

Orange and Rockland Utilities, Inc.
2014 Annual Financial Statements and Notes

Financial Statements

[Report of Independent Registered Public Accounting Firm](#)

[Consolidated Income Statement](#)

[Consolidated Statement of Comprehensive Income](#)

[Consolidated Statement of Cash Flows](#)

[Consolidated Balance Sheet](#)

[Consolidated Statement of Common Shareholder's Equity](#)

[Consolidated Statement of Capitalization](#)

[Notes to Financial Statements](#)

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Orange and Rockland Utilities, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets and related consolidated statements of capitalization as of December 31, 2014 and 2013, and the related consolidated statements of income, of comprehensive income, of common shareholder's equity and of cash flows for each of the three years in the period ended December 31, 2014.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orange and Rockland Utilities, Inc. and its subsidiaries at December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in accordance with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP
New York, NY
March 6, 2015

Orange and Rockland Utilities, Inc.
CONSOLIDATED INCOME STATEMENT

| | For the Years Ended December 31, | | |
|---|----------------------------------|--------------|--------------|
| | 2014 | 2013 | 2012 |
| | (Millions of Dollars) | | |
| OPERATING REVENUES | | | |
| Electric | \$ 680 | \$ 628 | \$ 592 |
| Gas | 212 | 205 | 203 |
| TOTAL OPERATING REVENUES | 892 | 833 | 795 |
| OPERATING EXPENSES | | | |
| Purchased power | 238 | 217 | 198 |
| Gas purchased for resale | 88 | 76 | 69 |
| Operations and maintenance | 318 | 302 | 291 |
| Depreciation and amortization | 61 | 56 | 53 |
| Taxes, other than income taxes | 60 | 62 | 61 |
| TOTAL OPERATING EXPENSES | 765 | 713 | 672 |
| OPERATING INCOME | 127 | 120 | 123 |
| OTHER INCOME | | | |
| Investment and other income | 2 | - | - |
| Allowance for equity funds used during construction | 1 | 1 | 2 |
| TOTAL OTHER INCOME | 3 | 1 | 2 |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 130 | 121 | 125 |
| INTEREST EXPENSE | | | |
| Interest on long-term debt | 33 | 34 | 33 |
| Other interest | 3 | 4 | (2) |
| Allowance for borrowed funds used during construction | (1) | (1) | (1) |
| NET INTEREST EXPENSE | 35 | 37 | 30 |
| INCOME BEFORE INCOME TAX EXPENSE | 95 | 84 | 95 |
| INCOME TAX EXPENSE | 35 | 19 | 31 |
| NET INCOME | \$ 60 | \$ 65 | \$ 64 |

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, | | |
|---|----------------------------------|-------|-------|
| | 2014 | 2013 | 2012 |
| | (Millions of Dollars) | | |
| NET INCOME | \$ 60 | \$ 65 | \$ 64 |
| OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | | | |
| Pension and other postretirement benefit plan liability adjustments, net of taxes | (15) | 25 | 6 |
| TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | (15) | 25 | 6 |
| COMPREHENSIVE INCOME | \$ 45 | \$ 90 | \$ 70 |

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

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

| | For the Years Ended December 31, | | |
|--|----------------------------------|--------------|--------------|
| | 2014 | 2013 | 2012 |
| | (Millions of Dollars) | | |
| OPERATING ACTIVITIES | | | |
| Net income | \$ 60 | \$ 65 | \$ 64 |
| PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME | | | |
| Depreciation and amortization | 61 | 56 | 53 |
| Deferred income taxes | 27 | 3 | 90 |
| Other non-cash items (net) | (9) | 23 | 26 |
| CHANGES IN ASSETS AND LIABILITIES | | | |
| Accounts receivable - customers, less allowance for uncollectibles | (2) | (13) | 2 |
| Accounts receivable from affiliated companies | 36 | 22 | (61) |
| Materials and supplies, including gas in storage | 2 | (4) | 8 |
| Prepayments, other receivables and other current assets | - | (12) | - |
| Accounts payable | 2 | (65) | 44 |
| Accounts payable to affiliated companies | 1 | 15 | 9 |
| Pensions and retiree benefits obligations (net) | 75 | 25 | 54 |
| Pensions and retiree contributions | (40) | (59) | (66) |
| Accrued taxes | (10) | (1) | 2 |
| Accrued interest | - | (1) | (3) |
| Accrued wages | 1 | - | - |
| Superfund and environmental remediation costs (net) | (7) | (1) | (1) |
| Deferred charges, noncurrent assets and other regulatory assets | (9) | 20 | (79) |
| Deferred credits and other regulatory liabilities | 16 | 30 | (9) |
| Other current and noncurrent liabilities | 5 | 5 | 6 |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 209 | 108 | 139 |
| INVESTING ACTIVITIES | | | |
| Utility construction expenditures | (146) | (135) | (131) |
| Cost of removal less salvage | (6) | (7) | (5) |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (152) | (142) | (136) |
| FINANCING ACTIVITIES | | | |
| Net Issuance of short-term debt | 7 | 66 | 3 |
| Retirement of long-term debt | (4) | (3) | (3) |
| Dividend to parent | (40) | (38) | (34) |
| NET CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES | (37) | 25 | (34) |
| CASH AND TEMPORARY CASH INVESTMENTS: | | | |
| NET CHANGE FOR THE PERIOD | 20 | (9) | (31) |
| BALANCE AT BEGINNING OF PERIOD | 29 | 38 | 69 |
| BALANCE AT END OF PERIOD | \$ 49 | \$ 29 | \$ 38 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid/(refunded) during the period for: | | | |
| Interest | \$29 | \$30 | \$31 |
| Income taxes | \$9 | \$(35) | \$(5) |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION | | | |
| Construction expenditures in accounts payable | \$ 11 | \$ 15 | \$ 14 |

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

| | December 31, 2014 | December 31, 2013 |
|--|-----------------------|-------------------|
| | (Millions of Dollars) | |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and temporary cash investments | \$ 49 | \$ 29 |
| Special deposits | - | 4 |
| Accounts receivable - customers, less allowance for uncollectible accounts of \$4 in 2014 and 2013 | 71 | 69 |
| Other receivables, less allowance for uncollectible accounts of \$2 in 2014 and 2013 | 9 | 13 |
| Accrued unbilled revenue | 43 | 38 |
| Accounts receivable from affiliated companies | 15 | 51 |
| Gas in storage, at average cost | 16 | 20 |
| Materials and supplies, at average cost | 18 | 16 |
| Prepayments | 29 | 28 |
| Regulatory assets | 16 | 3 |
| Deferred tax assets - current | 24 | 17 |
| Other current assets | 5 | 7 |
| TOTAL CURRENT ASSETS | 295 | 295 |
| INVESTMENTS | 18 | 18 |
| UTILITY PLANT, AT ORIGINAL COST | | |
| Electric | 1,491 | 1,377 |
| Gas | 633 | 603 |
| General | 200 | 182 |
| Total | 2,324 | 2,162 |
| Less: Accumulated depreciation | 644 | 603 |
| Net | 1,680 | 1,559 |
| Construction work in progress | 60 | 91 |
| NET UTILITY PLANT | 1,740 | 1,650 |
| OTHER NONCURRENT ASSETS | | |
| Regulatory assets | 675 | 564 |
| Other deferred charges and noncurrent assets | 21 | 21 |
| TOTAL OTHER NONCURRENT ASSETS | 696 | 585 |
| TOTAL ASSETS | \$ 2,749 | \$ 2,548 |

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

| | December 31, 2014 | December 31, 2013 |
|--|-----------------------|-------------------|
| | (Millions of Dollars) | |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| CURRENT LIABILITIES | | |
| Long-term debt due within one year | \$ 143 | \$ 4 |
| Notes payable | 76 | 69 |
| Accounts payable | 69 | 70 |
| Accounts payable to affiliated companies | 24 | 23 |
| Customer deposits | 13 | 12 |
| Accrued taxes | 4 | 2 |
| Accrued taxes to affiliated companies | 6 | 18 |
| Accrued interest | 7 | 7 |
| Accrued wages | 11 | 10 |
| Fair value of derivative liabilities | 4 | 2 |
| Regulatory liabilities | 45 | 41 |
| Other current liabilities | 40 | 29 |
| TOTAL CURRENT LIABILITIES | 442 | 287 |
| NONCURRENT LIABILITIES | | |
| Provision for injuries and damages | 6 | 15 |
| Pensions and retiree benefits | 421 | 274 |
| Superfund and other environmental costs | 98 | 105 |
| Deferred income taxes and investment tax credits | 533 | 506 |
| Regulatory liabilities | 156 | 132 |
| Other deferred credits and noncurrent liabilities | 11 | 9 |
| TOTAL NONCURRENT LIABILITIES | 1,225 | 1,041 |
| LONG-TERM DEBT | 457 | 600 |
| COMMON SHAREHOLDER'S EQUITY (See Statement of Shareholder's Equity) | 625 | 620 |
| TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY | \$ 2,749 | \$ 2,548 |

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

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

| (Millions of Dollars/Except Share Data) | <u>Common Stock</u> | | Additional | Retained | Accumulated Other Comprehensive | Total |
|---|---------------------|--------|-----------------|----------|---------------------------------------|--------|
| | Shares | Amount | Paid-In Capital | Earnings | Income/(Loss) | |
| BALANCE AS OF DECEMBER 31, 2011 | 1,000 | \$ - | \$ 304 | \$ 277 | \$ (49) | \$ 532 |
| Net Income | | | | 64 | | 64 |
| Common stock dividend to parent | | | | (34) | | (34) |
| Other comprehensive income | | | | | 6 | 6 |
| BALANCE AS OF DECEMBER 31, 2012 | 1,000 | \$ - | \$ 304 | \$ 307 | \$ (43) | \$ 568 |
| Net Income | | | | 65 | | 65 |
| Common stock dividend to parent | | | | (38) | | (38) |
| Other comprehensive income | | | | | 25 | 25 |
| BALANCE AS OF DECEMBER 31, 2013 | 1,000 | \$ - | \$ 304 | \$ 334 | \$ (18) | \$ 620 |
| Net Income | | | | 60 | | 60 |
| Common stock dividend to parent | | | | (40) | | (40) |
| Other comprehensive loss | | | | | (15) | (15) |
| BALANCE AS OF DECEMBER 31, 2014 | 1,000 | \$ - | \$ 304 | \$ 354 | \$ (33) | \$ 625 |

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED STATEMENT OF CAPITALIZATION

| | Shares outstanding | | At December 31, | |
|---|-----------------------|-------|-----------------|---------------|
| | December 31, 2014 | 2013 | 2014 | 2013 |
| | (Millions of Dollars) | | | |
| TOTAL COMMON SHAREHOLDER'S EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS | 1,000 | 1,000 | \$ 640 | \$ 638 |
| TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, PENSION PLAN LIABILITY ADJUSTMENTS, NET OF TAXES | | | (15) | (18) |
| TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF SHAREHOLDER'S EQUITY) | | | \$ 625 | \$ 620 |

| LONG-TERM DEBT | Interest | | | |
|--|----------|--------|-----------------|-----------------|
| Maturity | Rate | Series | | |
| DEBENTURES: | | | | |
| 2015 | 5.30% | 2005A | \$ 40 | \$ 40 |
| 2015 | 2.50 | 2010A | 55 | 55 |
| 2016 | 5.45 | 2006A | 75 | 75 |
| 2018 | 6.15 | 2008A | 50 | 50 |
| 2019 | 4.96 | 2009A | 60 | 60 |
| 2027 | 6.50 | 1997F | 80 | 80 |
| 2039 | 6.00 | 2009B | 60 | 60 |
| 2040 | 5.50 | 2010B | 115 | 115 |
| TOTAL DEBENTURES | | | 535 | 535 |
| FIRST MORTGAGE BONDS: | | | | |
| 2018 | 7.07% | 1998C | 3 | 3 |
| TOTAL FIRST MORTGAGE BONDS | | | 3 | 3 |
| TRANSITION BONDS: | | | | |
| 2019* | 5.22% | 2004-1 | 18 | 22 |
| TOTAL TRANSITION BONDS | | | 18 | 22 |
| TAX-EXEMPT DEBT - Notes Issued to New York State Energy Research and Development Authority for Pollution Control Refunding Revenue Bonds**: | | | | |
| 2015 | 0.06% | 1995 | 44 | 44 |
| TOTAL TAX-EXEMPT DEBT | | | 44 | 44 |
| TOTAL | | | 600 | 604 |
| Less: Long-term debt due within one year | | | 143 | 4 |
| TOTAL LONG-TERM DEBT | | | 457 | 600 |
| TOTAL CAPITALIZATION | | | \$ 1,082 | \$ 1,220 |

* The final date to pay the entire remaining unpaid principal balance, if any, of all outstanding bonds is May 17, 2021.

** Rate are to be reset weekly; December 31, 2014 rate shown.

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 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 years ended December 31, 2014, 2013 and 2012, operating revenues for RECO and Pike were 20.0 percent and 1.2 percent, 21.6 percent and 1.0 percent and 23.8 percent and 0.9 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 has a subsidiary, Rockland Electric Company Transition Funding LLC (Transition Funding), which was formed in 2004 in connection with the securitization of certain purchased power costs. See "Long-Term Debt" in Note C.

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

The Company has, pursuant to the accounting rules for subsequent events, evaluated events or transactions that occurred after December 31, 2014 through the posting on its website (March 6, 2015) of the Annual Financial Statements for potential recognition or disclosure in the consolidated financial statements.

Note A – Summary of Significant Accounting Policies

Principles of Consolidation

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

Accounting Policies

The accounting policies of the Company conform to generally accepted accounting principles in the United States of America (GAAP). For the Company, these accounting principles include the accounting rules for regulated operations and the accounting requirements of the FERC and the state regulators having jurisdiction.

The accounting rules for regulated operations specify 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 the accounting rules for regulated operations. If revenues are recorded for costs that are expected to be incurred in the future, these revenues

Notes to the Financial Statements - Continued

would be recorded as deferred credits or “regulatory liabilities” under the accounting rules for regulated operations.

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 state regulators.

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 (AFUDC). 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 N.

Rates used for AFUDC 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 AFUDC rates for the Company were 2.6 percent, 5.7 percent and 7.0 percent for 2014, 2013 and 2012, 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 2.9 percent, 2.8 percent and 2.9 percent for 2014, 2013 and 2012, respectively.

The estimated lives for utility plant for the Company range from 5 to 75 years for electric and gas and 5 to 50 years for general plant.

Notes to the Financial Statements - Continued

At December 31, 2014 and 2013, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

| (Millions of Dollars) | 2014 | 2013 |
|-------------------------------|---------|---------|
| Electric | | |
| Transmission | \$212 | \$180 |
| Distribution | 830 | 780 |
| Gas* | 476 | 456 |
| General | 152 | 132 |
| Held for future use | 10 | 11 |
| Construction work in progress | 60 | 91 |
| Net Utility Plant | \$1,740 | \$1,650 |

* Primarily distribution.

Under O&R's rate plans, the aggregate annual depreciation allowance in effect at December 31, 2014 was \$55 million.

Impairments

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 are written down to their estimated fair value. No impairment charges were recognized in 2014, 2013 or 2012.

Revenues

The Company recognizes revenues for energy service on a monthly billing cycle basis. The Company defers over a 12-month period net interruptible gas revenues, other than those authorized by the NYSPSC 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, 2014 and 2013 were \$43 million and \$38 million, respectively.

O&R's New York electric and gas rate plans each contain a revenue decoupling mechanism under which the Company's actual energy delivery revenues are compared with the authorized delivery revenues and the difference accrued, with interest, for refund to, or recovery from, customers, as applicable. See "Rate Plans" in Note B.

O&R and Pike are required to record gross receipts tax and RECO was 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. O&R and Pike recorded \$8.8 million and \$0.5 million, \$8.4 million and \$0.4 million, and \$8.3 million and \$0.3 million, of gross receipts tax in 2014, 2013 and 2012,

Notes to the Financial Statements - Continued

respectively. RECO recorded \$3.2 million and \$4.6 million in TEFA tax in 2013 and 2012, respectively. The TEFA tax is no longer assessed by the State of New Jersey as of January 1, 2014.

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. 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 independent system operator, PJM Interconnection LLC (PJM). 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.

Pike bills its customers for the electricity it supplies to them based on a default service rate approved by the PAPUC. Pike defers the difference between actual and billed electric supply costs to charge or refund customers during the next billing cycle (normally within one or two months) through a default service supply adjustment charge.

New York Independent System Operator (NYISO)

O&R purchases electricity for all of its New York and Pennsylvania requirements and a portion of its New Jersey needs through the wholesale electricity market administered by the 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.

Notes to the Financial Statements - Continued

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 cash surrender value and include the supplemental retirement income plan's corporate-owned life insurance assets.

Pension and Other Postretirement Benefits

The accounting rules for retirement benefits require 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 accounting rules generally require 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.

For O&R pension and other postretirement benefits and Pike other postretirement benefits, regulatory accounting treatment is applied in accordance with the accounting rules for regulated operations. RECO pension and other postretirement benefits and Pike pension benefits do not have regulatory accounting treatment. For benefits subject to regulatory accounting treatment, unrecognized prior service costs or credits and unrecognized actuarial gains and losses are recorded to regulatory assets or liabilities, rather than OCI. See Notes E and F.

The net periodic benefit costs are recognized in accordance with the accounting rules for retirement benefits. Investment gains and losses are recognized in expense over a 15-year period and other actuarial gains and losses are recognized in expense over a 10-year period, subject to the deferral provisions in the rate plans.

In accordance with the Statement of Policy issued by the NYSPSC and its current electric and gas rate plans, O&R defers for payment to or recovery from customers the difference between such expenses for the Company's New York business and the amounts for such expenses reflected in O&R's rates. Pike has a similar deferral provision for its other postretirement benefits plan. The rate plans for RECO and Pike do not have comparable deferral provisions for RECO's retirement benefits and Pike's pension plan. See Note B – Regulatory Matters.

Notes to the Financial Statements - Continued

The Company calculates the expected return on pension and other postretirement benefit plan assets by multiplying the expected rate of return on plan assets by the market-related value (MRV) of plan assets at the beginning of the year, taking into consideration anticipated contributions and benefit payments that are to be made during the year. The accounting rules allow the MRV of plan assets to be either fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. The Company uses a calculated value when determining the MRV of the plan assets that adjusts for 20 percent of the difference between fair value and expected MRV of plan assets. This calculated value has the effect of stabilizing variability in assets to which the Company applies the expected return.

Federal Income Tax

In accordance with the accounting rules for income taxes, the Company has recorded an accumulated deferred federal income tax liability for temporary differences between the book and tax basis of assets and liabilities at current tax rates. In accordance with rate plans, O&R has recovered amounts from customers for a portion of the tax liability it 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 the accounting rules for regulated operations, 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 I. In 1993, the NYSPSC issued a Policy Statement approving accounting procedures consistent with the accounting rules for income taxes and providing assurances that these future increases in taxes will be recoverable in rates. See Note I.

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 federal 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 among members of the consolidated group. Tax loss carryforwards are allocated among members in accordance with consolidated tax return regulations.

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. Each member’s share of the New York State tax is based on its own New York State taxable income or loss.

RECO files a New Jersey Corporate Income Tax Return. The income of RECO is subject to New Jersey State taxation, after adjustments for differences between federal and New Jersey law.

Notes to the Financial Statements - Continued

Pike files a Pennsylvania Corporate Net Income Tax Return. The income of Pike is subject to Pennsylvania taxation, after adjustments for differences between federal and Pennsylvania law.

Reclassification

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

Estimates

The preparation of financial statements in conformity with GAAP 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.

Changes in Accumulated Other Comprehensive Income by Component

Changes to accumulated OCI are as follows:

| (Millions of Dollars) | |
|--|--------|
| Accumulated OCI, net of taxes, at December 31, 2012 | \$(43) |
| OCI before reclassifications, net of tax of \$(13) | 19 |
| Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(4)(a)(b) | 6 |
| Total OCI, net of taxes, at December 31, 2013 | 25 |
| Accumulated OCI, net of taxes, at December 31, 2013(b) | \$(18) |
| OCI before reclassifications, net of tax of \$14 | (20) |
| Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(3)(a)(b) | 5 |
| Total OCI, net of taxes, at December 31, 2014 | (15) |
| Accumulated OCI, net of taxes, at December 31, 2014(b) | \$(33) |

(a) Only RECO's portion of unrecognized pension and other postretirement benefit costs and Pike's portion of unrecognized pension costs are recorded into, and amortized out of, OCI. All other such costs are recorded through regulatory assets. The net actuarial losses and prior service costs recognized during the period are included in the computation of net periodic pension and other postretirement benefit cost. See Notes E and F.

(b) Tax reclassified from accumulated OCI is reported in the income tax expense line item of the income statement.

Note B – Regulatory Matters

Rate Plans

The Company provides service to New York customers according to the terms of tariffs approved by the NYSPSC. Tariffs for service to customers of the Company's New Jersey and Pennsylvania regulated utility subsidiaries are approved by utility regulators in those states. The tariffs include schedules of rates for service that limit the rates charged by the Company to amounts that recover from its customers costs approved by the regulator, including capital costs, of providing service to customers as defined by the tariff. The tariffs implement rate plans adopted by state utility regulators in rate orders issued at the conclusion of rate proceedings.

Pursuant to the Company's rate plans, there generally can be no change to the charges to customers during the respective terms of the rate plans other than specified adjustments provided for in the rate plans. The Company's rate plans each cover specified periods, but rates determined pursuant to a plan generally continue in effect until a new rate plan is approved by the state utility regulator.

Notes to the Financial Statements - Continued

Common provisions of the Company's rate plans include:

Recoverable energy costs that allows the Company to recover on a current basis the costs for the energy it supplies with no mark-up to their full-service customers.

Cost reconciliations that reconcile pension and other postretirement benefit costs, environmental remediation costs, property taxes, variable rate tax-exempt debt and certain other costs to amounts reflected in delivery rates for such costs. The Company generally retains the right to petition for recovery or accounting deferral of extraordinary and material cost increases for items such as major storm events and provision is sometimes made for the utility to retain a share of cost reductions, for example, property tax refunds.

Revenue decoupling mechanisms that reconcile actual energy delivery revenues to the authorized delivery revenues approved by the NYSPSC. The difference is accrued with interest for refund to, or recovery from customers, as applicable.

Earnings sharing that requires the Company to defer for customer benefit a portion of earnings over specified rates of return on common equity. There is no symmetric mechanism for earnings below specified rates of return on common equity.

Negative revenue adjustments for failure to meet certain performance standards relating to service, reliability, safety and other matters.

Net utility plant reconciliations that require deferral as a regulatory liability of the revenue requirement impact of the amount, if any, by which actual average net utility plant balances are less than amounts reflected in rates.

Rate base is, in general, the sum of the Company's net plant and working capital less deferred taxes. For each rate plan, the NYSPSC uses a forecast of the average rate base for each year that new rates would be in effect ("rate year"). The NJBPU and the PAPUC use the rate base balances that would exist at the beginning of the rate year.

Weighted average cost of capital is determined based on the authorized common equity ratio, return on common equity, cost of long-term debt and customer deposits reflected in each rate plan. For each rate plan, the revenues designed to provide the utility a return on invested capital for each rate year is determined by multiplying the Company's rate base by the utility's pre-tax weighted average cost of capital. The Company's actual return on common equity will reflect its actual operations for each rate year, and may be more or less than the authorized return on equity reflected in its rate plan (and if more, may be subject to earnings sharing).

Notes to the Financial Statements - Continued

The following tables contain a summary of the Company's rate plans:

O&R New York - Electric

| | |
|--|---|
| Effective period | July 2012 – June 2015 |
| Base rate changes | Yr. 1 - \$19.4 million Yr. 2 - \$8.8 million Yr. 3 - \$15.2 million |
| Amortizations to income of net regulatory (assets) and liabilities | \$(32.2) million over three years |
| Revenue decoupling mechanisms | In 2012, 2013 and 2014, the Company deferred for the customer's benefit \$2.6 million, \$3.2 million and (\$3.4) million, respectively. |
| Recoverable energy costs | Current rate recovery of purchased power and fuel costs. |
| Negative revenue adjustments | Potential penalties (up to \$3 million annually) if certain customer service and system reliability performance targets are not met. In 2012, 2013 and 2014, the Company did not record any negative revenue adjustments. |
| Cost reconciliations | In 2012, 2013 and 2014, the Company deferred \$7.8 million, \$4.1 million and \$(0.2) million as a net increase (decrease) to regulatory assets, respectively. |
| Net utility plant reconciliations | Target levels reflected in rates were: Yr. 1 - \$678 million; Yr. 2 - \$704 million; Yr. 3 - \$753 million The Company increased its regulatory liability by \$4.2 million in 2012. The Company reduced its regulatory liability by \$1.1 million and \$2.3 million in 2013 and 2014, respectively. |
| Average rate base | Yr. 1 – \$671 million Yr. 2 – \$708 million Yr. 3 – \$759 million |
| Weighted average cost of capital (after-tax) | Yr. 1 – 7.61 percent Yr. 2 – 7.65 percent Yr. 3 – 7.48 percent |
| Authorized return on common equity | Yr. 1 – 9.4 percent Yr. 2 – 9.5 percent Yr. 3 – 9.6 percent |
| Earnings sharing | The Company recorded a regulatory liability of \$1 million for earnings above the sharing threshold under the rate plan as of December 31, 2014. |
| Cost of long-term debt | Yr. 1 – 6.07 percent Yr. 2 – 6.07 percent Yr. 3 – 5.64 percent |
| Common equity ratio | 48 percent |

On November 14, 2014, O&R filed a request with the NYSPSC for an increase in the rates it charges for electric service rendered in New York, effective November 1, 2015, of \$33.4 million. The filing reflects a return on common equity of 9.75 percent and a common equity ratio of 48 percent. The filing proposes continuation of the current provisions with respect to recovery from customers of the cost of purchased power, and the reconciliation of actual expenses allocable to the electric business to the amounts for such costs reflected in electric rates for storm costs, pension and other postretirement benefit costs, environmental remediation and property taxes.

Notes to the Financial Statements - Continued

O&R New York - Gas

| | |
|---|--|
| Effective period | November 2009 – December 2014 |
| Base rate changes | Yr. 1 - \$9 million Yr. 2 - \$9 million Yr. 3 - \$4.6 million Yr. 3 - \$4.3 million collected through a surcharge |
| Amortization to income of net regulatory (assets) and liabilities | \$(2) million over three years |
| Revenue decoupling mechanisms | In 2012, 2013 and 2014, the Company deferred \$4.7 million, \$0.7 million and \$(0.1) million of regulatory liabilities, respectively. |
| Recoverable energy costs | Current rate recovery of purchased gas costs. |
| Negative revenue adjustments | Potential penalties (up to \$1.4 million annually) if certain operations and customer service requirements are not met. In 2012, 2013 and 2014, the Company did not record any negative revenue adjustments. |
| Cost reconciliations | In 2012, 2013 and 2014, the Company deferred \$0.7 million, \$8.3 million and \$8.3 million as net regulatory assets, respectively. |
| Net utility plant reconciliations | The Company deferred \$0.7 million in 2012 as a regulatory asset and no deferrals were recorded in 2013 or 2014. |
| Average rate base | Yr. 1 - \$280 million Yr. 2 - \$296 million Yr. 3 - \$309 million |
| Weighted average cost of capital (after-tax) | 8.49 percent |
| Authorized return on common equity | 10.4 percent |
| Earnings sharing | Earnings above an annual earnings threshold of 11.4 percent are to be applied to reduce regulatory assets. In 2012, 2013 and 2014, earnings did not exceed the earnings threshold. |
| Cost of long-term debt | 6.81 percent |
| Common equity ratio | 48 percent |

On November 14, 2014, O&R filed a request with the NYSPSC for an increase in the rates it charges for gas service rendered in New York, effective November 1, 2015, of \$40.7 million. The filing reflects a return on common equity of 9.75 percent and a common equity ratio of 48 percent. The filing proposes continuation of the current provisions with respect to recovery from customers of the cost of purchased gas, and the reconciliation of actual expenses allocable to the gas business to the amounts for such costs reflected in gas rates for pension and other postretirement benefit costs, environmental remediation and property taxes.

RECO

| | | |
|---|---|---|
| Effective period | May 2010 - July 2014 | August 2014 – July 2015 |
| Base rate changes | Yr. 1 - \$9.8 million | Yr. 1 - \$13.0 million |
| Amortization to income of net regulatory (assets) and liabilities | \$(3.9) million over four years and \$(4.9) million of deferred storm costs over five years | \$0.4 million over three years and \$(25.6) million of deferred storm costs over four years |
| Recoverable energy costs | Current rate recovery of purchased power costs. | Continuation of current rate recovery of purchased power costs. |
| Cost reconciliations | None | None |
| Average rate base | \$148.6 million | \$172.2 million |
| Weighted average cost of capital (after-tax) | 8.21 percent | 7.83 percent |
| Authorized return on common equity | 10.3 percent | 9.75 percent |
| Cost of long-term debt | 6.16 percent | 5.89 percent |
| Common equity ratio | 50 percent | 50 percent |

Notes to the Financial Statements - Continued

Pike – Electric

| | | |
|---|---|--|
| Effective period | April 2009 – August 2014 | September 2014 – August 2015 |
| Base rate changes(a) | Yr. 1 - \$0.9 million | Yr. 1 - \$1.25 million |
| Amortization to income of net regulatory (assets) and liabilities | \$0.1 million over 5 years | \$(0.7) million of deferred storm costs over five years |
| Cost reconciliations | True-up of Other Postretirement Benefits costs. The company deferred an immaterial amount as regulatory liabilities in 2012 and 2013. | True-up of Other Postretirement Benefits costs. The company deferred an immaterial amount as a regulatory liability in 2014. |

(a) Under the current plan, the earliest that Pike can file for a new base rate change is September 1, 2016.

Pike - Gas

| | | |
|---|---|--|
| Effective period | April 2009 - August 2014 | September 2014 – August 2015 |
| Base Rate changes(a) | Yr. 1 - \$0.3 million | Yr. 1 - \$0.1 million |
| Amortization to income of net regulatory (assets) and liabilities | None | None |
| Cost reconciliations | True-up of Other Postretirement Benefits costs. The company deferred an immaterial amount as regulatory liabilities in 2012 and 2013. | True-up of Other Postretirement Benefits costs. The company deferred an immaterial amount as a regulatory liability in 2014. |

(a) Under the current plan, the earliest that Pike can file for a new base rate change is September 1, 2016.

Other Regulatory Matters

In late October 2012, Superstorm Sandy caused extensive damage to the Company's electric distribution system and interrupted service to approximately 0.3 million customers. As of December 31, 2014, O&R incurred response and restoration costs for Superstorm Sandy of \$91 million (including capital expenditures of \$15 million). Most of the costs that were not capitalized were deferred for recovery as a regulatory asset under the Company's electric rate plans. See "Regulatory Assets and Liabilities" below. In November 2014, O&R requested recovery of deferred storm costs for its New York electric operations, which are subject to NYSPSC review. RECO's current electric rate plan includes collection from customers of deferred storm costs. See "Rate Plans" above.

In June 2014, the NYSPSC initiated a proceeding to investigate the practices of qualifying persons to perform plastic fusions on gas facilities. New York State regulations require gas utilities to qualify and, except in certain circumstances, annually requalify workers that perform fusion to join plastic pipe. The NYSPSC directed the New York gas utilities to provide information in this proceeding about their compliance with the qualification and requalification requirements and related matters; their procedures for compliance with all gas safety regulations; and their annual chief executive officer certifications regarding these and other procedures. O&R had not timely requalified certain workers that had been qualified under its procedures to perform fusion to join plastic pipe. O&R has requalified its workers who perform plastic pipe fusions. In October 2014, O&R submitted for NYSPSC staff review its plans for testing plastic pipe fusions that were performed on its gas delivery system, additional leakage surveying and reporting.

Notes to the Financial Statements - Continued

Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2014 and 2013 were comprised of the following items:

| (Millions of Dollars) | 2014 | 2013 |
|---|--------------|--------------|
| Regulatory assets | | |
| Unrecognized pension and other postretirement costs | \$237 | \$120 |
| Future income tax | 108 | 114 |
| Environmental remediation costs | 105 | 108 |
| Deferred storm costs | 95 | 107 |
| Property tax reconciliation | 36 | 22 |
| Transition bond charges | 27 | 33 |
| Pension and other postretirement benefits deferrals | 24 | 29 |
| Revenue taxes | 12 | 11 |
| Surcharge for New York State assessment | 7 | 4 |
| Deferred derivative losses – noncurrent | 2 | 1 |
| Other | 22 | 15 |
| Regulatory assets – noncurrent | 675 | 564 |
| Future income taxes - current | 10 | - |
| Deferred derivative losses - current | 5 | 3 |
| Recoverable energy costs - current | 1 | - |
| Regulatory assets - current | 16 | 3 |
| Total regulatory assets | \$691 | \$567 |
| Regulatory liabilities | | |
| Allowance for cost of removal less salvage | \$98 | \$87 |
| Carrying charges on deferred tax liability | 17 | 10 |
| Other postretirement benefit deferrals | 10 | 2 |
| Carrying charges on net utility plant reconciliations | 1 | 8 |
| Other | 30 | 25 |
| Regulatory liabilities – noncurrent | 156 | 132 |
| Refundable energy cost – current | 45 | 34 |
| Revenue decoupling mechanisms | - | 4 |
| Deferred derivative gains - current | - | 3 |
| Regulatory liabilities – current | 45 | 41 |
| Total regulatory liabilities | \$201 | \$173 |

Unrecognized pension and other postretirement costs represents the net regulatory asset associated with the accounting rules for retirement benefits. See Note A.

Deferred storm costs represent response and restoration costs, other than capital expenditures, in connection with Superstorm Sandy and other major storms that were deferred by the Company under its New York electric rate plan. See “Other Regulatory Matters,” above.

Note C – Capitalization

Common Stock

At December 31, 2014 and 2013, all of the outstanding common stock (\$5.00 par value) of the Company was owned by Con Edison. In accordance with NYSPSC 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.

Notes to the Financial Statements - Continued

Long-term Debt

Long-term debt maturing in the period 2015-2019 is as follows:

| (Millions of Dollars) | |
|------------------------------|-------|
| 2015 | \$143 |
| 2016 | 79 |
| 2017 | 4 |
| 2018 | 58 |
| 2019 | 62 |

O&R has issued \$44 million of tax-exempt debt through the New York State Energy Research and Development Authority (NYSERDA) that currently bears interest at a rate determined weekly and is subject to tender by bondholders for purchase by the Company.

The carrying amounts and fair values of long-term debt at December 31, 2014 and 2013 are:

| (Millions of Dollars) | 2014 | | 2013 | |
|--|-----------------|------------|-----------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Long-Term Debt (including current portion) | \$600 | \$689 | \$604 | \$650 |

Fair values of long-term debt have been estimated primarily using available market information.

At December 31, 2014 and 2013, long-term debt of the Company included \$3 million of mortgage bonds, collateralized by substantially all utility plant and other physical property of Pike. Long-term debt also included \$18 million and \$22 million at December 31, 2014 and 2013, respectively, of Transition Bonds issued by Transition Funding in July 2004. The proceeds from the Transition Bonds were used to purchase from RECO the right to be paid a Transition Bond Charge and associated tax charges by its customers relating to previously deferred purchased power costs for which the NJBPU had authorized recovery.

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 was in compliance with its significant debt covenants at December 31, 2014.

The tax-exempt financing arrangements involved the issuance of an uncollateralized promissory note 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, including covenants with respect to the use of the facilities financed. The arrangements include provisions for the maintenance of liquidity and credit facilities,

Notes to the Financial Statements - Continued

the failure to comply with which would, except as otherwise provided, constitute an event of default with respect to the debt.

The failure to comply with debt covenants would, except as otherwise provided, constitute an event of default for 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 provisions 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 Company 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. The liquidity facility also includes as an event of default, defaults in payments of other debt obligations in excess of \$12.5 million.

Note D – Short-Term Borrowing

In October 2011, O&R, along with Con Edison and CECONY, entered into a credit agreement (Credit Agreement), under which banks are committed to provide loans and letters of credit on a revolving credit basis. The Credit Agreement, as amended in 2013, expires in October 2017. There is a maximum of \$200 million of credit available to O&R (subject to increase to \$250 million of credit if the necessary regulatory approvals are requested and obtained). The Credit Agreement supports the Company's commercial paper programs. The Company has not borrowed under the Credit Agreement. At December 31, 2014 and 2013, O&R had \$76 million and \$69 million of commercial paper outstanding, respectively. At December 31, 2014 and 2013, an immaterial amount and \$15 million of letters of credit, respectively, were outstanding for O&R under the Credit Agreement.

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 the Company, the banks may terminate their commitments with respect to the Company, declare any amounts owed by the Company under the Credit Agreement immediately due and payable and require the Company to provide cash collateral relating to the letters of credit issued for it under the Credit Agreement. 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, 2014 this ratio was 0.51 to 1 for O&R); having liens on its assets in an aggregate amount exceeding five percent of its consolidated total capital, subject to certain exceptions; and the failure, following any applicable notice period, to meet certain other customary covenants. Interest and fees charged for the revolving credit facilities and any loans made or letters of credit issued under the Credit Agreement reflect the Company's credit ratings. The Company was in compliance with its covenants at December 31, 2014.

See Note O for information about short-term borrowing between related parties.

Notes to the Financial Statements - Continued

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 CECONY 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 supplemental pension plans.

Net Periodic Benefit Cost

The components of the Company's total periodic benefit costs for 2014, 2013 and 2012 were as follows:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|--|-------------|-------------|-------------|
| Service cost – including administrative expenses | \$15 | \$18 | \$16 |
| Interest cost on projected benefit obligation | 36 | 33 | 34 |
| Expected return on plan assets | (42) | (37) | (34) |
| Recognition of net actuarial loss | 32 | 44 | 38 |
| Recognition of prior service costs | 2 | 2 | 2 |
| TOTAL PERIODIC BENEFIT COST | \$43 | \$60 | \$56 |
| Cost capitalized | (13) | (21) | (17) |
| Reconciliation to rate level | 10 | 3 | 4 |
| Cost charged to operating expenses | \$40 | \$42 | \$43 |

Funded Status

The funded status at December 31, 2014, 2013 and 2012 was as follows:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|--|----------------|----------------|----------------|
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | | |
| Projected benefit obligation at beginning of year | \$763 | \$830 | \$748 |
| Service cost – excluding administrative expenses | 15 | 17 | 15 |
| Interest cost on projected benefit obligation | 36 | 33 | 35 |
| Net actuarial (gain)/loss | 156 | (81) | 67 |
| Plan amendments | 6 | - | - |
| Benefits paid | (38) | (36) | (35) |
| PROJECTED BENEFIT OBLIGATION AT END OF YEAR | \$938 | \$763 | \$830 |
| CHANGE IN PLAN ASSETS | | | |
| Fair value of plan assets at beginning of year | \$552 | \$463 | \$389 |
| Actual return on plan assets | 37 | 68 | 54 |
| Employer contributions | 43 | 59 | 56 |
| Benefits paid | (38) | (36) | (35) |
| Administrative expenses | (2) | (2) | (1) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | \$592 | \$552 | \$463 |
| FUNDED STATUS | \$(346) | \$(211) | \$(367) |
| Unrecognized net loss | \$270 | \$141 | \$295 |
| Unrecognized prior service costs | 15 | 11 | 12 |
| Accumulated benefit obligation | 895 | 731 | 790 |

In 2014, the Company amended its pension plan to reflect changes in the collective bargaining agreement covering certain O&R employees, resulting in an increase in the obligation of \$6 million.

The increase in the pension plan's projected benefit obligation (due primarily to decreased discount rates and, as discussed below, the release of new mortality tables by the Society of Actuaries reflecting longer life expectancies) was the primary cause of the increased pension liability at O&R of \$135 million compared with December 31, 2013. This increase in pension liability resulted in an increase to regulatory assets of \$109 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility

Notes to the Financial Statements - Continued

business consistent with the accounting rules for regulated operations, a charge to OCI of \$14 million (net of taxes) for the unrecognized net losses, and a charge to OCI of \$1 million (net of taxes) for the unrecognized prior service costs associated with O&R's New Jersey and Pennsylvania utility subsidiaries.

A portion of the unrecognized net loss and prior service cost for the pension plan, equal to \$41 million and \$2 million, respectively, will be recognized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R.

At December 31, 2014 and 2013, the Company's investments included \$18 million held in external trust accounts for benefit payments pursuant to the supplemental retirement plans. See Note M. The accumulated benefit obligations for the supplemental retirement plans for O&R were \$39 million and \$35 million as of December 31, 2014 and 2013, respectively.

Assumptions

The actuarial assumptions were as follows:

| | 2014 | 2013 | 2012 |
|---|-------|-------|-------|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount rate | 3.90% | 4.80% | 4.10% |
| Rate of compensation increase | 4.00% | 4.25% | 4.25% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount rate | 4.80% | 4.10% | 4.70% |
| Expected return on plan assets | 8.00% | 8.00% | 8.00% |
| Rate of compensation increase | 4.25% | 4.25% | 4.25% |

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.

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 (Aa or higher by either Moody's Investors Service or Standard & Poor's) 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 percent and 200 percent of the original price, the yield must lie between 1 percent and 20 percent, and the amount of the bond issue outstanding must be in excess of \$50 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.

Notes to the Financial Statements - Continued

Expected Benefit Payments

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

| (Millions of Dollars) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020-2024 |
|-----------------------|------|------|------|------|------|-----------|
| O&R | \$40 | \$41 | \$43 | \$44 | \$46 | \$253 |

Expected Contributions

Based on estimates as of December 31, 2014, O&R expects to make contributions to the pension plan during 2015 of \$53 million. O&R's policy is to fund the total periodic benefit cost of the qualified plan to the extent tax deductible.

Plan Assets

The asset allocations for the pension plan at the end of 2014, 2013 and 2012, and the target allocation for 2015 are as follows:

| Asset Category | Target Allocation Range | Plan Assets at December 31, | | | |
|-------------------|-------------------------|-----------------------------|------|------|--|
| | 2015 | 2014 | 2013 | 2012 | |
| Equity Securities | 55% - 65% | 58% | 60% | 60% | |
| Debt Securities | 27% - 33% | 32% | 30% | 31% | |
| Real Estate | 8% - 12% | 10% | 10% | 9% | |
| 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 participants and beneficiaries and payment of plan expenses.

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 pension plan's 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 investment objectives of the Con Edison pension plan are to maintain a level and form of assets adequate to meet benefit obligations to participants, to achieve the expected long-term total return on the trust assets within a prudent level of risk and maintain a level of volatility that is not expected to have a material impact on the Company's expected contribution and expense or the Company's ability to meet plan obligations. The assets of the plan have no significant concentration of risk in one country (other than the United States), industry or entity.

The strategic asset allocation is intended to meet the objectives of the pension plan by diversifying its funds across asset classes, investment styles and fund managers. An asset/liability study typically is conducted every few years to determine whether the current strategic asset allocation continues to represent the appropriate balance of expected risk and reward for the plan to meet expected liabilities. Each study considers the

Notes to the Financial Statements - Continued

investment risk of the asset allocation and determines the optimal asset allocation for the plan. The target asset allocation for 2015 reflects the results of such a study conducted in 2011.

Individual fund 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. Con Edison management regularly monitors, and the named fiduciaries review and report to the Committee regarding, asset class performance, total fund performance, and compliance with asset allocation guidelines. Management changes fund managers and rebalances the portfolio as appropriate. At the direction of the named fiduciaries, such changes are reported to the Committee.

The pension plan is one tax-qualified plan for Con Edison and its subsidiaries. O&R employee benefits are paid out of the assets detailed below which represent the assets of the entire plan.

Assets measured at fair value on a recurring basis are summarized below under a three-level hierarchy as defined by the accounting rules for fair value measurements (see Note M).

The fair values of the pension plan assets at December 31, 2014 by asset category are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|--|---------|---------|---------|----------|
| U.S. Equity(a) | \$3,168 | \$- | \$- | \$3,168 |
| International Equity(b) | 2,841 | 361 | - | 3,202 |
| Private Equity(c) | - | - | 114 | 114 |
| U.S. Government Issued Debt(d) | - | 2,113 | - | 2,113 |
| Corporate Bonds Debt(e) | - | 1,351 | - | 1,351 |
| Structured Assets Debt(f) | - | 4 | - | 4 |
| Other Fixed Income Debt(g) | - | 208 | - | 208 |
| Real Estate(h) | - | - | 1,137 | 1,137 |
| Cash and Cash Equivalents(i) | 188 | 477 | - | 665 |
| Futures(j) | 192 | 37 | - | 229 |
| Hedge Funds(k) | - | - | 224 | 224 |
| Total investments | \$6,389 | \$4,551 | \$1,475 | \$12,415 |
| Funds for retiree health benefits(l) | (184) | (131) | (43) | (358) |
| Investments(excluding funds for retiree health benefits) | \$6,205 | \$4,420 | \$1,432 | \$12,057 |
| Pending activities(m) | | | | (562) |
| Total fair value of plan net assets | | | | \$11,495 |

- (a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and actively-managed small-capitalization equities.
- (b) International Equity includes international equity index funds and actively-managed international equities.
- (c) Private Equity consists of global equity funds that are not exchange-traded.
- (d) U.S. Government Issued Debt includes agency and treasury securities.
- (e) Corporate Bonds Debt consists of debt issued by various corporations.
- (f) Structured Assets Debt includes commercial-mortgage-backed securities and collateralized mortgage obligations.
- (g) Other Fixed Income Debt includes municipal bonds, sovereign debt and regional governments.
- (h) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.
- (i) Cash and Cash Equivalents include short term investments, money markets, foreign currency and cash collateral.
- (j) Futures consist of exchange-traded financial contracts encompassing U.S. Equity, International Equity and U.S. Government indices.
- (k) Hedge Funds are within a commingled structure which invests in various hedge fund managers who can invest in all financial instruments.
- (l) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Company's other postretirement benefit obligation. The net assets held in the 401(h) account are applicable entirely to CECONY.
- (m) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received and reflects adjustments for available estimates at year end.

Notes to the Financial Statements - Continued

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2014 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2014 | Assets Still Held at Reporting Date – Unrealized Gains/(Losses) | Assets Sold During the Year – Realized Gains/(Losses) | Purchases Sales and Settlements | Transfer In/(Out) of Level 3 | Ending Balance as of December 31, 2014 |
|---|---|--|--|---------------------------------------|------------------------------------|---|
| Real Estate | \$1,062 | \$86 | \$20 | \$(31) | \$- | \$1,137 |
| Private Equity | 67 | 12 | - | 35 | - | 114 |
| Hedge Funds | 206 | 11 | - | 7 | - | 224 |
| Total investments | \$1,335 | \$109 | \$20 | \$11 | \$- | \$1,475 |
| Funds for retiree health benefits | (42) | (1) | - | - | - | (43) |
| Investments (excluding funds for retiree health benefits) | \$1,293 | \$108 | \$20 | \$11 | \$- | \$1,432 |

The fair values of the pension plan assets at December 31, 2013 by asset category are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|--|---------|---------|---------|----------|
| U.S. Equity(a) | \$3,057 | \$- | \$- | \$3,057 |
| International Equity(b) | 2,303 | 871 | - | 3,174 |
| Private Equity(c) | - | - | 67 | 67 |
| U.S. Government Issued Debt(d) | - | 1,855 | - | 1,855 |
| Corporate Bonds Debt(e) | - | 1,151 | - | 1,151 |
| Structured Assets Debt(f) | - | 4 | - | 4 |
| Other Fixed Income Debt(g) | - | 150 | - | 150 |
| Real Estate(h) | - | - | 1,062 | 1,062 |
| Cash and Cash Equivalents(i) | 127 | 558 | - | 685 |
| Futures(j) | 348 | - | - | 348 |
| Hedge Funds(k) | - | - | 206 | 206 |
| Total investments | \$5,835 | \$4,589 | \$1,335 | \$11,759 |
| Funds for retiree health benefits(l) | (185) | (145) | (42) | (372) |
| Investments(excluding funds for retiree health benefits) | \$5,650 | \$4,444 | \$1,293 | \$11,387 |
| Pending activities(m) | - | - | - | (632) |
| Total fair value of plan net assets | - | - | - | \$10,755 |

- (a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and actively-managed small-capitalization equities.
- (b) International Equity includes international equity index funds and actively-managed international equities.
- (c) Private Equity consists of global equity funds that are not exchange-traded.
- (d) U.S. Government Issued Debt includes agency and treasury securities.
- (e) Corporate Bonds Debt consists of debt issued by various corporations.
- (f) Structured Assets Debt includes commercial-mortgage-backed securities and collateralized mortgage obligations.
- (g) Other Fixed Income Debt includes municipal bonds, sovereign debt and regional governments.
- (h) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.
- (i) Cash and Cash Equivalents include short term investments, money markets, foreign currency and cash collateral.
- (j) Futures consist of exchange-traded financial contracts encompassing U.S. Equity, International Equity and U.S. Government indices.
- (k) Hedge Funds are within a commingled structure which invests in various hedge fund managers who can invest in all financial instruments.
- (l) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Company's other postretirement benefit obligation. The net assets held in the 401(h) account are applicable entirely to CECONY.
- (m) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received and reflects adjustments for available estimates at year end.

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2013 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2013 | Assets Still Held at Reporting Date – Unrealized Gains/(Losses) | Assets Sold During the Year – Realized Gains/(Losses) | Purchases Sales and Settlements | Transfer In/(Out) of Level 3 | Ending Balance as of December 31, 2013 |
|---|---|--|--|---------------------------------------|------------------------------------|---|
| Real Estate | \$833 | \$114 | \$1 | \$114 | \$- | \$1,062 |
| Private Equity | 20 | 5 | - | 42 | - | 67 |
| Hedge Funds | - | 6 | - | 200 | - | 206 |
| Total investments | \$853 | \$125 | \$1 | \$356 | \$- | \$1,335 |
| Funds for retiree health benefits | (31) | (3) | - | (8) | - | (42) |
| Investments (excluding funds for retiree health benefits) | \$822 | \$122 | \$1 | \$348 | \$- | \$1,293 |

Notes to the Financial Statements - Continued

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) | 2014 | 2013 | 2012 |
| O&R | \$3 | \$3 | \$2 |

Mortality Table Revision

The Company adopted revised mortality tables effective December 31, 2014 in the measurement of its pension and other postretirement benefit plan obligations, accounting costs and required contribution amounts. The revised tables reflect the RP-2014 mortality tables published by the Society of Actuaries in October 2014, as adjusted based on the actual experience of the Company. The new tables incorporate substantial life expectancy improvements relative to the last tables published in 2000 (RP-2000). As a result of the adoption, O&R recognized an increase in its pension benefit obligation of approximately \$50 million as of December 31, 2014. The Company, under its current New York rate plans, defers as a regulatory asset or liability, as the case may be, the differences between the actual level of expenses for pension and other postretirement benefits and amounts for those expenses reflected in rates.

Note F – Other Postretirement Benefits

The Company currently 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.

Net Periodic Benefit Cost

The components of the Company's total periodic postretirement benefit costs for 2014, 2013 and 2012 were as follows:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|--|------|------|------|
| Service cost | \$4 | \$5 | \$5 |
| Interest cost on accumulated other postretirement benefit obligation | 9 | 8 | 10 |
| Expected return on plan assets | (9) | (9) | (10) |
| Recognition of net actuarial loss | 5 | 8 | 11 |
| Recognition of prior service cost | (4) | (4) | (3) |
| TOTAL PERIODIC POSTRETIREMENT BENEFIT COST | \$5 | \$8 | \$13 |
| Cost capitalized | (2) | (3) | (6) |
| Reconciliation to rate level | 9 | 8 | 4 |
| Cost charged to operating expenses | \$12 | \$13 | \$11 |

Notes to the Financial Statements - Continued

Funded Status

The funded status of the programs at December 31, 2014, 2013 and 2012 were as follows:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|--|---------------|---------------|---------------|
| CHANGE IN BENEFIT OBLIGATION | | | |
| Benefit obligation at beginning of year | \$197 | \$214 | \$244 |
| Service cost | 4 | 5 | 5 |
| Interest cost on accumulated postretirement benefit obligation | 9 | 8 | 10 |
| Amendments | (12) | - | (39) |
| Net actuarial loss/(gain) | 19 | (21) | 4 |
| Benefits paid and administrative expenses | (10) | (10) | (12) |
| Participant contributions | 1 | 1 | 1 |
| Medicare prescription subsidy | - | - | 1 |
| BENEFIT OBLIGATION AT END OF YEAR | \$208 | \$197 | \$214 |
| CHANGE IN PLAN ASSETS | | | |
| Fair value of plan assets at beginning of year | \$134 | \$123 | \$106 |
| Actual return on plan assets | 6 | 18 | 14 |
| EGWP payments | 1 | 1 | - |
| Employer contributions | - | - | 12 |
| Participant contributions | 1 | 1 | 1 |
| Benefits paid | (9) | (9) | (10) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | \$133 | \$134 | \$123 |
| FUNDED STATUS | \$(75) | \$(63) | \$(91) |
| Unrecognized net loss | \$33 | \$15 | \$55 |
| Unrecognized prior service costs | (25) | (17) | (21) |

In 2012, the Company amended its postretirement life and health benefit plans for management employees, resulting in a reduction to the obligation of \$39 million. Also in 2012, the Company elected to change the method of receiving the subsidy under Medicare Part D for retiree prescription drug coverage from the Retiree Drug Subsidy to the Employer Group Waiver Plan (EGWP) beginning in January 2013. Participation in the EGWP allows the Company to offer substantially the same postretirement benefits to eligible participants while increasing subsidy reimbursements received by the plans from the Federal Government. This change was effective January 2013 and, as a result, the Company recognized a reduction to its postretirement health benefit obligations of \$12 million as of December 31, 2012, which was recorded as an actuarial gain. In 2014, the Company amended its postretirement life and health benefit plans to reflect changes in the collective bargaining agreement covering certain O&R employees, resulting in a reduction to the obligation of \$12 million.

The increase in the other postretirement benefit plan obligation (due primarily to decreased discount rates) was the primary cause of the increased liability for other postretirement benefits at O&R of \$12 million compared with December 31, 2013. This increased liability resulted in an increase to regulatory assets of \$8 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility business consistent with the accounting rules for regulated operations, a charge to OCI of \$2 million (net of taxes) for the unrecognized net losses and a credit to OCI of \$1 million (net of taxes) for the unrecognized prior service costs associated with O&R's New Jersey subsidiary.

A portion of the unrecognized net losses and prior service costs for the other postretirement benefits, equal to \$4 million and \$(6) million, respectively, will be recognized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R.

Notes to the Financial Statements - Continued

Assumptions

The actuarial assumptions were as follows:

| | 2014 | 2013 | 2012 |
|---|-------|-------|-------|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount Rate | 3.85% | 4.75% | 4.05% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount Rate | 4.75% | 4.05% | 4.55% |
| Expected Return on Plan Assets | 7.75% | 7.75% | 8.50% |

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, 2014 was 5.50 percent, which is assumed to decrease gradually to 4.50 percent by 2018 and remain at that level thereafter. The health care cost trend rate used to determine benefit obligations as of December 31, 2014 was 5.25 percent, which is assumed to decrease gradually to 4.50 percent by 2018 and remain at that level thereafter.

A one-percentage point change in the assumed health care cost trend rate would have the following effects in 2015:

| (Millions of Dollars) | 1-Percentage-Point | |
|---|--------------------|----------|
| | Increase | Decrease |
| Effect on accumulated other postretirement benefit obligation | \$21 | \$(16) |
| Effect on service cost and interest cost components for 2014 | 2 | (1) |

Expected Benefit Payments

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

| (Millions of Dollars) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020-2024 |
|-----------------------|------|------|------|------|------|-----------|
| O&R | \$10 | \$10 | \$10 | \$10 | \$10 | \$55 |

Expected Contributions

Based on estimates as of December 31, 2014, O&R expects to make a contribution of \$0.1 million to the other postretirement benefit plans in 2015.

Notes to the Financial Statements - Continued

Plan Assets

The asset allocations for O&R's other postretirement benefit plans at the end of 2014, 2013 and 2012, and the target allocation for 2015 are as follows:

| Asset Category | Target Allocation Range | Plan Assets at December 31 | | |
|-------------------|-------------------------|----------------------------|------|------|
| | 2015 | 2014 | 2013 | 2012 |
| Equity Securities | 57% - 73% | 59% | 61% | 62% |
| Debt Securities | 26% - 44% | 41% | 39% | 38% |
| Total | 100% | 100% | 100% | 100% |

Con Edison 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 Con Edison's investment policy for the assets held by its benefit plans.

The fair values of the plan assets at December 31, 2014 by asset category as defined by the accounting rules for fair value measurements (see Note M) are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------------|---------|---------|---------|-------|
| Equity(a) | \$- | \$79 | \$- | \$79 |
| Other Fixed Income Debt(b) | - | 53 | - | 53 |
| Cash and Cash Equivalents(c) | - | - | - | - |
| Total investments | \$- | \$132 | \$- | \$132 |
| Pending activities(d) | | | | 1 |
| Total fair value of plan net assets | | | | \$133 |

- (a) Equity includes a passively managed commingled index fund benchmarked to the MSCI All Country World Index.
(b) Other Fixed Income Debt includes a passively managed commingled index fund benchmarked to the Barclays Capital Aggregate Index.
(c) Cash and Cash Equivalents include short term investments and money markets.
(d) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received, and reflects adjustments for available estimates at year end.

The fair values of the plan assets at December 31, 2013 by asset category (see Note M) are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------------|---------|---------|---------|-------|
| Equity(a) | \$- | \$81 | \$- | \$81 |
| Other Fixed Income Debt(b) | - | 53 | - | 53 |
| Cash and Cash Equivalents(c) | - | 4 | - | 4 |
| Total investments | \$- | \$138 | \$- | \$138 |
| Pending activities(d) | | | | (4) |
| Total fair value of plan net assets | | | | \$134 |

- (a) Equity includes a passively managed commingled index fund benchmarked to the MSCI All Country World Index.
(b) Other Fixed Income Debt includes a passively managed commingled index fund benchmarked to the Barclays Capital Aggregate Index.
(c) Cash and Cash Equivalents include short term investments and money markets.
(d) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received, and reflects adjustments for available estimates at year end.

Mortality Table Revision

The Company adopted revised mortality tables effective December 31, 2014 in the measurement of its pension and other postretirement benefit plan obligations, accounting costs, and required contribution amounts as discussed in Note E. As a result of the adoption, the Company recognized an immaterial change in its other postretirement benefits obligation as of December 31, 2014.

Notes to the Financial Statements - Continued

Note G – Environmental Matters

Superfund Sites

Hazardous substances, such as asbestos, polychlorinated biphenyls (PCBs) and coal tar, 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 sites at which gas was manufactured or stored.

The Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state statutes (Superfund) impose joint and several liability, regardless of fault, upon generators of hazardous substances for investigation and remediation costs (which include costs of demolition, removal, disposal, storage, replacement, containment, and monitoring) and natural resource damages. Liability under these laws can be material and may be imposed for contamination from past acts, even though such past acts may have been lawful at the time they occurred. The sites at which O&R has been asserted to have liability under these laws, including its manufactured gas plant sites and any neighboring areas to which contamination may have migrated, are referred to herein as “Superfund Sites.”

For Superfund Sites where there are other potentially responsible parties and O&R is not managing the site investigation and remediation, the accrued liability represents an estimate of the amount O&R will need to pay to investigate and, where determinable, discharge its related obligations. For Superfund Sites (including the manufactured gas plant sites) for which O&R is managing the investigation and remediation, the accrued liability represents an estimate of the Company’s share of the undiscounted cost to investigate and remediate the sites. Remediation costs are estimated in light of the information available, applicable remediation standards and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at December 31, 2014 and 2013 were as follows:

| (Millions of Dollars) | 2014 | 2013 |
|------------------------------|-------------|--------------|
| Accrued Liabilities: | | |
| Manufactured gas plant sites | \$97 | \$103 |
| Other Superfund Sites | 1 | 2 |
| Total | \$98 | \$105 |
| Regulatory assets | \$105 | \$108 |

The Superfund Sites have been investigated. However, for some of the sites, the extent and associated cost of the required remediation has not yet been determined. As information pertaining to the required remediation becomes available, the Company expects that additional liability may be accrued, the amount of which is not presently determinable but may be material. O&R estimates that in 2015 it will incur costs for remediation of approximately \$4 million. The Company is unable to estimate the time period over which the remaining accrued liability will be incurred because, among other things, the required remediation has not been determined for some of the sites. Under its current rate plans, the Company is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs.

Notes to the Financial Statements - Continued

Insurance recoveries related to Superfund Sites for the years ended December 31, 2014 and 2013 were immaterial. Environmental remediation costs incurred related to Superfund Sites at December 31, 2014 and 2013 were as follows:

| (Millions of Dollars) | 2014 | 2013 |
|----------------------------|------|------|
| Remediation costs incurred | \$9 | \$5 |

In 2014, O&R estimated that for its manufactured gas plant sites, each of which has been investigated, the aggregate undiscounted potential liability for the remediation of coal tar and/or other environmental contaminants could range up to \$155 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.

Asbestos Proceedings

Suits have been brought in New York State and federal courts 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; however, the Company believes that these amounts are greatly exaggerated, based on the disposition of previous claims. At December 31, 2014 and 2013, the Company had accrued its estimated aggregate undiscounted potential liability for these suits and additional suits that may be brought over the next 15 years of \$0.3 million. The estimate was based upon a combination of modeling, historical data analysis and risk factor assessment. Trial courts have begun, and unless otherwise determined by an appellate court may continue, to apply a different standard for determining liability in asbestos suits than the standard that applied historically. As a result, the Company currently believes that there is a reasonable possibility of an exposure to loss in excess of the liability accrued for the suits. The Company is unable to estimate the amount or range of such loss. 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) and the amounts deferred as regulatory assets for the Company at December 31, 2014 and 2013 were as follows:

| (Millions of Dollars) | 2014 | 2013 |
|---|-------|-------|
| Accrued liability – asbestos suits | \$0.3 | \$0.3 |
| Regulatory assets – asbestos suits | \$0.3 | \$0.3 |
| Accrued liability – workers' compensation | \$5.0 | \$4.9 |
| Regulatory assets – workers' compensation | \$- | \$- |

Notes to the Financial Statements - Continued

Note H – Leases

O&R's leases include rights of way for electric and gas distribution facilities, office buildings and automobiles. In accordance with the accounting rules 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.

Capital leases: For ratemaking purposes capital leases are treated as operating leases; therefore, in accordance with the accounting rules for regulated operations, the amortization of the leased asset is based on the rental payments recovered from customers. The following asset under capital leases is included in O&R's balance sheet at December 31, 2014 and 2013:

| <u>(Millions of Dollars)</u> | <u>2014</u> | <u>2013</u> |
|------------------------------|-------------|-------------|
| Utility Plant - General | \$1.1 | \$1.3 |

The accumulated amortization of the capital lease was \$1.0 million and \$0.8 million at December 31, 2014 and 2013, respectively.

There is no future minimum lease commitment for the above asset.

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

| <u>(Millions of Dollars)</u> | |
|------------------------------|--------------|
| 2015 | \$0.7 |
| 2016 | 0.7 |
| 2017 | 0.7 |
| 2018 | 0.7 |
| 2019 | 0.7 |
| All years thereafter | 1.8 |
| <u>Total</u> | <u>\$5.3</u> |

Note I – Income Tax

The components of income tax for O&R are as follows:

| <u>(Millions of Dollars)</u> | <u>2014</u> | <u>2013</u> | <u>2012</u> |
|---------------------------------|-------------|-------------|-------------|
| State | | | |
| Current | \$5 | \$8 | \$(14) |
| Deferred | 3 | (5) | 24 |
| Federal | | | |
| Current | 3 | 8 | (45) |
| Deferred | 24 | 8 | 66 |
| <u>Total income tax expense</u> | <u>\$35</u> | <u>\$19</u> | <u>\$31</u> |

Notes to the Financial Statements - Continued

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

| (Millions of Dollars) | 2014 | 2013 |
|--|--------------|--------------|
| Deferred tax liabilities: | | |
| Property basis differences | \$477 | \$439 |
| Unrecognized pension and other postretirement costs | 96 | 49 |
| Regulatory asset – future income tax | 47 | 46 |
| Other regulatory assets | 47 | 38 |
| Environmental remediation costs | 42 | 44 |
| Deferred storm costs | 37 | 43 |
| Unamortized investment tax credits | 2 | 2 |
| Other | - | 1 |
| Total deferred tax liabilities and investment tax credits | 748 | 662 |
| Deferred tax assets: | | |
| Accrued pension and other postretirement costs | 151 | 93 |
| Superfund and other environmental costs | 42 | 45 |
| Regulatory liabilities | 41 | 35 |
| Other | 5 | - |
| Total deferred tax assets | 239 | 173 |
| Net deferred tax liabilities and investment tax credits | \$509 | \$489 |
| Deferred tax liabilities and investment tax credits – noncurrent | \$533 | \$506 |
| Deferred tax assets – current | (24) | (17) |
| Net deferred tax liabilities and investment tax credits | \$509 | \$489 |

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) | 2014 | 2013 | 2012 |
|--|------------|------------|------------|
| STATUTORY TAX RATE | | | |
| Federal | 35% | 35% | 35% |
| Changes in computed taxes resulting from: | | | |
| State income tax | 5 | 2 | 6 |
| AFUDC | - | (1) | (1) |
| Employee benefit plans | - | (1) | (2) |
| Property tax lien | - | (2) | (1) |
| Cost of removal | (2) | (3) | (2) |
| Adjustments to accumulated deferred income taxes | - | (8) | (1) |
| Depreciation related differences | - | - | (1) |
| Other | (1) | 1 | - |
| Effective Tax Rate | 37% | 23% | 33% |

In September 2013, the IRS issued final regulations, effective in 2014, that provide guidance on the appropriate tax treatment of costs incurred to acquire, produce or improve tangible property, as well as routine maintenance and repair costs. Proposed regulations were issued addressing the tax treatment of asset dispositions. The application of these regulations did not have a material impact on O&R's financial position, results of operations or liquidity.

In March 2014, tax legislation was enacted in the State of New York that reduced the corporate franchise tax rate from 7.1 percent to 6.5 percent, beginning January 1, 2016. The application of this legislation decreased O&R's accumulated deferred tax liabilities by \$4 million, decreased O&R's regulatory asset for future income tax by \$1 million and increased O&R's regulatory liability by \$3 million. This tax legislation had no impact on O&R's effective tax rate for the year ended December 31, 2014.

Notes to the Financial Statements - Continued

Under the Taxpayer Relief Act of 2012, 50 percent bonus depreciation expired on December 31, 2013. On December 19, 2014, President Obama signed into law the Tax Increase Prevention Act of 2014, which extended bonus depreciation for another year through December 31, 2014. As a result of the extension of bonus depreciation to 2014, Con Edison filed a refund request with the IRS in January 2015 to recover estimated federal tax payments, including \$5 million relating to O&R.

Uncertain Tax Positions

Under the accounting rules for income taxes, O&R is not permitted to recognize the tax benefit attributable to a tax position unless such 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.

In 2014 following the conclusion of its IRS audit, Con Edison filed amended state tax returns (primarily New York and New Jersey) for tax years 1998 through 2011. As a result of positions taken on the amended state tax returns, Con Edison increased its estimated liabilities for uncertain tax positions by \$27 million, including \$2 million that was attributable to O&R. The amended returns contain uncertain tax positions unique to the states, and the returns remain open for examination. The federal tax returns for 2011 through 2013 remain open for examination. These changes to the O&R's estimated liabilities for uncertain tax positions had no impact on income tax expense for the year ended December 31, 2014.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits for O&R follows:

| <u>(Millions of Dollars)</u> | <u>2014</u> | <u>2013</u> | <u>2012</u> |
|---|-------------|-------------|-------------|
| Balance at January 1, | \$1 | \$7 | \$10 |
| Additions based on tax positions of prior years | 2 | 1 | 1 |
| Reductions for tax positions of prior years | - | (7) | (4) |
| Balance at December 31, | <u>\$3</u> | <u>\$1</u> | <u>\$7</u> |

O&R recognizes interest on liabilities for uncertain tax positions in interest expense and would recognize penalties, if any, in operating expenses in O&R's consolidated income statements. In 2014, 2013 and 2012 O&R recognized an immaterial amount of interest and no penalties for uncertain tax positions in its consolidated income statements. At December 31, 2014 and 2013, O&R recognized an immaterial amount of interest and no penalties in its consolidated balance sheet.

The Company does not expect the total amount of uncertain tax positions to significantly increase or decrease within the next twelve months. At December 31, 2014, the total amount of unrecognized tax benefits that, if recognized, would reduce O&R's effective tax rate is \$3 million (\$2 million, net of federal taxes).

Note J – Stock-Based Compensation

O&R may compensate employees under Con Edison's stock-based compensation plans with, among other things, stock options, restricted stock units and contributions to the stock purchase plan. The Long Term

Notes to the Financial Statements - Continued

Incentive Plan, which was approved by Con Edison's shareholders in 2003 (2003 LTIP), and the Long Term Incentive Plan, which was approved by Con Edison's shareholders in 2013 (2013 LTIP), are collectively referred to herein as the LTIP. The LTIP provides for, among other things, awards to employees of restricted stock units and stock options. Existing awards under the 2003 LTIP continue in effect, however no new awards may be issued under the 2003 LTIP. The 2013 LTIP provides for awards for up to five million shares of common stock.

Shares of Con Edison common stock used to satisfy O&R's obligations with respect to stock-based compensation may be new (authorized, but unissued) shares, treasury shares or shares purchased in the open market. The Company intends to use treasury shares and new shares to fulfill its stock-based compensation obligations for 2015.

Under the accounting rules for stock compensation, 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 years ended December 31, 2014, 2013 and 2012:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|------------------------------------|-------------|-------------|-------------|
| Performance-based restricted stock | \$2.1 | \$1.8 | \$1.1 |
| Time-based restricted stock | 0.1 | 0.1 | 0.1 |
| Stock purchase plan | 0.2 | 0.2 | 0.2 |
| Total | \$2.4 | \$2.1 | \$1.4 |
| Income Tax Benefit | \$1.0 | \$0.8 | \$0.5 |

Stock Options

Stock options were last granted in 2006. The stock options generally vested over a three-year period and have a term of ten years. Options were granted at an exercise price equal to the fair market value of a common share when the option was granted. The Company generally recognized compensation expense (based on the fair value of stock option awards) over the vesting period.

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.

A summary of changes in the status of stock options as of December 31, 2014 is as follows:

| | Shares | Weighted Average Exercise Price |
|-------------------------|---------------|--|
| Outstanding at 12/31/13 | 38,500 | \$43.83 |
| Exercised | (18,500) | 44.78 |
| Forfeited | - | - |
| Outstanding at 12/31/14 | 20,000 | \$42.94 |

Note: The weighted average remaining contractual life is one year for all outstanding options as of 12/31/14.

Notes to the Financial Statements - Continued

The following table summarizes information about stock options for the years ended December 31, 2014 and 2013:

| (Millions of Dollars) | 2014 | 2013 |
|---|-------|-------|
| Aggregate intrinsic value* | | |
| Options outstanding | \$0.5 | \$0.4 |
| Options exercised | 0.3 | 0.3 |
| Cash received by Con Edison for payment of exercise price | 0.8 | 0.7 |

* Aggregate intrinsic value represents the changes in the fair value of all outstanding options from their grant dates to December 31 of the years presented above.

Restricted Stock Units

Restricted stock unit awards under the LTIP have been made as follows: (i) awards that provide for adjustment of the number of units (performance-restricted stock units or Performance RSUs) to certain officers and employees; and (ii) time-based awards to certain employees. Restricted stock units awarded represents the right to receive, upon vesting, shares of Con Edison common stock, or, the cash value of shares or a combination thereof.

The number of units in each annual Performance RSU award 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 200 percent, based on Con Edison's total shareholder return relative to a specified peer group 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 120 percent for management employees and from 0 to 200 percent, based on determinations made in connection with O&R's annual incentive plans or, for certain executive officers, actual performance as compared to certain performance measures during a specified performance period (the non-TSR portion). Performance RSU awards generally vest upon completion of the performance period.

Performance against the established targets is recomputed each reporting period as of the earlier of the reporting date and the vesting date. The TSR portion applies a Monte Carlo simulation model, and the non-TSR portion is the product of the market price at the end of the period multiplied by the average non-TSR determination over the vesting period. Performance RSUs 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:

| | 2014 | 2013 | 2012 |
|------------------------------------|---------------|---------------|---------------|
| Risk-free interest rate(a) | 0.23% – 3.07% | 0.13% - 5.17% | 0.15% - 3.39% |
| Expected term(b) | 3 years | 3 years | 3 years |
| Expected share price volatility(c) | 13.14% | 13.52% | 15.27% |

(a) The risk-free rate is based on the U.S. Treasury zero-coupon yield curve on the date of grant.

(b) The expected term of the Performance RSUs equals the vesting period. The Company does not expect significant forfeitures to occur.

(c) The expected volatility is calculated using daily closing stock prices over a period of three years, which approximates the expected term of the awards.

A summary of changes in the status of the Performance RSUs' TSR and non-TSR portions during the year ended December 31, 2014 is as follows:

Notes to the Financial Statements - Continued

| | Units | Weighted Average Grant Date Fair Value(a) | |
|------------------------|----------|---|--------------------|
| | | TSR Portion(b) | Non-TSR Portion(c) |
| Non-vested at 12/31/13 | 103,072 | \$48.79 | \$55.02 |
| Granted | 44,280 | 26.82 | 53.87 |
| Vested | (41,694) | 43.69 | 50.01 |
| Forfeited | (1,858) | 42.52 | 56.41 |
| Non-vested at 12/31/14 | 103,800 | \$41.58 | \$56.51 |

(a) The TSR and non-TSR Portions each account for 50 percent of the awards' value.

(b) Fair value is determined using the Monte Carlo simulation described above. Weighted average grant date fair value does not reflect any accrual or payment of dividends prior to vesting.

(c) Fair value is determined using the market price of one share of Con Edison common stock on the grant date. The market price has not been discounted to reflect that dividends do not accrue and are not payable on Performance RSUs until vesting.

The total expense to be recognized by O&R's in future periods for unvested Performance RSUs outstanding as of December 31, 2014 is \$2 million and is expected to be recognized over a weighted average period of one year.

In accordance with the accounting rules for stock compensation, for time-based awards, the Company has accrued a liability based on the market value of a Con Edison common share on the grant date and is recognizing compensation expense over the vesting period. The vesting period for awards is three years and is based on the employee's 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 summary of changes in the status of time-based awards during the year ended December 31, 2014 is as follows:

| | Units | Weighted Average Grant Date Fair Value |
|------------------------|---------|--|
| Non-vested at 12/31/13 | 3,550 | \$56.81 |
| Granted | 1,200 | 53.65 |
| Vested | (1,100) | 50.72 |
| Forfeited | (400) | 56.59 |
| Non-vested at 12/31/14 | 3,250 | \$57.73 |

The total expense to be recognized by the Company in future periods for unvested time-based awards outstanding as of December 31, 2014 was immaterial and is expected to be recognized over a weighted average period of one year.

Stock Purchase Plan

Under the Con Edison Stock Purchase Plan, which was approved by shareholders in 2004 and 2014, the Company contributes up to \$1 for each \$9 invested by its officers or employees to purchase Con Edison common stock under the plan. 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 percent of their pay). Dividends paid on shares held under the plan are reinvested in additional shares unless otherwise directed by the participant.

Notes to the Financial Statements - Continued

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 2014, 2013 and 2012, 708,276, 864,281 and 665,718 shares were purchased under the Stock Purchase Plan at a weighted average price of \$56.23, \$57.24 and \$59.72 per share, respectively.

Note K – Financial Information by Business Segment

The business segments of the Company, which are its operating segments, were determined based on management's reporting and decision-making requirements in accordance with the accounting rules for segment reporting.

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, 2014 (Millions of Dollars) | Operating revenues | Inter- segment revenues | Depreciation and amortization | Operating income | Interest charges | Income taxes on operating income(a) | Total assets (b) | Construction expenditures |
|--|-----------------------|-------------------------------|-------------------------------------|---------------------|---------------------|--|------------------------|------------------------------|
| Electric | \$680 | \$- | \$46 | \$102 | \$24 | \$29 | \$1,972 | \$105 |
| Gas | 212 | - | 15 | 25 | 10 | 6 | 776 | 37 |
| Other(b) | - | - | - | - | 1 | - | 1 | - |
| Total O&R | \$892 | \$- | \$61 | \$127 | \$35 | \$35 | \$2,749 | \$142 |
| As of and for the Year Ended December 31, 2013 (Millions of Dollars) | Operating revenues | Inter- segment revenues | Depreciation and amortization | Operating income | Interest charges | Income taxes on operating income(a) | Total assets (b) | Construction expenditures |
| Electric | \$628 | \$- | \$41 | \$87 | \$25 | \$13 | \$1,899 | \$98 |
| Gas | 205 | - | 15 | 33 | 11 | 7 | 647 | 37 |
| Other(b) | - | - | - | - | 1 | - | 2 | - |
| Total O&R | \$833 | \$- | \$56 | \$120 | \$37 | \$20 | \$2,548 | \$135 |
| As of and for the Year Ended December 31, 2012 (Millions of Dollars) | Operating revenues | Inter- segment revenues | Depreciation and amortization | Operating income | Interest charges | Income taxes on operating income(a) | Total assets (b) | Construction expenditures |
| Electric | \$592 | \$- | \$38 | \$83 | \$19 | \$17 | \$1,960 | \$98 |
| Gas | 203 | - | 15 | 40 | 10 | 11 | 706 | 39 |
| Other(b) | - | - | - | - | 1 | - | 5 | - |
| Total O&R | \$795 | \$- | \$53 | \$123 | \$30 | \$28 | \$2,671 | \$137 |

(a) Income taxes on non-operating income were immaterial, \$(1) and \$(3) in 2014, 2013 and 2012, respectively.

(b) Includes amounts related to the RECO securitization.

Note L – Derivative Instruments and Hedging Activities

The Company hedges market price fluctuations associated with physical purchases and sales of electricity and natural gas by using derivative instruments including futures, forwards and options. Derivatives are recognized

Notes to the Financial Statements - Continued

on the balance sheet at fair value (see Note M), unless an exception is available under the accounting rules for derivatives and hedging. Qualifying derivative contracts that have been designated as normal purchases or normal sales contracts are not reported at fair value under the accounting rules.

The fair values of the Company's commodity derivatives including the offsetting of assets and liabilities on the consolidated balance sheet at December 31, 2014 and 2013 were:

| (Millions of Dollars) | 2014 | | | 2013 | | |
|--|---|----------------------------|---|---|----------------------------|---|
| Balance Sheet Location | Gross Amounts of Recognized Assets/ (Liabilities) | Gross Amounts Offset | Net Amounts of Assets/ (Liabilities)(a) | Gross Amounts of Recognized Assets/ (Liabilities) | Gross Amounts Offset | Net Amounts of Assets/ (Liabilities)(a) |
| Fair value of derivative assets | | | | | | |
| Current | \$2 | \$(2) | \$- | \$7 | \$(3) | \$4(b) |
| Non-current | 3 | (2) | 1 | 3 | (2) | 1 |
| Total fair value of derivative assets | \$5 | \$(4) | \$1 | \$10 | \$(5) | \$5 |
| Fair value of derivative liabilities | | | | | | |
| Current | \$(6) | \$2 | \$(4) | \$(3) | \$3 | \$- |
| Non-current | (4) | 3 | (1) | (3) | 3 | - |
| Total fair value of derivative liabilities | \$(10) | \$5 | \$(5) | \$(6) | \$6 | \$- |
| Net fair value derivative assets/(liabilities) | \$(5) | \$1 | \$(4) | \$4 | \$1 | \$5(b) |

- (a) Derivative instruments and collateral were set off on the consolidated balance sheet as applicable under the accounting rules. The Company enters into master agreements for its commodity derivatives. These agreements typically provide setoff in the event of contract termination. In such case, generally the non-defaulting party's payable will be set-off by the defaulting party's payable. The non-defaulting party will customarily notify the defaulting party within a specific time period and come to an agreement on the early termination amount.
- (b) At December 31, 2013, margin deposits of \$1 million were classified as derivative assets in the balance sheet, but not included in the table. Margin is collateral, typically cash, that the holder of a derivative instrument is required to deposit in order to transact on an exchange and to cover its potential losses with its broker or the exchange.

The Company generally recovers its prudently incurred purchased power and gas costs, including hedging gains and losses, in accordance with rate provisions approved by the applicable state utility regulators. See "Recoverable Energy Costs" in Note A. In accordance with the accounting rules for regulated operations, the Company records a regulatory asset or liability to defer recognition of unrealized gains and losses on its electric and gas derivatives. As gains and losses are realized in future periods, they will be recognized as purchased power, gas and fuel costs in the Company's consolidated income statements.

O&R and CECONY (together with O&R, the Utilities) have combined their gas requirements, and contracts to meet those requirements, into a single portfolio. The combined portfolio is administered by, and related management services (including hedging market price fluctuations associated with the physical purchase of gas) are provided by, CECONY (for itself and as agent for O&R) and costs (net of the effect of the related hedging transactions) are allocated between the Utilities in accordance with provisions approved by the NYSPPSC. See Note O.

Notes to the Financial Statements - Continued

The following table presents the realized and unrealized gains or losses on commodity derivatives that have been deferred or recognized in earnings for the years ended December 31, 2014 and 2013:

| (Millions of Dollars) | Balance Sheet Location | 2014 | 2013 |
|---|----------------------------|-------|------|
| Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations: | | | |
| Current | Deferred derivative gains | \$(3) | \$3 |
| Long-term | Deferred derivative gains | - | - |
| Total deferred gains/(losses) | | \$(3) | \$3 |
| Current | Deferred derivative losses | \$(5) | \$8 |
| Current | Recoverable energy costs | 10 | (3) |
| Long-term | Deferred derivative losses | - | 14 |
| Total deferred gains/(losses) | | \$5 | \$19 |
| Net deferred gains/(losses) | | \$2 | \$22 |

The following table presents the hedged volume of the Company's derivative transactions at December 31, 2014:

| Electric Energy (MWHs)(a) | Natural Gas (Dt)(a) |
|---------------------------|---------------------|
| 1,211,680 | 4,890,000 |

(a) Volumes are reported net of long and short positions.

The Company is exposed to credit risk related to transactions entered into primarily for the various electric supply and hedging activities. Credit risk relates to the loss that may result from a counterparty's nonperformance. 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 measures credit risk exposure as the replacement cost for open energy commodity and derivative positions plus amounts owed from counterparties for settled transactions. The replacement cost of open positions represents unrealized gains, net of any unrealized losses where the Company has a legally enforceable right of setoff.

At December 31, 2014, the Company had \$1 million of credit exposure in connection with energy supply and hedging activities, net of collateral. The net credit exposure was with investment-grade counterparties and commodity exchange brokers.

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. Most derivative instrument contracts contain provisions that may require a party to provide collateral on its derivative instruments that are in a net liability position. The amount of collateral to be provided will depend on the fair value of the derivative instruments and the party's credit ratings.

The following table presents the aggregate fair value of the Company's derivative instruments with credit-risk-related contingent features that are in a net liability position, the collateral posted for such positions and the additional collateral that would have been required to be posted had the lowest applicable credit rating been reduced one level and to below investment grade at December 31, 2014:

Notes to the Financial Statements - Continued

(Millions of Dollars)

| | |
|---|--------|
| Aggregate fair value – net liabilities(a) | \$5 |
| Collateral posted | \$- |
| Additional collateral(b) (downgrade one level from current ratings) | \$- |
| Additional collateral(b) (downgrade to below investment grade from current ratings) | \$7(c) |

(a) Non-derivative transactions for the purchase and sale of electricity and gas and qualifying derivative instruments, which have been designated as normal purchases or normal sales, are excluded from the table. These transactions primarily include purchases of electricity from independent system operators. In the event the Company was no longer extended unsecured credit for such purchases, the Company would be not be required to post collateral at December 31, 2014. For certain other such non-derivative transactions, the Company could be required to post collateral under certain circumstances, including in the event counterparties had reasonable grounds for insecurity.

(b) The additional collateral amounts shown above are based upon the estimated O&R allocation of the Utilities' collateral requirements. The Utilities measure the collateral requirements by taking into consideration the fair value amounts of derivative instruments that contain credit-risk-related contingent features that are in a net liabilities position plus amounts owed to counterparties for settled transactions and amounts required by counterparties for minimum financial security. The fair value amounts represent unrealized losses, net of any unrealized gains where the Company has a legally enforceable right of setoff.

(c) Derivative instruments that are net assets have been excluded from the table. At December 31, 2014, if the Company had been downgraded to below investment grade, it would have been required to post an immaterial amount of additional collateral.

Note M – Fair Value Measurements

The accounting rules for fair value measurements and disclosures define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in a principal or most advantageous market. Fair value is a market-based measurement that is determined based on inputs, which refer broadly to assumptions that market participants use in pricing assets or liabilities. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company often makes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, and the risks inherent in the inputs to valuation techniques. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

The accounting rules for fair value measurements and disclosures established a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value in three broad levels. The rules require that assets and liabilities be classified in their entirety based on the level of input that is significant to the fair value measurement. Assessing the significance of a particular input may require judgment considering factors specific to the asset or liability, and may affect the valuation of the asset or liability and their placement within the fair value hierarchy. The Company classifies fair value balances based on the fair value hierarchy defined by the accounting rules for fair value measurements and disclosures as follows:

- Level 1 – Consists of assets or liabilities whose value is based on unadjusted quoted prices in active markets at the measurement date. An active market is one in which transactions for assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis. This category includes contracts traded on active exchange markets valued using unadjusted prices quoted directly from the exchange.
- Level 2 – Consists of assets or liabilities valued using industry standard models and based on prices, other than quoted prices within Level 1, that are either directly or indirectly observable as of the measurement date. The industry standard models consider observable assumptions including time value, volatility factors, and current market and contractual prices for the underlying commodities, in

Notes to the Financial Statements - Continued

addition to other economic measures. This category includes contracts traded on active exchanges or in over-the-counter markets priced with industry standard models.

- Level 3 – Consists of assets or liabilities whose fair value is estimated based on internally developed models or methodologies using inputs that are generally less readily observable and supported by little, if any, market activity at the measurement date. Unobservable inputs are developed based on the best available information and subject to cost benefit constraints. This category includes contracts priced using models that are internally developed and contracts placed in illiquid markets. It also includes contracts that expire after the period of time for which quoted prices are available and internal models are used to determine a significant portion of the value.

Assets and liabilities measured at fair value on a recurring basis for the years ended December 31, 2014 and 2013 are summarized below.

| (Millions of Dollars) | 2014 | | | | | 2013 | | | | |
|------------------------------|------------|-------------|------------|------------------------|-------------|------------|-------------|------------|------------------------|-------------|
| | Level 1 | Level 2 | Level 3 | Netting Adjustment (e) | Total | Level 1 | Level 2 | Level 3 | Netting Adjustment (e) | Total |
| Derivative assets: | | | | | | | | | | |
| Commodity(a)(b)(c) | \$- | \$1 | \$- | \$- | \$1 | \$- | \$7 | \$- | \$(1) | \$6 |
| Other(a)(b)(d) | 8 | 10 | - | - | 18 | 7 | 10 | - | - | 17 |
| Total assets | \$8 | \$11 | \$- | \$- | \$19 | \$7 | \$17 | \$- | \$(1) | \$23 |
| Derivative liabilities: | | | | | | | | | | |
| Commodity(a)(b)(c) | \$- | \$6 | \$- | \$(1) | \$5 | \$- | \$3 | \$- | \$(3) | \$- |
| Interest rate contract(a)(b) | - | - | - | - | - | - | 2 | - | - | 2 |
| Total liabilities | \$- | \$6 | \$- | \$(1) | \$5 | \$- | \$5 | \$- | \$(3) | \$2 |

- (a) The Company's policy is to review the fair value hierarchy and recognize transfers into and transfers out of the levels at the end of each reporting period. There were no transfers between levels 1, 2 and 3 for the years ended December 31, 2014 and 2013.
- (b) Level 2 assets and liabilities include investments held in the deferred compensation plan and/or non-qualified retirement plans, interest rate swap, exchange-traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1, and certain over-the-counter derivative instruments for electricity and natural gas. Derivative instruments classified as Level 2 are valued using industry standard models that incorporate corroborated observable inputs; such as pricing services or prices from similar instruments that trade in liquid markets, time value and volatility factors.
- (c) The accounting rules for fair value measurements and disclosures require consideration of the impact of nonperformance risk (including credit risk) from a market participant perspective in the measurement of the fair value of assets and liabilities. At December 31, 2014 and 2013, the Company determined that nonperformance risk would have no material impact on its financial position or results of operation.
- (d) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.
- (e) Amounts represent the impact of legally-enforceable master netting agreements that allow the Company to net gain and loss positions and cash collateral held or placed with the same counterparties.

The employees in CECONY's risk management group develop and maintain the valuation policies and procedures for, and verify pricing and fair value valuation of, commodity derivatives for the Utilities. Under CECONY's policies and procedures, multiple independent sources of information are obtained for forward price curves used to value commodity derivatives. Fair value and changes in fair value of commodity derivatives are reported on a monthly basis to the Utilities' risk committees, comprised of officers and employees of the Utilities' that oversee energy hedging. The risk management group reports to CECONY's Vice President and Treasurer.

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the years ended December 31, 2014 and 2013 and classified as Level 3 in the fair value hierarchy:

| (Millions of Dollars) | 2014 | 2013 |
|---|------------|------------|
| Beginning Balance as of January 1, | \$- | \$(19) |
| Included in Earnings | - | (3) |
| Included in Regulatory Assets and Liabilities | - | 19 |
| Settlements | - | 3 |
| Ending Balance as of December 31, | \$- | \$- |

Notes to the Financial Statements - Continued

Realized gains and losses on Level 3 commodity derivative assets and liabilities are reported as part of purchased power costs. The Company generally recovers these costs in accordance with rate provisions approved by the applicable state public utilities regulators. See Note A. Unrealized gains and losses for commodity derivatives are generally deferred on the consolidated balance sheet in accordance with the accounting rules for regulated operations.

Note N – Asset Retirement Obligations

The Company recognizes a liability at fair value for legal obligations associated with the retirement of long-lived assets in the period in which they are incurred, or when sufficient information becomes available to reasonably estimate the fair value of such legal obligations. The Company evaluates these assumptions underlying the asset retirement obligation liability on an annual basis or as frequently as needed. Any such obligations identified by the Company were immaterial.

The Company includes in depreciation rates the estimated removal costs, less salvage, for utility plant assets. The amounts related to removal costs that are associated with asset retirement obligations are classified as an asset retirement liability. Pursuant to accounting rules for regulated operations, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities. Accretion and depreciation expenses related to removal costs that represent legal asset retirement obligations are applied against the Company's regulatory liabilities. Asset retirement costs that are recoverable from customers are recorded as regulatory liabilities to reflect the timing difference between costs recovered through the rate-making process and recognition of costs. The related net regulatory liabilities recorded for the Company were \$94 million and \$87 million at December 31, 2014 and 2013, respectively.

Note O – 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 NYSPPSC and/or other regulatory authorities, as applicable. The services received include substantial administrative support operations, such as corporate secretarial and associated managerial 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, 2014, 2013 and 2012 were as follows:

| (Millions of Dollars) | 2014 | 2013 | 2012 |
|---------------------------|------|------|------|
| Cost of services provided | \$18 | \$17 | \$19 |
| Cost of services received | \$41 | \$40 | \$42 |

At December 31, 2014, 2013 and 2012, O&R's payable to Con Edison and its other subsidiaries associated with these services was \$7 million, \$5 million and \$8 million, respectively.

Notes to the Financial Statements - Continued

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY \$80 million, \$72 million and \$54 million of natural gas for the years ended December 31, 2014, 2013 and 2012, respectively. These amounts are net of the effect of related hedging transactions. At December 31, 2014, 2013 and 2012, O&R's net payable to CECONY associated with these gas purchases was \$3 million, \$10 million and \$9 million, respectively. At December 31, 2014, 2013 and 2012, O&R's payable to Con Edison's competitive energy businesses associated with electricity purchases and retail services was \$1 million.

At December 31, 2014 and 2013, the Company's payable to Con Edison for income taxes was \$6 million and \$2 million, respectively. At December 31, 2012, the Company's receivable from Con Edison for income taxes was \$63 million.

At December 31, 2014 and 2013, the Company's receivable from CECONY for an Economic Stimulus Grant was immaterial.

FERC has authorized CECONY through 2015 to lend funds to O&R from time to time, for periods of not more than 12 months, in amounts not to exceed \$250 million outstanding at any time, at prevailing market rates. At December 31, 2014 and 2013, there were no loans outstanding for O&R.

Note P – New Financial Accounting Standards

In April 2014, the Financial Accounting Standards Board (FASB) issued amendments on reporting discontinued operations through Accounting Standards Update (ASU) No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments revise the definition of a discontinued operation as a disposal of a component of an entity or a group of components of an entity, or a business or nonprofit activity that represents a strategic shift that has or will have a major effect on an entity's operations and financial results. The amendments also require additional disclosures for discontinued operations and individually significant disposals that do not qualify for discontinued operations presentation in the financial statements. For public entities, the amendments are effective prospectively for reporting periods beginning on or after December 15, 2014. The application of this guidance does not have a material impact on the Company's financial position, results of operations and liquidity.

In May 2014, the FASB and the International Accounting Standards Board (IASB) jointly issued a revenue recognition standard that will supersede the revenue recognition requirements within Accounting Standards Codification (ASC) Topic 605, "Revenue Recognition," and most industry-specific guidance under the Codification through ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The purpose of the new guidance is to create a consistent framework for revenue recognition. The guidance clarifies how to measure and recognize revenue arising from customer contracts to depict the transfer of goods or services in an amount that reflects the consideration the entity expects to receive. The new guidance must be adopted using either a full retrospective approach or a modified retrospective approach. For public entities reporting under

Notes to the Financial Statements - Continued

GAAP, the new guidance is effective for periods beginning after December 15, 2016. The Company is in the process of evaluating the application and impact of the new guidance on the Company's financial position, results of operations and liquidity.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)." The amendments clarify the accounting treatment regarding performance targets. Under the new guidance, a performance target that affects vesting and that could be achieved after the requisite service period is required to be treated as a performance condition and should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized only when it becomes probable that the performance target will be achieved. The amendments are effective for periods beginning after December 15, 2015. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and liquidity.

In August 2014, the FASB issued amendments on reporting about an entity's ability to continue as a going concern in ASU No. 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205 - 40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The amendments provide guidance about management's responsibility to evaluate whether there is substantial doubt surrounding an entity's ability to continue as a going concern. If management concludes that substantial doubt exists, the amendments also require additional disclosures relating to management's evaluation and conclusion. The amendments are effective for the annual reporting period ending after December 15, 2016 and interim periods thereafter. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and liquidity.

In November 2014, the FASB issued amendments on pushdown accounting for subsidiaries and acquired entities in ASU No. 2014-17, "Business Combinations (Topic 805): Pushdown Accounting." The amendments provide guidance as to whether and at what threshold an acquired entity can apply pushdown accounting in its separate financial statements. The amendments are effective as of the date of issuance. The application of this guidance does not have a material impact on the Company's financial position, results of operations and liquidity.