
OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES			
Supplemental pension plan minimum liability adjustments, net of $(1), $(1) and $0 taxes in 2006, 2005 and 2004 respectively	(1)	(1)	(1)
Unrealized gains/(losses) on derivatives qualified as cash flow hedges, net of $(2), $3 and $2, taxes in 2006, 2005 and 2004, respectively	(2)	4	3
Less: Reclassification adjustment gains/(losses) included in net income, net of $(1), $1 and $1, taxes in 2006, 2005 and 2004, respectively	(2)	1	2
TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES	(1)	2	-
COMPREHENSIVE INCOME	$ 44	$ 52	$ 46

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED STATEMENT OF COMMON SHAREHOLDER'S EQUITY

(Millions of Dollars/Except Share Data)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
BALANCE AS OF DECEMBER 31, 2003	1,000	$ -	$ 194	$ 186	$ (10)	$ 370
Net Income				46		46
Common stock dividend to parent				(28)		(28)
BALANCE AS OF DECEMBER 31, 2004	1,000	$ -	$ 194	$ 204	$ (10)	$ 388
Net Income				50		50
Common stock dividend to parent				(71)		(71)
Other comprehensive income					2	2
BALANCE AS OF DECEMBER 31, 2005	1,000	$ -	$ 194	$ 183	$ (8)	$ 369
Net Income				45		45
Common stock dividend to parent				(28)		(28)
Other comprehensive loss					(1)	(1)
Adjustment to initially apply FASB Statement No. 158, net of tax (Notes E and F)					(25)	(25)
BALANCE AS OF DECEMBER 31, 2006	1,000	$ -	$ 194	$ 200	$ (34)	$ 360

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED STATEMENT OF CASH FLOWS

	For the Twelve Months Ended December 31,		
	2006	2005	2004
	(Millions of Dollars)		
OPERATING ACTIVITIES			
Net income	$ 45	$ 50	$ 46
PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME			
Depreciation and amortization	35	34	33
Deferred income taxes	16	4	7
Other non-cash items (net)	(9)	-	(2)
CHANGES IN ASSETS AND LIABILITIES			
Accounts receivable - customers, less allowance for uncollectibles	13	(30)	11
Accounts receivable from affiliated companies	22	(7)	(12)
Materials and supplies, including gas in storage	4	(20)	(13)
Prepayments, other receivables and other current assets	(10)	(15)	(11)
Recoverable energy costs	(6)	-	5
Accounts payable	(4)	15	(5)
Accounts payable to affiliated companies	15	(7)	10
Pensions and retiree benefits	4	3	-
Accrued taxes	1	2	(2)
Accrued interest	4	-	-
Deferred charges and other regulatory assets	(17)	(5)	(24)
Deferred credits and regulatory liabilities	17	2	17
Superfund and other environmental costs	(4)	(5)	18
Other assets	-	(1)	(1)
Other liabilities	18	(1)	4
NET CASH FLOWS FROM OPERATING ACTIVITIES	144	19	81
INVESTING ACTIVITIES			
Utility construction expenditures	(110)	(87)	(79)
Cost of removal less salvage	-	(3)	(2)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(110)	(90)	(81)
FINANCING ACTIVITIES			
Net proceeds from/(payments of) short-term debt	(67)	101	(15)
Issuance of long-term debt	75	40	46
Retirement of long-term debt	(2)	(2)	-
Dividend to parent	(28)	(71)	(28)
NET CASH FLOWS FROM/(USED IN) FINANCING ACTIVITIES	(22)	68	3
CASH AND TEMPORARY CASH INVESTMENTS:			
NET CHANGE FOR THE PERIOD	12	(3)	3
BALANCE AT BEGINNING OF PERIOD	9	12	9
BALANCE AT END OF PERIOD	$ 21	$ 9	$ 12
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the period for:			
Interest	$ 23	$ 24	$ 18
Income Taxes	$ 36	$ 30	$ 29

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

Orange and Rockland Utilities, Inc.
Consolidated Statement of Capitalization

	Interest Rate	Series	Shares outstanding December 31, 2006	Shares outstanding December 31, 2005	At December 31, 2006	At December 31, 2005
					(Millions of Dollars)	
TOTAL COMMON SHAREHOLDER'S EQUITY LESS ACCUMULATED OTHER COMPREHENSIVE LOSS			1,000	1,000	$ 394	$ 377
ACCUMULATED OTHER COMPREHENSIVE LOSS						
Supplemental pension plan minimum liability adjustments, net of $(1) taxes in 2005					(2)	(1)
Adjustment to initially apply FASB Statement No. 158, net of $(15) taxes in 2006 (Notes E and F)					(25)	-
Unrealized losses on derivatives qualified as cash flow hedges net of $(5) and $(3) taxes in 2006 and 2005, respectively					(7)	(5)
Less: Reclassification adjustment for gains included in net income net of $1 taxes in 2005					-	2
TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAXES					(34)	(8)
TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF COMMON SHAREHOLDER'S EQUITY AND NOTE C)					$ 360	$ 369
LONG-TERM DEBT (NOTE C) Maturity	Interest Rate	Series				
DEBENTURES:						
2010	7.50%	2000A			$ 55	$ 55
2015	5.30	2005A			40	40
2016	5.45	2006A			75	-
2027	6.50	1997F			80	80
2029	7.00	1999G			45	45
TOTAL DEBENTURES					295	220
FIRST MORTGAGE BONDS:						
2007	7.125	1997J			20	20
2018	7.07	1998C			3	3
TOTAL FIRST MORTGAGE BONDS					23	23
TRANSITION BONDS:						
2019	5.22	2004-1			42	45
TOTAL TRANSITION BONDS					42	45
TAX-EXEMPT DEBT - Notes Issued to New York State Energy Research and Development Authority for Facilities Revenue Bonds*:						
2014 (Note N)	3.83	1994A**			55	55
2015	3.83	1995A**			44	44
TOTAL TAX-EXEMPT DEBT					99	99
Unamortized debt discount					(1)	(1)
TOTAL					458	386
Less: long-term debt due within one year					22	2
TOTAL LONG-TERM DEBT					436	384
TOTAL CAPITALIZATION					$ 796	$ 753

* Rate reset weekly or by auction held every 35 days; December 31, 2006 rate shown.
** Issued for pollution control financing.

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

Notes to the Financial Statements

General

These notes accompany and form an integral part of the interim financial statements of Orange and Rockland Utilities, Inc., a New York corporation, and its subsidiaries (the Company or O&R). The Company is a regulated utility, the equity of which is owned entirely by Consolidated Edison, Inc. (Con Edison). O&R has two regulated utility subsidiaries: Rockland Electric Company (RECO) and Pike County Light & Power Company (Pike). For the period ended December 31, 2006 and 2005, operating revenues for RECO and Pike were 21.7 percent and 1.2 percent and 20.8 percent and 1.1 percent, respectively, of O&R's consolidated operating revenues. O&R, along with its regulated utility subsidiaries, provides electric service in southeastern New York and adjacent areas of northern New Jersey and eastern Pennsylvania and gas service in southeastern New York and adjacent areas of eastern Pennsylvania. RECO owns Rockland Electric Company Transition Funding LLC, which was formed in 2004 in connection with the securitization of certain purchased power costs.

The Company is subject to regulation by the Federal Energy Regulatory Commission (FERC), the New York Public Service Commission (PSC), the New Jersey Board of Public Utilities (NJBPU) and the Pennsylvania Public Utility Commission (PPUC) with respect to rates and accounting.

Note A – Summary of Significant Accounting Policies

Principles of Consolidation

The Company's consolidated financial statements include the accounts of its subsidiaries, including Transition Funding. All intercompany balances and transactions have been eliminated.

Accounting Policies

The accounting policies of the Company conform to accounting principles generally accepted in the United States of America. These accounting principles include the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 71 (SFAS No. 71), "Accounting for the Effects of Certain Types of Regulation," and, in accordance with SFAS No. 71, the accounting requirements of the FERC and the state public utility regulatory commissions having jurisdiction.

SFAS No. 71 specifies the economic effects that result from the causal relationship of costs and revenues in the rate-regulated environment and how these effects are to be accounted for by a regulated enterprise. Revenues intended to cover some costs may be recorded either before or after the costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, these costs would be recorded as deferred charges or "regulatory assets" under SFAS No. 71. If revenues are recorded for costs that are expected to be incurred in the future, these revenues would be recorded as deferred credits or "regulatory liabilities" under SFAS No. 71.

The Company's principal regulatory assets and liabilities are detailed in Note B. The Company is receiving or being credited with a return on all of its regulatory assets for which a cash outflow has been made, and is paying or being charged with a return on all of its regulatory liabilities for which a cash inflow has been received. The

Company's regulatory assets and liabilities will be recovered from customers, or applied for customer benefit, in accordance with rate provisions approved by the applicable public utility regulatory commission.

Other significant accounting policies of the Company are referenced below in this Note A and in the notes that follow.

Plant and Depreciation

Utility Plant

Utility plant is stated at original cost. The cost of repairs and maintenance is charged to expense and the cost of betterments is capitalized. The capitalized cost of additions to utility plant includes indirect costs such as engineering, supervision, payroll taxes, pensions, other benefits and an allowance for funds used during construction (AFDC). The original cost of property is charged to expense over the estimated useful lives of the assets. Upon retirement, the original cost of property is charged to accumulated depreciation. See Note O.

Rates used for AFDC include the cost of borrowed funds and a reasonable rate of return on the Company's own funds when so used, determined in accordance with regulations of the FERC or the state public utility regulatory authority having jurisdiction. The rate is compounded semiannually, and the amounts applicable to borrowed funds are treated as a reduction of interest charges, while the amounts applicable to the Company's own funds are credited to other income (deductions). The AFDC rates for the Company were 5.0 percent, 3.9 percent and 3.6 percent for 2006, 2005 and 2004, respectively.

The Company generally computes annual charges for depreciation using the straight-line method for financial statement purposes, with rates based on average service lives and net salvage factors. The average depreciation rates for the Company were 2.8 percent for 2006 and 2.9 percent for 2005 and 2004.

The estimated lives for utility plant for the Company range from 5 to 65 years for electric, 5 to 75 years for gas and 5 to 55 years for general plant.

At December 31, 2006 and 2005, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

(Millions of Dollars)	2006	2005
Electric		
Transmission	$112	$92
Distribution	517	490
Gas*	292	272
General	79	80
Held for future use	4	1
Construction work in progress	39	32
NET UTILITY PLANT	$1,043	$967

* Primarily distribution.

Impairments

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company evaluates the impairment of long-lived assets, based on projections of undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. In the event an evaluation indicates that such cash flows cannot be expected to be sufficient to fully recover the assets, the assets would be written down to their estimated fair value. No impairments were identified by the tests in 2004 to 2006.

Revenues

The Company recognizes revenues for electric and gas service on a monthly billing cycle basis. The Company generally defers over a 12-month period net interruptible gas revenues, other than those authorized by the PSC to be retained by the Company, for refund to firm gas sales and transportation customers. The Company accrues revenues at the end of each month for estimated energy service not yet billed to customers. Unbilled revenues included in O&R's balance sheet at December 31, 2006 and 2005 were $36 million and $29 million, respectively.

O&R and Pike are required to record gross receipts tax and RECO is required to record transitional energy facilities assessment (TEFA) tax as revenues and expenses on a gross income statement presentation basis (i.e., included in both revenue and expense). The recovery of these taxes is included in the revenue requirement within each of the respective approved rate plans.

Recoverable Energy Costs

O&R generally recovers all of its prudently incurred purchased power and gas costs, including hedging gains and losses, in accordance with rate provisions approved by the applicable state public utility commissions. If the actual energy supply costs for a given month are more or less than the amounts billed to customers for that month, the difference in most cases is recoverable from or refundable to customers.

For each billing cycle, O&R bills its energy costs to customers based upon its estimate of the cost to supply energy for that billing cycle. Differences between actual and billed electric supply costs are generally deferred for charge or refund to customers during the next billing cycle (normally within one or two months). For O&R's gas costs, differences between actual and billed gas costs during the 12-month period ending each August are charged or refunded to customers during a subsequent 12-month period.

RECO purchases electric energy under a competitive bidding process supervised by the NJBPU for contracts ranging from one to three years. Basic Generation Service rates are adjusted to conform to contracted prices when new contracts take effect and differences between actual monthly costs and revenues are reconciled and charged or credited to customers on a two-month lag. See Note B for a description of the 2003 NJBPU ruling regarding previously deferred purchased power costs.

Pike bills its customers for the electricity it supplies to them based on a default service rate approved by the PPUC. Pike neither collects nor refunds to customers differences between actual amounts billed for electric supply and electric supply costs it incurs. See Note B.

Independent System Operators

O&R purchases electricity for all its New York and Pennsylvania requirements and a portion of its New Jersey needs through the wholesale electricity market administered by the New York Independent System Operator (NYISO). The difference between purchased power and related costs initially billed to the Company by the NYISO and the actual cost of power subsequently calculated by the NYISO is refunded by the NYISO to the Company, or paid to the NYISO by the Company. Certain other payments to or receipts from the NYISO are also subject to reconciliation, with shortfalls or amounts in excess of specified rate allowances recoverable from or refundable to customers.

For RECO, approximately 90 percent of the energy supply is covered by fixed price contracts ranging from one to three years that are competitively bid through the NJBPU auction process and provided through the Pennsylvania-Jersey-Maryland (PJM) Independent System Operator.

Temporary Cash Investments

Temporary cash investments are short-term, highly-liquid investments that generally have maturities of three months or less at the date of purchase. They are stated at cost, which approximates market. The Company considers temporary cash investments to be cash equivalents.

Investments

Investments are recorded at either cost or cash surrender value and include the supplemental retirement income plan’s corporate-owned life insurance assets.

Federal Income Tax

In accordance with SFAS No. 109, “Accounting for Income Taxes” (SFAS No. 109), the Company has recorded an accumulated deferred federal income tax liability for temporary differences between the book and tax bases of assets and liabilities at current tax rates. In accordance with rate agreements, O&R has recovered amounts from customers for a portion of the tax liability they will pay in the future as a result of the reversal or “turn-around” of these temporary differences. As to the remaining tax liability, in accordance with SFAS No. 71, the Company has established regulatory assets for the net revenue requirements to be recovered from customers for the related future tax expense. See Notes B and K. In 1993, the PSC issued a Policy Statement approving accounting procedures consistent with SFAS No. 109 and providing assurances that these future increases in taxes will be recoverable in rates.

Accumulated deferred investment tax credits are amortized ratably over the lives of the related properties and applied as a reduction to future federal income tax expense.

The Company, along with Con Edison and its other subsidiaries, files a consolidated federal income tax return. The consolidated income tax liability is allocated to each member of the consolidated group using the separate return method. Each member pays or receives an amount based on its own taxable income or loss in accordance with tax sharing agreements between the members of the consolidated group.

State Income Tax

The Company, along with Con Edison and its other subsidiaries, files a combined New York State Corporation Business Franchise Tax Return. Similar to a federal consolidated income tax return, the income of all entities in the combined group is subject to New York State taxation, after adjustments for differences between federal and New York law and apportionment of income among the states in which the Company does business. Each member of the group pays or receives an amount based on its own New York State taxable income or loss.

Reclassification

Certain prior year amounts have been reclassified to conform with the current year presentation.

Estimates

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

Note B – Regulatory Matters

Rate and Restructuring Agreements

Electric

In October 2003, the PSC approved agreements among O&R, the staff of the PSC and other parties with respect to the rates O&R can charge to its New York customers for electric service. The electric agreement, which covered the period from July 2003 through October 2006, provided for no changes to electric base rates and provided for the amortization and offset of regulatory assets and liabilities, the net effect of which was to reduce electric operating income by a total of $11 million (pre tax) over the period covered by the agreement. The agreement provided for recovery of energy costs from customers on a current basis. It also provided for O&R to share equally with customers earnings above a 12.75 percent return on common equity during the three-year period from July 2003 through June 2006. Beginning July 2006, O&R was not subject to earnings sharing. Pursuant to these provisions, $3.6 million and $6.7 million were deferred for future customer benefit in 2006 and 2005, respectively. In December 2006, the PSC issued an order requiring O&R to demonstrate why its electric rates should not be reduced on a temporary basis, propose new earnings sharing targets and recommend

mechanisms to reduce and eliminate outstanding deferrals. In February 2007, the company filed its response, which stated that rates should not be reduced, and that the issues regarding earnings sharing targets and deferral recovery mechanisms raised by the PSC should be examined in a proceeding setting rates for O&R (which proceeding would entail an in-depth examination of the company) not a temporary rate proceeding. After evidentiary hearings were held before an Administrative Law Judge, by Order issued March 1, 2007, the PSC ordered that O&R's rates be made temporary effective March 1, 2007. The PSC took this action due to a concern that the Company may be over-earning in a period in which the Company was, pursuant to the PSC policy, deferring expense recognition of certain expenses for future rate recognition. In the Order, the PSC confirmed that no issues had been raised regarding the Company's service adequacy or operations. O&R's rates will remain temporary until a permanent rate proceeding is concluded, which is expected to occur not later than September 2007.

In July 2003, the NJBPU ruled on the petitions of RECO for an increase in electric rates and recovery of deferred purchased power costs. The NJBPU ordered a $7 million decrease in RECO's electric base rates, effective August 2003, authorized RECO's recovery of approximately $83 million of previously deferred purchased power costs and associated interest and disallowed recovery of approximately $19 million of such costs and associated interest.

In July 2004, the NJBPU approved RECO's Phase II petition to increase base rates annually by $2.7 million (2.0 percent), effective August 1, 2004. The Phase II decision provided for the recovery of carrying costs for two substation projects and specified additional reliability programs. Also in July 2004, Transition Funding issued $46 million of 5.22% Transition Bonds and used the proceeds thereof to purchase from RECO the right to be paid a Transition Bond Charge (TBC) and associated tax charges by its customers relating to the balance of previously deferred purchased power costs, discussed above.

In June 2006, RECO filed a request with the NJBPU for an increase in the rates it charges for electric service, effective April 1, 2007, of $13.2 million. The filing reflected a return on common equity of 11 percent and a common equity ratio of 49.7 percent of capitalization. On March 8, 2007, RECO entered into a Stipulation Settlement with the other parties in this proceeding. Pursuant to the Stipulation, RECO has agreed to a three-year rate agreement intended to provide a distribution revenue increase of $6.4 million effective April 1, 2007. The NJBPU approved the Stipulation at its open session on March 22, 2007.

Pike bills its customers for the electricity it supplies to them based on a default service rate approved by the PPUC. Pike neither collects from nor refunds to customers differences between actual amounts billed for electric supply and electric supply costs it incurs. In January 2006, based upon the results of an auction overseen by the PPUC in which an affiliate of Con Edison was the winning bidder, an increase in the default service rate of approximately 70 percent was approved by the PPUC. In February 2006, the PPUC initiated a fact-finding investigation in the competitive electric market in Pike's service territory, which investigation is ongoing. On June 1, 2006, the Law Bureau of the PPUC issued a report that contained various recommendations for future action. The report recommended that the PPUC consider integrating Pike's energy procurement with that of either O&R,

RECO or another Pennsylvania electric distribution company, having an independent study performed regarding the costs and benefits of interconnecting Pike with PJM, and having an independent study performed regarding the costs and benefits of the sale of Pike to another Pennsylvania electric distribution company or a rural electric cooperative. The PPUC has yet to act on any of these recommendations.

Approximately 50 customers of Pike have filed complaints with the PPUC regarding the increase in Pike's default service rates. The PPUC has consolidated these complaints in one administrative proceeding. Pike has moved to dismiss these complaints. Evidentiary hearings were held in November 2006 and January 2007 to consider these complaints. The PPUC is expected to render a decision in the second quarter of 2007. O&R does not expect that the PPUC's decision on these complaints will have a material adverse effect on its financial position, results of operation or liquidity.

Pike is obligated under Pennsylvania law to serve those customers who do not purchase electricity from other suppliers. See "Recoverable Energy Costs" in Note A.

Gas

In October 2003, the PSC approved a gas rate agreement among O&R, the PSC staff and other parties. This agreement, which covered the period November 2003 through October 2006, provided for annual increases in gas base rates of $9 million effective November 2003, $9 million effective November 2004 and $5 million effective November 2005. The agreement provided for O&R to share equally with customers earnings in excess of an 11 percent return on common equity. Earnings for the rate years ended October 2006, 2005 and 2004 were below this level. The rate agreement also included the amortization of certain regulatory assets and liabilities. The net effect of this amortization was a non-cash increase in gas revenues of $2 million over the period of the three-year rate plan.

In October 2006, the PSC approved the June 2006 settlement agreement among O&R, the staff of the PSC and other parties. The settlement agreement establishes a rate plan that covers the three-year period November 1, 2006 through October 31, 2009. The rate plan provides for rate increases in base rates of $12 million in the first year, $0.7 million in the second year and $1.1 million in the third year. To phase-in the effect of the increase for customers, the rate plan provides for O&R to accrue revenues for, but defer billing to customers of, $5.5 million of the first rate year rate increase by establishing a regulatory asset which, together with interest, will be billed to customers in the second and third years. As a result, O&R's billings to customers will increase $6.5 million in each of the first two years and $6.3 million in the third. The first year rate increase includes $2.3 million relating to a change in the way customers are provided the benefit of non-firm revenue from sales of pipeline transportation capacity. Under the prior rate plan, base rates were reduced to reflect the assumption that the company would realize these revenues. Under the new rate plan, such revenues will be used to offset the cost of gas to be recovered from customers. The rate plan continues the provisions pursuant to which the company recovers its cost of purchasing gas and the provisions pursuant to which the effects of weather on gas income are moderated.

The rate plan provides that if the actual amount of pension or other postretirement benefit costs, environmental remediation costs, property taxes and certain other costs vary from the respective amount for each such cost reflected in gas rates (cost reconciliations), the company will defer recognition of the variation in income and, as the case may be, establish a regulatory asset or liability for recovery from, or refund to, customers of the variation (86 percent of the variation, in the case of property tax differences due to assessment changes).

Earnings attributable to its gas business excluding any penalties (O&R Adjusted Earnings) up to an 11 percent annual return on common equity (based upon the actual average common equity ratio, subject to a maximum 50 percent of capitalization) are retained by the company. O&R Adjusted Earnings above an 11 percent return are to be used to offset up to one-half of any regulatory asset to be recorded in that year resulting from the cost reconciliations (discussed in the preceding paragraph). One-half of any remaining O&R Adjusted Earnings between 11 and 12 percent return are retained by the company, with the balance being deferred for the benefit of customers. Thirty-five percent of any remaining O&R Adjusted Earnings between a 12 and 14 percent return are retained by the company, with the balance deferred for the benefit of customers. Any remaining O&R Adjusted Earnings above a 14 percent return are to be deferred for the benefit of customers. For purposes of these earnings sharing provisions, if in any rate year O&R Adjusted Earnings is less than 11 percent, the shortfall will be deducted from O&R Adjusted Earnings for the other rate years. The earnings sharing thresholds will each be reduced by 20 basis points if certain objectives relating to the company’s retail choice program are not met.

The rate plan also includes up to $1 million of potential penalties in the first year of the agreement, increasing up to $1.2 million in the third year, if the company does not comply with certain requirements regarding safety and customer service.

In May 2005, the PPUC approved an increase to the rates Pike charges for gas service by $0.1 million, effective June 1, 2005.

Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2006 and 2005 were comprised of the following items:

(Millions of Dollars)	2006	2005
Regulatory assets		
Unrecognized pension and other postretirement costs	$152	$ -
Transition bond charges	67	70
Environmental remediation costs	63	59
Pension and other postretirement benefits deferrals	59	50
Future federal income tax	54	50
Other	17	15
Regulatory assets	412	244
Deferred derivative losses - current	24	-
Recoverable energy costs - current	22	29
Total regulatory assets	$458	$273
Regulatory liabilities		
Allowance for cost of removal less salvage	$60	$57
Refundable energy costs	27	40
NYS tax law changes	10	12
Property tax deferral	5	3
Unrealized gains on hedging	1	16
Earnings sharing reserve	-	2
Other	17	8
Regulatory liabilities	120	138
Deferred derivative gains – current	1	54
Total regulatory liabilities	$121	$192

"Unrecognized pension and other postretirement costs" represents the net regulatory asset associated with the Company's adoption of FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88,106, and 132(R)" (SFAS No. 158) in December 2006. See Notes E and F.

Note C – Capitalization

Common Stock

At December 31, 2006 and 2005, all of the outstanding common stock of the Company was owned by Con Edison. In accordance with PSC requirements, the dividends that the Company generally may pay to Con Edison are limited to not more than 100 percent of its income available for dividends calculated on a two-year rolling average basis. Excluded from the calculation of "income available for dividends" are non-cash charges to income resulting from accounting changes or charges to income resulting from significant unanticipated events. The restriction also does not apply to dividends paid in order to transfer to Con Edison proceeds from major transactions, such as asset sales, or to dividends reducing the Company's equity ratio to a level appropriate to its business risk. The amount of dividends the Company pays to Con Edison could be affected by the PSC's decision that the Company's rates be made temporary effective March 1, 2007 (see "Rate and Restructuring Agreements" in Note B).

Long-Term Debt

Long-term debt maturing in the period 2007-2011 is as follows:

(Millions of Dollars)	
2007	$22
2008	3
2009	3
2010	58
2011	3

O&R has issued certain series of tax-exempt debt through the New York State Energy Research and Development Authority (NYSERDA) that currently bear interest at a rate determined weekly and, in certain circumstances, is subject to mandatory tender for purchase by the Company. This tax-exempt debt includes O&R's $55 million aggregate principal amount of Series 1994A and $44 million aggregate principal amount of Series 1995A.

Long-term debt is stated at cost, which in total, as of December 31, 2006, approximates fair value (estimated based on current rates for debt of the same remaining maturities).

At December 31, 2006 and 2005, long-term debt of the Company included $23 million of mortgage bonds collateralized by substantially all utility plant and other physical property of RECO and Pike ($20 million of which related to RECO and was paid at its maturity in February 2007). It also included $42 million and $45 million at December 31, 2006 and 2005, respectively, of Transition Bonds issued by Transition Funding. See Note B.

Significant Debt Covenants

There are no significant debt covenants under the financing arrangements for the debentures of O&R, other than obligations to pay principal and interest when due and covenants not to consolidate with or merge into any other corporation unless certain conditions are met, and no cross default provisions. The tax-exempt financing arrangements of the Company are subject to these covenants and the covenants discussed below. The Company believes that they were in compliance with their significant debt covenants at December 31, 2006.

The tax-exempt financing arrangements involved the issuance of uncollateralized promissory notes of the Company to NYSERDA in exchange for the net proceeds of a like amount of tax-exempt bonds with substantially the same terms sold to the public by NYSERDA. The tax-exempt financing arrangements include covenants with respect to the tax-exempt status of the financing and the maintenance of liquidity and credit facilities, the failure to comply with which would, except as otherwise provided, constitute an event of default with respect to the debt to which such provisions applied. If an event of default were to occur, the principal and accrued interest on the debt to which such event of default applied might and, in certain circumstances would, become due and payable immediately.

The liquidity and credit facilities currently in effect for the tax-exempt financing include covenants that the ratio of debt to total capital of the obligated utility will not at any time exceed 0.65 to 1 and that, subject to certain exceptions, the utility will not mortgage, lien, pledge or otherwise encumber its assets. Certain of the facilities also include as events of default, defaults in payments of other debt obligations in excess of $12.5 million.

Note D – Short-Term Borrowing

In June 2006, O&R along with Con Edison and its other regulated utility subsidiary, Consolidated Edison of New York, Inc. (Con Edison of New York), entered into an Amended and Restated Credit Agreement (Credit Agreement) under which banks committed to provide loans and letters of credit, on a revolving credit basis, in an aggregate amount of up to $2.25 billion, with $200 million available to O&R. O&R is solely responsible for its obligations under the credit agreements and no company is responsible for the obligations of any company other than itself. O&R uses the credit agreements to support its commercial paper program and obtain letters of credit.

At December 31, 2006 and 2005, O&R had $34 million and $101 million of commercial paper outstanding at a weighted average interest rate of 5.4 percent and 4.4 percent, respectively. At December 31, 2006 and 2005, $2 million and $6 million of letters of credit were outstanding under the agreements, respectively.

The banks' commitments under the Credit Agreement are subject to certain conditions, including that there be no event of default. The commitments are not subject to maintenance of credit rating levels or the absence of a material adverse change. Upon a change of control of, or upon an event of default by Con Edison, Con Edison of New York or O&R, the banks may terminate their commitments with respect to that company and declare any amounts owed by that company under the credit agreements immediately due and payable. Events of default include the exceeding at any time of a ratio of consolidated debt to consolidated total capital of 0.65 to 1 (at December 31, 2006, this ratio was 0.58 to 1 for O&R); having liens on its assets in an aggregate amount exceeding 5 percent of its consolidated total capital, subject to certain exceptions; and the failure by O&R, following any applicable notice period, to meet certain other customary covenants. The fees charged to O&R for the revolving credit facilities and any loans made or letters of credit issued under the credit agreements reflect O&R's respective credit ratings.
See Note P for information about short-term borrowing between related parties.

Note E – Pension Benefits

Substantially all employees of O&R are covered by a tax-qualified, non-contributory pension plan maintained by Con Edison, which also covers substantially all employees of Con Edison of New York and certain employees of Con Edison's competitive energy businesses. The plan is designed to comply with the Internal Revenue Code and the Employee Retirement Income Security Act of 1974. In addition, Con Edison maintains additional non-qualified pension plans covering certain current and retired O&R officers.

Investment gains and losses are fully recognized in expense over a 15-year period and other actuarial gains and losses are fully recognized in expense over a 10-year period, subject to the deferral provisions in the next

paragraph. This amortization is in accordance with the Statement of Policy issued by the PSC and is permitted under SFAS No. 87, "Employers' Accounting for Pensions," which provides a "corridor method" for moderating the effect of investment gains and losses on pension expense, or alternatively, allows for any systematic method of amortization of unrecognized gains and losses that is faster than the corridor method and is applied consistently to both gains and losses.

In accordance with O&R's current electric and gas rate plans, the Company defers any difference between expenses recognized under SFAS No. 87 for the Company's New York business and the amount reflected in O&R's rates for such expenses. The rate plans for RECO and Pike do not have comparable deferral provisions.

Net Periodic Benefit Cost

The components of the Company's net periodic benefit costs for 2006, 2005 and 2004 were as follows:

(Millions of Dollars)	2006	2005	2004
Service cost – including administrative expenses	$10	$9	$8
Interest cost on projected benefit obligation	29	28	26
Expected return on plan assets	(25)	(24)	(23)
Amortization of net actuarial loss	22	17	12
Amortization of prior service costs	1	1	1
NET PERIODIC BENEFIT COST	$37	$31	$24
Cost capitalized	(8)	(7)	(6)
Cost deferred	(13)	(11)	(1)
Cost charged to operating expenses	$16	$13	$17

Funded Status

The funded status of the Company's pension obligations at December 31, 2006, 2005 and 2004 was as follows:

(Millions of Dollars)	2006	2005	2004
CHANGE IN PROJECTED BENEFIT OBLIGATION			
Projected benefit obligation at beginning of year	$521	$471	$425
Service cost – excluding administrative expenses	9	9	8
Interest cost on projected benefit obligation	29	28	26
Plan amendments	-	-	10
Net actuarial loss	(5)	38	26
Benefits paid	(27)	(25)	(24)
PROJECTED BENEFIT OBLIGATION AT END OF YEAR	$527	$521	$471
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	$294	$267	$236
Actual return on plan assets	37	22	32
Employer contributions	37	31	24
Benefits paid	(27)	(25)	(24)
Administrative expenses	(2)	(1)	(1)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	$339	$294	$267
FUNDED STATUS	$(188)	$(227)	$(204)
Unrecognized net loss	118	157	133
Unrecognized prior service costs	11	12	13
NET PREPAID BENEFIT COST	$-	$(58)	$(58)
ACCUMULATED BENEFIT OBLIGATION	$505	$498	$452

In December 2006, O&R adopted SFAS No. 158. This Statement requires an employer to recognize an asset or liability for the overfunded or underfunded status of its pension and other postretirement benefit plans. For a pension plan, the asset or liability is the difference between the fair value of the plan's assets and the projected benefit obligation. For any other postretirement benefit plan, the asset or liability is the difference between the fair

value of the plan's assets and the accumulated postretirement benefit obligation. The Statement required employers to recognize all unrecognized prior service costs and credits and unrecognized actuarial gains and losses in accumulated other comprehensive income (OCI), net of tax. Such amounts will be adjusted as they are subsequently recognized as components of net periodic benefit cost or income pursuant to the current recognition and amortization provisions.

Upon adoption of SFAS No. 158, the Company recognized an additional pension liability of $125 million. A regulatory asset of $99 million was recorded for the unrecognized net losses and unrecognized prior service costs associated with the Company consistent with SFAS No. 71. An OCI charge of $15 million (net of taxes) was recorded for the unrecognized net losses and unrecognized prior service costs associated with O&R's New Jersey and Pennsylvania utility subsidiaries.

Prior to adoption of SFAS No. 158, amounts recognized in the Company's consolidated balance sheet at December 31, 2005 were as follows:

(Millions of Dollars)	2005
Accrued benefit cost	$(58)
Additional minimum pension liability	(3)
Accumulated other comprehensive income	3
Net accrued benefit cost	$(58)

The estimated net loss and prior service cost for the pension plan that will be amortized into net periodic benefit cost over the next year for O&R are $21 million and $1 million, respectively.

At December 31, 2006 and 2005, the Company's investments include $11 million, held in an external trust account for benefit payments pursuant to the supplemental retirement plans. The accumulated benefit obligations for the supplemental retirement plans for O&R was $33 million as of December 31, 2006 and 2005.

Assumptions

The actuarial assumptions were as follows:

	2006	2005	2004
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount rate	6.00%	5.70%	5.90%
Rate of compensation increase	4.00%	4.00%	4.00%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount rate	5.70%	5.90%	6.30%
Expected return on plan assets	8.50%	8.80%	8.80%
Rate of compensation increase	4.00%	4.00%	4.00%

The expected return assumption reflects anticipated returns on the plan's current and future assets. The Company's expected return was based on an evaluation of the current environment, market and economic outlook, relationships between the economy and asset class performance patterns, and recent and long-term trends in asset class performance. The projections were based on the plan's target asset allocation and were adjusted for historical and expected experience of active portfolio management results compared to benchmark

returns. Historical plan performance and peer data are also reviewed to check for reasonability and appropriateness.

Discount Rate Assumption

To determine the assumed discount rate, the Company uses a model that produces a yield curve based on yields on selected highly rated (Aaa or Aa, by Moody's Investors Service) corporate bonds. Bonds with insufficient liquidity, bonds with questionable pricing information and bonds that are not representative of the overall market are excluded from consideration. For example, the bonds used in the model cannot be callable, they must have a price between 50 and 200, the yield must lie between 1 percent and 20 percent, and the amount of the issue must be in excess of $100 million. The spot rates defined by the yield curve and the plan's projected benefit payments are used to develop a weighted average discount rate.

Expected Benefit Payments

Based on current assumptions, the Company expects to make the following benefit payments over the next ten years:

(Millions of Dollars)	2007	2008	2009	2010	2011	2012-2016
O&R	$28	$30	$31	$32	$34	$187

Expected Contributions

Based on current estimates, the Company is not required under funding regulations and laws to make any contributions to the pension plan during 2007. The Company's policy is to fund its accounting cost to the extent tax deductible, therefore, O&R expects to make a discretionary contribution of $33 million to the pension plan during 2007.

Plan Assets

The asset allocations for the pension plan at the end of 2006, 2005 and 2004, and the target allocation for 2007 are as follows:

	Target Allocation	Plan Assets at December 31		
ASSET CATEGORY	2007	2006	2005	2004
Equity Securities	65%	66%	67%	67%
Debt Securities	30%	28%	28%	28%
Real Estate	5%	6%	5%	5%
Total	100%	100%	100%	100%

Con Edison has established a pension trust for the investment of assets to be used for the exclusive purpose of providing retirement benefits to pension plan participants and beneficiaries.

Pursuant to resolutions adopted by Con Edison's Board of Directors, the Management Development and Compensation Committee of the Board of Directors (the Committee) has general oversight responsibility for Con Edison's pension and other employee benefit plans. The plans' Named Fiduciaries have been granted the authority to control and manage the operation and administration of the plans, including overall responsibility for

the investment of assets in the trust and the power to appoint and terminate investment managers. The Named Fiduciaries consist of Con Edison's chief executive, chief financial and chief accounting officers and others the Board of Trustees may appoint in addition to or in place of the designated Named Fiduciaries.

The investment objective for the pension trust is to maximize the long-term total return on the trust assets within a prudent level of risk. The investment strategy is to diversify its funds across asset classes, investment styles and fund managers. The target asset allocation is reviewed periodically based on asset/liability studies and may be modified as appropriate. The target asset allocation for 2007 reflects the results of such a study conducted in 2003.

Individual managers operate under written guidelines provided by Con Edison, which cover such areas as investment objectives, performance measurement, permissible investments, investment restrictions, trading and execution, and communication and reporting requirements. Manager performance, total fund performance, and compliance with asset allocation guidelines are monitored on an ongoing basis, and reviewed by the Named Fiduciaries and reported to the Committee on a regular basis. Changes in fund managers and rebalancing of the portfolio are undertaken as appropriate. The Named Fiduciaries approve such changes, which are also reported to the Committee.

O&R also offers a defined contribution savings plan that covers substantially all employees and made contributions to the plan as follows:

	For the Years Ended December 31,		
(Millions of Dollars)	2006	2005	2004
O&R	$2	$2	$2

Note F – Other Postretirement Benefits

The Company has contributory comprehensive hospital, medical and prescription drug programs for all retirees, their dependents and surviving spouses. In addition, the Company has a non-contributory life insurance program for retirees.

Investment plan gains and losses are fully recognized in expense over a 15-year period and other actuarial gains and losses are fully recognized in expense over a 10-year period, provided, however, that O&R defers any difference between expenses recognized under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pension," and the current rate allowance for its electric and gas operations. The electric rate plan for Pike has a comparable deferral provision. The rate plan for RECO and the gas rate plan for Pike do not have comparable deferral provisions.

Net Periodic Benefit Cost

The components of the Company's net periodic postretirement benefit costs for 2006, 2005 and 2004 were as follows:

(Millions of Dollars)	2006	2005	2004
Service cost	$4	$4	$3
Interest cost on accumulated other postretirement benefit obligation	10	10	8
Expected return on plan assets	(6)	(5)	(5)
Amortization of net actuarial loss	9	9	5
NET PERIODIC POSTRETIREMENT BENEFIT COST	$17	$18	$11
Cost capitalized	(4)	(4)	(3)
Cost deferred	(5)	(6)	(1)
Cost charged to operating expenses	$8	$8	$7

Funded Status

The funded status of the programs at December 31, 2006, 2005 and 2004 was as follows:

(Millions of Dollars)	2006	2005	2004
CHANGE IN BENEFIT OBLIGATION			
Benefit obligation at beginning of year	$184	$157	$131
Service cost	4	4	3
Interest cost on accumulated postretirement benefit obligation	10	10	8
Net actuarial loss	(8)	23	25
Benefits paid and administrative expenses	(10)	(10)	(10)
Medicare prescription subsidy	1	-	-
Plan amendments	8	-	-
BENEFIT OBLIGATION AT END OF YEAR	$189	$184	$157
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	$64	$55	$49
Actual return on plan assets	8	3	4
Employer contributions	13	13	8
Benefits paid	(8)	(7)	(6)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	$77	$64	$55
FUNDED STATUS	$(112)	$(120)	$(102)
Unrecognized net loss	61	80	64
Unrecognized prior service costs	7	(1)	(1)
ACCRUED POSTRETIREMENT BENEFIT COST	-	$(41)	$(39)

For discussion of SFAS No. 158, see Note E. Upon adoption of SFAS No. 158, O&R recognized an additional liability for other postretirement benefits of $69 million. A regulatory asset of $53 million was recorded for the unrecognized net losses, unrecognized prior service costs and unrecognized transition liability associated with the Company consistent with SFAS No. 71. An OCI charge of $10 million (net of taxes) was recorded for the unrecognized net losses, unrecognized prior service costs and unrecognized transition liability associated with O&R's New Jersey and Pennsylvania utility subsidiaries.

The estimated net loss and prior service costs for the other postretirement benefits that will be amortized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R are $9 million and $1 million, respectively.

Assumptions

The actuarial assumptions were as follows:

	2006	2005	2004
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount Rate	6.00%	5.70%	5.90%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount Rate	5.70%	5.90%	6.30%
Expected Return on Plan Assets			
Tax-Exempt	8.50%	8.80%	8.80%
Taxable	8.00%	8.30%	8.30%

Refer to Note E for descriptions of the basis for determining the expected return on assets, investment policies and strategies, and the assumed discount rate.

The health care cost trend rate used to determine net periodic benefit cost for the year ended December 31, 2006 was 9 percent, which is assumed to decrease gradually to 4.5 percent by 2011 and remain at that level thereafter. The health care cost trend rate used to determine benefit obligations for the year ended December 31, 2006 was 9 percent, which is assumed to decrease gradually to 4.5 percent by 2012 and remain at that level thereafter.

A one-percentage point change in the assumed health care cost trend rate would have the following effects at December 31, 2006:

	1-Percentage-Point	
(Millions of Dollars)	Increase	Decrease
Effect on accumulated other postretirement benefit obligation	$20	$(17)
Effect on service cost and interest cost components for 2006	2	(2)

Expected Benefit Payments

Based on current assumptions, O&R expects to make the following benefit payments over the next ten years:

(Millions of Dollars)	2007	2008	2009	2010	2011	2012-2016
Gross Benefit Payments	$11	$12	$13	$14	$15	$78
Medicare Prescription Benefit Receipts	1	1	1	1	1	8

Expected Contributions

Based on current estimates, O&R expects to make contributions of $13 million to the other postretirement benefit plans in 2007.

Plan Assets

The asset allocations for O&R's other postretirement benefit plans at the end of 2006, 2005 and 2004, and the target allocation for 2007 are as follows:

	Target Allocation	Plan Assets at December 31		
ASSET CATEGORY	2007	2006	2005	2004
Equity Securities	65%	63%	64%	63%
Debt Securities	35%	37%	36%	37%
Total	100%	100%	100%	100%

O&R has established postretirement health and life insurance benefit plan trusts for the investment of assets to be used for the exclusive purpose of providing other postretirement benefits to participants and beneficiaries.

Refer to Note E for a discussion of the investment policy for its benefit plans.

Effect of Medicare Prescription Benefit

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 created a benefit for certain employers who provide postretirement drug programs. FASB Staff Position (FSP) No. FAS 106-2, issued by the FASB in May 2004, provides accounting and disclosure requirements relating to the Act. The Company's actuaries have determined that each prescription drug plan provides a benefit that is at least actuarially equivalent to the Medicare prescription drug plan and projections indicate that this will be the case for 20 years; therefore, the Company has determined that it is eligible to receive the benefit that the Act makes available.

Note G – Environmental Matters

Hazardous substances, such as coal tar and asbestos, have been used or generated in the course of operations of O&R and its predecessors and are present at sites and in facilities and equipment they currently or previously owned, including seven sites at which gas was manufactured (the MGP Sites).

MGP Sites

The New York State Department of Environmental Conservation (DEC) requires O&R to develop and implement remediation programs for its MGP Sites. O&R has investigated and detected soil and/or groundwater contamination to varying degrees at its MGP Sites. Remediation has been completed at one MGP site and is currently underway at another MGP site. Additional investigation will be required for three of the remaining MGP sites and remediation required at all of them. At December 31, 2006 and 2005, O&R had an accrued liability of $49 million and $53 million, respectively, for its MGP Sites.

In 2006, O&R estimated that the aggregate undiscounted potential liability for the remediation of the MGP Sites, each of which has been investigated, could range up to $96 million. These estimates were based on assumptions regarding the extent of contamination and the type and extent of remediation that may be required. Actual experience may be materially different.

O&R is permitted under its New York rate agreements to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs. At December 31, 2006 and 2005, O&R's regulatory asset for recovery of these costs were $63 million and $59 million, respectively. The environmental remediation costs for the years ended December 31, 2006 and 2005 were approximately $8 million and $5 million, respectively. There were no insurance recoveries during these periods.

In February 2006, a suit was brought against the Company seeking unspecified compensatory and punitive damages with respect to two decedents whose deaths were allegedly caused by exposure to contaminants from an O&R MGP site. The Company is in the process of investigating the allegations.

Asbestos Proceedings

Suits have been brought against O&R and many other defendants, wherein a large number of plaintiffs sought large amounts of compensatory and punitive damages for deaths and injuries allegedly caused by exposure to asbestos at various O&R premises. The suits that have been resolved, which are many, have been resolved without any payment by O&R, or for amounts that were not, in the aggregate, material to the Company. The amounts specified in all the remaining suits total billions of dollars but the Company believes that these amounts are greatly exaggerated, based on the disposition of previous claims.

In addition, certain current and former employees have claimed or are claiming workers' compensation benefits based on alleged disability from exposure to asbestos. The Company defers as regulatory assets (for subsequent recovery through rates) liabilities incurred for asbestos claims by employees and third-party contractors relating to its divested generating plants.

The Company's accrued liability for asbestos suits and workers' compensation proceedings (including those related to asbestos exposure) was $5 million at December 31, 2006 and 2005.

Note H – Other Material Contingencies

Generating Assets Sold To Mirant

In June 1999, O&R completed the sale of all of its generating assets to affiliates (the Mirant Affiliates) of Mirant Corporation (formerly Southern Energy, Inc.). The total gross proceeds from the sale amounted to $343 million. In 2003, Mirant and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In January 2006, Mirant and most of its subsidiaries, but not including the Mirant Affiliates, emerged from bankruptcy.

In May 2006, Mirant, the Mirant Affiliates and another Mirant subsidiary (the Claimants) commenced a proceeding seeking, among other things, to void the sale of the generating assets and recover the amounts paid by the Mirant Affiliates in connection with the sale (which the Claimants allege exceeded the fair value of the assets), together with interest on such amounts. In addition, the Claimants seek damages, and a declaration that O&R defend and indemnify the Mirant Affiliates, in connection with certain environmental, operational and other matters relating to some of the assets, the costs of which could be substantial. The Claimants also object to the allowance of claims totaling approximately $1 million filed by O&R in the bankruptcy proceeding.

In October 2006, the Mirant Affiliate that owns the Lovett generating units notified the PSC and O&R of its intention to retire the units in 2007 and 2008. O&R is in the process of constructing upgrades to its transmission

and distribution system to meet anticipated demand growth, and believes that these upgrades will allow the system to meet existing and future demand requirements in the event that the Lovett units are shut down.

O&R is unable to predict whether or not any Mirant related lawsuits or other actions will have a material adverse effect on its financial position, results of operations or liquidity.

Note I – Non-Utility Generators and Other Power Purchase Agreements

O&R had long-term power purchase agreements (PPAs) with non-utility generators (NUGs) and others for generating capacity. The Company recovers its purchase power costs in accordance with provisions approved by the applicable state public utility commissions. See “Recoverable Energy Costs” in Note A.

On December 31, 2006, O&R terminated the Crossroads PPA, which obligated O&R to make capacity and other fixed payments. The Company entered into an agreement to pay Crossroads a buyout amount, calculated in accordance with an agreed upon formula.

For energy delivered under the PPAs, the Company was obligated to pay variable prices. The Company’s payments under the PPAs for capacity, energy and other fixed payments in 2006, 2005 and 2004 were as follows:

	For the Years Ended December 31,		
(Millions of Dollars)	2006	2005	2004
Lederle*	$2	$14	$12
Crossroads**	3	2	3

* Contract ended January 31, 2006.
** Contract terminated on December 31, 2006.

Note J – Leases

O&R leases include rights of way for electric and gas distribution facilities, office buildings and automobiles. In accordance with SFAS No. 13, “Accounting for Leases,” these leases are classified as operating leases. Generally, it is expected that leases will be renewed or replaced in the normal course of business.

The future minimum lease commitments under the Company’s non-cancelable operating lease agreements are as follows:

(Millions of Dollars)	
2007	$2
2008	2
2009	1
2010	1
2011	1
All years thereafter	-
Total	$7

Note K – Income Tax

The components of income tax for the Company are as follows:

(Millions of Dollars)	2006	2005	2004
Charge/(benefit) to operations:			
State			
Current	$1	$4	$3
Deferred – net	5	3	(8)
Federal			
Current	8	23	7
Deferred – net	11	1	15
TOTAL CHARGE TO OPERATIONS	25	31	17
TOTAL CHARGE/(BENEFIT) TO OTHER INCOME	1	-	-
TOTAL	$26	$31	$17

The tax effect of temporary differences, which gave rise to deferred tax assets and liabilities, is as follows:

(Millions of Dollars)	2006	2005
Deferred tax liabilities:		
Depreciation	$116	$113
Regulatory liability – future income tax	70	67
Unrecognized pension and other postretirement costs – SFAS No. 158	62	-
State income tax	16	10
Capitalized overheads	33	28
Other	31	30
Total deferred tax liabilities	328	248
Deferred tax assets:		
Unrecognized pension and other postretirement costs – SFAS No. 158	62	-
Regulatory asset – future income tax	16	17
Other	55	42
Total deferred tax assets	133	59
NET LIABILITIES	195	189
INVESTMENT TAX CREDITS	4	5
DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS	199	194
DEFERRED INCOME TAXES – RECOVERABLE ENERGY COSTS	9	12
TOTAL DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS	$208	$206

Reconciliation of the difference between income tax expense and the amount computed by applying the prevailing statutory income tax rate to income before income taxes is as follows:

(% of Pre-tax income)	2006	2005	2004
STATUTORY TAX RATE			
Federal	35%	35%	35%
Changes in computed taxes resulting from:			
State income tax	6	6	(5)
Depreciation related differences	(1)	-	-
Cost of removal	(2)	(1)	(2)
Other	(2)	(1)	(1)
Effective Tax Rate	36%	39%	27%

Timing of Deduction of Construction-Related Costs

In August 2005, the Internal Revenue Service (IRS) issued Revenue Ruling 2005-53 with respect to when federal income tax deductions can be taken for certain construction-related costs. The Company used the "simplified service cost method" (SSCM) to determine the extent to which these costs could be deducted in 2002, 2003, 2004 and 2005, and as a result reduced its current tax expense by $30 million.

The Company expects that it will be required to repay, with interest, a portion of their past SSCM tax benefits and to capitalize and depreciate over a period of years costs they previously deducted under SSCM. Interest on all past SSCM tax benefits for O&R would be approximately $7 million. In 2006, O&R accrued interest of $3 million representing its best estimate of the interest that may be required, and subsequently deferred $2 million, the portion related to its New York operations, as a regulatory asset pending recovery through rates. Repayment of the SSCM tax benefits would not otherwise affect O&R's results of operations because deferred taxes have been previously provided for the related temporary differences between the SSCM deductions taken for federal income tax purposes and the corresponding amounts charged to expense for financial reporting purposes.

Uncertain Tax Positions

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertain tax positions in accordance with FASB Statement No. 109 and becomes effective for fiscal years beginning after December 15, 2006. Under the interpretation, an enterprise would not be allowed to recognize, in its financial statements, the benefit of a tax position unless that position is more likely than not to be sustained upon examination by taxing authorities, including resolution of any related appeals and litigation processes, based solely on the technical merits of the position. Con Edison and its subsidiaries, including O&R, file a consolidated federal income tax return. The IRS has essentially completed its audits of O&R's federal income tax returns through June 1999, the date of its merger with Con Edison. The IRS has essentially completed its audits of Con Edison's federal income tax returns through 2001 and for tax year 2005. Con Edison's federal income tax returns for 2002 through 2004, which the IRS is reviewing, reflect certain tax positions with which the IRS does not or may not agree, including tax positions with respect to O&R's deduction of certain construction related costs. The adoption of FIN 48 is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

Note L – Stock-Based Compensation

O&R provides stock-based compensation to its employees under Con Edison's stock-based compensation plans. These plans include stock options, restricted stock units and contributions to a discount stock purchase plan. The Stock Option Plan (the 1996 Plan) provided for awards of stock options to officers and employees of Con Edison and its subsidiaries for up to 10 million shares of common stock. The Long Term Incentive Plan (LTIP) among other things, provides for awards of restricted stock units to officers, stock options to employees and deferred stock units to Con Edison's non-officer directors for up to 10 million shares of common stock (of which not more than four million shares may be restricted stock or stock units).

Shares of Con Edison common stock used to satisfy the obligations with respect to O&R's stock-based compensation may be new (authorized, but unissued) shares, treasury shares or shares purchased in the open market. The shares used during the period ended December 31, 2006 have been new shares.

In January 2006, Con Edison adopted SFAS No. 123(R), "Share-Based Payment" (SFAS No. 123(R)), applying the modified prospective approach. Pursuant to SFAS No. 123(R), the Company has recognized the cost of stock-based compensation as an expense using a fair value measurement method. The following table summarizes stock-based compensation expense recognized by the Company in the period ended December 31, 2006, 2005 and 2004:

(Thousands of Dollars)	2006	2005	2004
Stock options	$527	$-	$-
Restricted stock units	2	601	720
Performance-based restricted stock	767	198	273
Total	$1,296	$799	$993

Stock Options

Stock options generally vest over a three-year period and have a term of ten years. Options are granted at an exercise price equal to the fair market value of a common share when the option was granted. The Company generally recognizes compensation expense (based on the fair value of stock option awards) over the continuous period in which the options vest. Awards to employees currently eligible for retirement are expensed in the month awarded.

The outstanding options are "equity awards" because shares of Con Edison common stock are delivered upon exercise of the options. As equity awards, the fair value of the options is measured at the grant date. The weighted average fair values of options granted in 2006, 2005 and 2004 are $3.81, $4.51 and $5.12 per share, respectively. These values were estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2006	2005	2004
Risk-free interest rate	4.62%	3.95%	3.47%
Expected life	4.6 years	4.6 years	6 years
Expected stock volatility	13.41%	19.00%	20.63%
Expected dividend yield	5.06%	5.37%	5.16%

The weighted average risk-free rate is calculated using the five-year U.S. Treasury securities rate on the grant date of each stock option and then weighted for the number of shares awarded. The expected life of the options is based on historical employee exercise behavior and post-vesting cancellations. The expected stock volatility is calculated using the quarterly closing prices of Con Edison stock over a period of five years, which approximates the expected term of the options. The expected dividend yield is calculated using the annualized dividend divided by the stock price on the date of grant.

A summary of changes in the status of stock options awarded to O&R employees as of December 31, 2006, 2005 and 2004 is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at 12/31/03	388,500	$38.800
Granted	101,500	43.753
Exercised	(24,000)	33.594
Forfeited	(1,000)	44.100
Outstanding at 12/31/04	465,000	40.139
Granted	105,000	43.031
Exercised	(32,000)	38.715
Forfeited	-	-
Outstanding at 12/31/05	538,000	40.788
Granted	124,000	45.599
Exercised	(47,150)	38.337
Forfeited	-	-
Outstanding at 12/31/06	614,850	$41.946

The change in the fair value of all outstanding options from their grant dates to December 31, 2006 (aggregate intrinsic value) for O&R was $4 million. The aggregate intrinsic value of options exercised in 2006 was $0.5 million and the cash received by Con Edison for payment of the exercise price was $2 million. The weighted average remaining contractual life of options outstanding is seven years as of December 31, 2006.

The following table summarizes O&R employees' stock options outstanding at December 31, 2006 for each plan year:

Plan Year	Remaining Contractual Life	Options Outstanding	Weighted Average Exercise Price	Options Exercisable
2006	9	124,000	$45.600	-
2005	8	105,000	43.031	-
2004	7	100,500	43.750	-
2003	6	92,350	39.737	92,350
2002	5	95,000	42.510	95,000
2001	4	62,500	37.750	62,500
2000	3	35,500	32.500	35,500
Total		614,850	$41.946	285,350

The exercise prices of options awarded in 2006 and 2005 range from $43.50 and $46.88 and $42.18 to $43.72, respectively. The total expense to be recognized in future periods for the unvested stock options outstanding as of December 31, 2006 is $0.2 million for O&R.

Restricted Stock Units

Restricted stock unit awards under the LTIP have been made as follows: (i) annual awards to O&R officers under restricted stock unit agreements that provide for adjustment of the number of units (performance-restricted stock units or Performance RSUs); and (ii) restricted stock unit agreements with an officer. Each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. No other awards of restricted stock units were made in 2006.

In accordance with SFAS No. 123(R), for outstanding restricted stock awards other than Performance RSUs, the Company has accrued a liability based on the market value of a common share on the grant date and are recognizing compensation expense over the vesting period. The weighted average vesting period for outstanding awards is two years and is based on the employees' continuous service to O&R. Prior to vesting, the awards are subject to forfeiture in whole or in part under certain circumstances. The awards are "liability awards" because each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, prior to vesting, changes in the fair value of the units are reflected in net income. A senior officer of O&R was awarded restricted stock units in 2000 and 2002. The units, each of which represented the right to receive one share of Con Edison common stock, became fully vested in 2005 and the receipt of certain of these units was deferred by the officer until a future date. Pursuant to APB No. 25, O&R recognized compensation expense for the units, which was not material, over the vesting period. At December 31, 2006, there were 35,000 units outstanding for O&R. The weighted average fair value as of the grant date of the outstanding units is $34.783 per unit for O&R.

The number of units in each annual Performance RSU is subject to adjustment as follows: (i) 50 percent of the units awarded will be multiplied by a factor that may range from 0 to 150 percent based on Con Edison's total shareholder return relative to the Standard & Poor's Electric Utilities Index during a specified performance period (the TSR portion); and (ii) 50 percent of the units awarded will be multiplied by a factor that may range from 0 to 132 percent based on determinations made in connection with the O&R Annual Team Incentive Plan (the EIP portion). Units generally vest when the performance period ends.

For the TSR portion of Performance RSU, the Company uses a Monte Carlo simulation model to estimate the fair value of the awards. The fair value is recomputed each reporting period as of the earlier of the reporting date and the vesting date. For the EIP portion of Performance RSU, the fair value of the awards is determined using the market price on the date of grant. Performance RSU awards are "liability awards" because each Performance RSU represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, changes in the fair value of the Performance RSUs are reflected in net income. The following table illustrates the assumptions used to calculate the fair value of the awards:

	2006
Risk-free interest rate	4.56% - 4.95%
Expected term	3 years
Expected volatility	12.59%
Expected quarterly dividends	$0.575 - $0.59

The risk-free rate is based on the U.S. Treasury zero-coupon yield curve on the date of grant. The expected term of the Performance RSUs is three years, which equals the vesting period. The Company does not expect significant forfeitures to occur. The expected volatility is calculated using daily closing stock prices over a period of three years, which approximates the expected term of the awards. Expected annual escalation of dividends is based on historical trends.

A summary of changes in the status of the Performance RSUs TSR portion during the period ended December 31, 2006 is as follows:

	Units	Weighted Average Fair Value*
Non-vested at 12/31/05	7,300	$34.37
Granted	4,900	35.64
Vested and Exercised	(3,625)	43.06
Forfeited	-	-
Non-vested at 12/31/06	8,575	$18.58

* Fair value is determined using the Monte Carlo simulation described above.

A summary of changes in the status of the Performance RSUs' EIP portion during the period ended December 31, 2006 is as follows:

	Units	Weighted Average Price
Non-vested at 12/31/05	7,300	$43.39
Granted	4,900	46.88
Vested and Exercised	(3,625)	43.06
Forfeited	-	-
Non-vested at 12/31/06	8,575	$48.07

The total expense to be recognized by O&R in future periods for unvested Performance RSUs outstanding as of December 31, 2006 is $0.5 million.

Stock Purchase Plan

Under the Con Edison Stock Purchase Plan, O&R contributes $1 for each $9 invested by its officers and employees to purchase Con Edison common stock. Eligible participants may invest up to $25,000 during any calendar year (subject to an additional limitation for officers and employees of not more than 20% of their pay). Dividends paid on shares held under the plan are reinvested in additional shares unless otherwise directed by the participant.

Participants in the plan immediately vest in shares purchased by them under the plan. The fair value of the shares of Con Edison common stock purchased under the plan was calculated using the average of the high and low composite sale prices at which shares were traded at the New York Stock Exchange on the trading day immediately preceding such purchase dates. During 2006, 2005 and 2004, 624,751, 590,413 and 605,118 shares were purchased under the Stock Purchase Plan at a weighted average price of $45.33, $45.05 and $41.67 per share, respectively.

Note M – Financial Information By Business Segment

The business segments of the Company were determined based on management's reporting and decision-making requirements in accordance with SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information."

The Company's principal business segments are its regulated electric and gas utility activities.

All revenues of these business segments are from customers located in the United States of America. Also, all assets of the business segments are located in the United States of America. The accounting policies of the segments are the same as those described in Note A.

Common services shared by the business segments are assigned directly or allocated based on various cost factors, depending on the nature of the service provided.

The financial data for the business segments are as follows:

As of and for the Year Ended December 31, 2006 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$582	$25	$20	$ 53	$18	$1,230	$84
Gas	236	10	5	16	7	495	26
Other*	-	-	-	-	3	43	-
Total	$818	$35	$25	$69	$28	$1,768	$110

As of and for the Year Ended December 31, 2005 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$596	$ 25	$25	$57	$15	$1,082	$61
Gas	228	9	6	16	7	459	26
Other*	-	-	-	-	2	47	-
Total	$824	$34	$31	$73	$24	$1,588	$87

As of and for the Year Ended December 31, 2004 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$499	$25	$13	$49	$13	$935	$51
Gas	204	8	4	16	6	406	28
Other*	-	-	-	-	1	49	-
Total	$703	$33	$17	$65	$20	$1,390	$79

* Includes amounts related to Transition Funding.

Note N – Derivative Instruments and Hedging Activities

Derivative instruments and hedging activities are accounted for in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133). Under SFAS No. 133, derivatives are recognized on the balance sheet at fair value, unless an exception is available under the standard. Certain qualifying derivative contracts have been designated as normal purchases or normal sales contracts. These contracts are not reported at fair value under SFAS No. 133.

Energy Price Hedging

The Company hedges market price fluctuations associated with physical purchases and sales of electricity and natural gas by using derivative instruments including futures, forwards, basic swaps, or options. The fair values of these hedges at December 31, 2006 and 2005 were as follows:

(Millions of Dollars)	2006	2005
Fair value of net assets	$(19)	$69

Credit Exposure

The Company is exposed to credit risk related to transactions entered into primarily for the various energy supply and hedging activities. The Company uses credit policies to manage this risk, including an established credit approval process, monitoring of counterparty limits, netting provisions within agreements and collateral or prepayment arrangements.

The Company had $2 million credit exposure in connection with energy supply and hedging activities, net of collateral and reserves, at December 31, 2006. The entire $2 million was with investment-grade counterparties.

Cash Flow Hedges

The Company designates a portion of its derivative instruments as cash flow hedges under SFAS No. 133. Under cash flow hedge accounting, to the extent a hedge is determined to be “effective,” the unrealized gain or loss on the hedge is recorded in OCI and reclassified to earnings at the time the underlying transaction is completed. A gain or loss relating to any portion of the hedge determined to be “ineffective” is recognized in earnings in the period in which such determination is made.

At December 31, 2006, the cash flow hedges included in accumulated OCI and the portion expected to be reclassified to earnings during the next 12 months had a maximum term of 12 months and was immaterial to the results of operations of the Company. The actual amounts that will be reclassified to earnings may vary from the expected amounts as a result of changes in market prices. The effect of reclassification from accumulated OCI to earnings will generally be offset by the recognition of the hedged transaction in earnings.

The unrealized net gains and losses relating to the hedge ineffectiveness of these cash flow hedges that were recognized in net earnings for the years ended December 31, 2006, 2005 and 2004 were immaterial to the results of operations of the Company for those periods.

Generally, the collateral requirements associated with, and settlement of, derivative transactions are included in net cash flows from operating activities in the Company’s consolidated statement of cash flows.

Interest Rate Hedging

The Company uses interest rate swaps to manage interest rate exposure associated with debt. The fair values of these interest rate swaps at December 31, 2006 and 2005 were as follows:

(Millions of Dollars)	2006	2005
Fair value of interest rate swaps	$(12)	$(13)

Cash Flow Hedges

The Company's interest rate swaps are designated as cash flow hedges under SFAS No. 133. Any gain or loss on the hedges is recorded in OCI and reclassified to interest expense and included in earnings during the periods in which the hedged interest payments occur. The contractual component of the interest rate swap accounted for as cash flow hedges is as follows:

Debt	Maturity Date	Notional Amount (Millions of Dollars)	Fixed Rate Paid	Variable Rate Received
Pollution Control Refunding Revenue Bond, 1994 Series A	2014	$55	6.09%	Current bond rate

The following table presents selected information related to these cash flow hedges included in accumulated OCI at December 31, 2006:

(Millions of Dollars)	Accumulated Other Comprehensive Income/(Loss) Net of Tax	Portion Expected to be Reclassified to Earnings during the Next 12 Months
Interest Rate Swaps	$(7)	$(1)

The actual amounts that will be reclassified to earnings may vary from the expected amounts presented above as a result of changes in interest rates. For the Company, these costs are generally recovered in rates and the reclassification will have no impact on results of operations.

Note O – Asset Retirement Obligations

In accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143), companies are required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The Company has not identified any such obligations and, accordingly, has not recognized any asset retirement obligation under SFAS No. 143.

The Company includes in depreciation the estimated removal costs, less salvage, for utility plant assets. In accordance with SFAS No. 143, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities pursuant to SFAS No. 71. The related regulatory liabilities recorded for the Company were $60 million and $57 million in 2006 and 2005, respectively.

Note P – Related Party Transactions

The Company provides and receives administrative and other services to and from Con Edison and its subsidiaries pursuant to cost allocation procedures developed in accordance with rules approved by the PSC and/or other regulatory authorities, as applicable. The services received include substantial administrative support operations, such as corporate secretarial and associated ministerial duties, accounting, treasury, investor relations, information resources, legal, human resources, fuel supply, and energy management services. The costs of administrative and other services provided by the Company, and received from Con Edison and its other subsidiaries for the years ended December 31, 2006, 2005 and 2004 were as follows:

(Millions of Dollars)	2006	2005	2004
Cost of services provided	$16	$14	$14
Cost of services received	$28	$25	$23

In addition, Con Edison of New York and O&R have joint gas supply arrangements, in connection with which O&R purchased from Con Edison of New York $149 million, $185 million and $142 million of natural gas for the years ended December 31, 2006, 2005 and 2004, respectively. These amounts are net of the effect of related hedging transactions.

Con Edison of New York also hedges electricity purchases for O&R. Electric hedging transactions executed by Con Edison of New York on behalf of O&R resulted in a charge to purchase power of $9.2 million for the year ended December 31, 2006 and a credit to purchase power of $1.2 million and $1.9 million for the years ended December 31, 2005 and 2004, respectively.

As at December 31, 2006 and 2005, O&R's net payable to Con Edison of New York associated with derivatives for energy price hedging were $49 million and $2 million, respectively. See Note N.

As at December 31, 2006, the Company's receivable from Con Edison for income taxes was immaterial. As at December 31, 2005, the receivable was $15 million. See Note A.

Pike purchased from Consolidated Edison Energy, Inc., a wholly owned subsidiary of Con Edison, $1 million of electricity for the year ended December 31, 2006, pursuant to energy auctions. RECO purchased from Consolidated Edison Energy, Inc. $2 million and $9 million of electricity for the periods ended December 31, 2005 and 2004, respectively, pursuant to energy auctions.

In December 2006, the FERC authorized Con Edison of New York to lend funds to O&R, for periods of not more than 12 months, in amounts not to exceed $200 million outstanding at any time, at prevailing market rates. O&R has not borrowed any funds from Con Edison of New York.

Note Q – New Financial Accounting Standards

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - including an amendment of FASB Statement No. 115." This Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The guidance in this Statement becomes effective for fiscal periods beginning after November 15, 2007. The Company is currently evaluating the impact of this Statement on its financial position, results of operations and liquidity.

In September 2006, the FASB issued Emerging Issues Task Force (EITF) Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements." This Issue requires employers to record a liability for future benefits for endorsement split-dollar life insurance arrangements that provide a postretirement benefit to an employee. The guidance in this EITF becomes effective for fiscal periods beginning after December 15, 2007. The Company is currently evaluating the impact of this Issue on its financial position, results of operations and liquidity.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands the disclosures about fair value measurements. It applies to other accounting pronouncements that require fair value measurements and, accordingly, does not require any new fair value measurements. The guidance in this Statement becomes effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this Statement on its financial position, results of operations and liquidity.

In June 2006, the FASB issued EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)", which is effective for fiscal years beginning after December 15, 2006. This Issue concerns the income statement presentation of any taxes assessed by a governmental authority on a revenue producing transaction between a seller and a buyer and does not require re-evaluation of existing policies. The Task Force concluded that presentation of such taxes, on a gross or net basis, is a matter of accounting policy and should be disclosed. The adoption of EITF No. 06-3 is not expected to have a material impact on the Company's financial position, results of operations or liquidity. See "Revenues" in Note A for description of the Company's presentation of its revenues.

In April 2006, the FASB issued Staff Position No. FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)" (the FSP), which is effective prospectively for reporting periods beginning after June 15, 2006. The FSP clarifies that the variability to be considered in applying FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," should be based on an analysis of the design of the entity. The application of this FSP did not have a material impact on the Company's financial position, results of operations or liquidity.

In March 2006, the FASB issued Statement No. 156, “Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140” (SFAS No. 156), which is effective for fiscal years beginning after September 15, 2006. The Statement clarifies the accounting for servicing rights, requires servicing rights to be initially measured at fair value, and provides the option to subsequently account for servicing rights at either fair value or under the amortization method previously required under FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” The adoption of SFAS No. 156 is not expected to have a material impact on the Company’s financial position, results of operations or liquidity.

In February 2006, the FASB issued Statement No. 155, “Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140” (SFAS No. 155), which is effective for fiscal years beginning after September 15, 2006. This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It establishes a requirement to evaluate interests in securitized financial assets to determine whether they are freestanding derivatives or whether they contain embedded derivatives. The adoption of SFAS No. 155 is not expected to have a material impact on the Company’s financial position, results of operations or liquidity.