

Orange and Rockland Utilities, Inc.
Financial Statements (Unaudited)
Third Quarter 2018



Report of Independent Auditors

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

We have reviewed the accompanying consolidated interim financial information of Orange and Rockland Utilities, Inc. and its subsidiaries (the "Company"), which comprise the consolidated balance sheet as of September 30, 2018, the consolidated statement of shareholder's equity for the nine-month period ended September 30, 2018, the related consolidated statements of income and comprehensive income for the three-month and nine-month periods ended September 30, 2018 and 2017, and the related consolidated statement of cash flows for the nine-month periods ended September 30, 2018 and 2017.

Management's Responsibility for the Consolidated Interim Financial Information

The Company's management is responsible for the preparation and fair presentation of the consolidated interim financial information in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of the consolidated interim financial information in accordance with accounting principles generally accepted in the United States of America.

Auditors' Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet and related consolidated statement of capitalization of the Company as of December 31, 2017, and the related consolidated statements of income, comprehensive income, cash flows, and of shareholder's equity for the year then ended (not presented herein), and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 6, 2018. In our opinion, the information set forth in the accompanying consolidated balance sheet information and consolidated statement of shareholder's equity as of December 31, 2017, is consistent, in all material respects, with the audited consolidated balance sheet from which it has been derived.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

November 13, 2018

Orange and Rockland Utilities, Inc.
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Orange and Rockland Utilities, Inc.
CONSOLIDATED INCOME STATEMENT (UNAUDITED)

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
OPERATING REVENUES				
Electric	\$212	\$206	\$505	\$495
Gas	34	28	186	172
TOTAL OPERATING REVENUES	246	234	691	667
OPERATING EXPENSES				
Purchased power	73	60	167	148
Gas purchased for resale	12	10	60	52
Other operations and maintenance	80	75	234	221
Depreciation and amortization	19	18	57	53
Taxes, other than income taxes	20	21	63	62
TOTAL OPERATING EXPENSES	204	184	581	536
OPERATING INCOME	42	50	110	131
OTHER INCOME (DEDUCTIONS)				
Allowance for equity funds used during construction	—	—	1	—
Other deductions	(5)	(5)	(17)	(15)
TOTAL OTHER INCOME (DEDUCTIONS)	(5)	(5)	(15)	(15)
INCOME BEFORE INTEREST AND INCOME TAX EXPENSE	37	45	95	116
INTEREST EXPENSE				
Interest on long-term debt	9	9	27	27
Other interest	1	—	3	1
Allowance for borrowed funds used during construction	—	—	(1)	(1)
NET INTEREST EXPENSE	10	9	29	27
INCOME BEFORE INCOME TAX EXPENSE	27	36	66	89
INCOME TAX EXPENSE	6	14	14	36
NET INCOME	\$21	\$22	\$52	\$53

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

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

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
NET INCOME	\$21	\$22	\$52	\$53
OTHER COMPREHENSIVE INCOME, NET OF TAXES				
Pension and other postretirement benefit plan liability adjustments, net of taxes	2	1	7	1
TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAXES	2	1	7	1
COMPREHENSIVE INCOME	\$23	\$23	\$59	\$54

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

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

<i>(Millions of Dollars)</i>	For the Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES		
Net income	\$52	\$53
PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME		
Depreciation and amortization	57	53
Deferred income taxes	25	22
Rate case amortizations	13	14
Common equity component of allowance for funds used during construction	(1)	—
Unbilled revenue	24	19
Other non-cash items, net	24	4
CHANGES IN ASSETS AND LIABILITIES		
Accounts receivable - customers	(27)	(10)
Accounts receivable from affiliated companies	(20)	(1)
Materials and supplies, including gas in storage	(4)	(4)
Prepayments, other receivables and other current assets	(12)	(32)
Accounts payable	39	29
Accounts payable to affiliated companies	(8)	(8)
Pensions and retiree benefits obligations, net	22	31
Pensions and retiree benefits contributions	(39)	(46)
Accrued taxes to affiliated companies	(21)	7
Accrued interest	2	1
System benefit charge	3	18
Superfund and environmental remediation costs, net	—	(2)
Deferred charges, noncurrent assets and other regulatory assets	(48)	2
Deferred credits and other regulatory liabilities	32	12
Other current and noncurrent liabilities	(11)	2
NET CASH FLOWS FROM OPERATING ACTIVITIES	102	164
INVESTING ACTIVITIES		
Utility construction expenditures	(142)	(129)
Cost of removal less salvage	(5)	(6)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(147)	(135)
FINANCING ACTIVITIES		
Net payment of short-term debt	(16)	(1)
Issuance of long-term debt	125	—
Retirement of long-term debt	(51)	(3)
Debt issuance costs	(1)	—
Dividend to parent	(35)	(33)
NET CASH FLOWS FROM/(USED IN) FINANCING ACTIVITIES	22	(37)
CASH, TEMPORARY CASH INVESTMENTS, AND RESTRICTED CASH:		
NET CHANGE FOR THE PERIOD	(23)	(8)
BALANCE AT BEGINNING OF PERIOD	47	49
BALANCE AT END OF PERIOD	\$24	\$41
SUPPLEMENTAL DISCLOSURE OF CASH INFORMATION		
Cash paid during the period for:		
Interest	\$27	\$26
Income taxes	\$25	\$8
SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION		
Construction expenditures in accounts payable	\$14	\$13
Software licenses acquired but unpaid as of end of period	\$5	—

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET (UNAUDITED)

<i>(Millions of Dollars)</i>	September 30, 2018	December 31, 2017
ASSETS		
CURRENT ASSETS		
Cash and temporary cash investments	\$22	\$46
Accounts receivable – customers, less allowance for uncollectible accounts of \$5 and \$4 in 2018 and 2017, respectively	97	71
Other receivables, less allowance for uncollectible accounts of \$1 in 2018 and 2017	6	8
Accrued unbilled revenue	21	45
Accounts receivable from affiliated companies	24	4
Gas in storage, at average cost	14	12
Materials and supplies, at average cost	22	20
Prepayments	46	26
Regulatory assets	6	4
Restricted cash	2	1
Other current assets	5	12
TOTAL CURRENT ASSETS	265	249
INVESTMENTS	27	29
UTILITY PLANT, AT ORIGINAL COST		
Electric	1,769	1,694
Gas	794	758
General	273	256
TOTAL	2,836	2,708
Less: Accumulated depreciation	778	743
Net	2,058	1,965
Construction work in progress	97	103
NET UTILITY PLANT	2,155	2,068
OTHER NONCURRENT ASSETS		
Regulatory assets	374	403
Other deferred charges and noncurrent assets	21	24
TOTAL OTHER NONCURRENT ASSETS	395	427
TOTAL ASSETS	\$2,842	\$2,773

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET (UNAUDITED)

<i>(Millions of Dollars)</i>	September 30, 2018	December 31, 2017
LIABILITIES AND SHAREHOLDER'S EQUITY		
CURRENT LIABILITIES		
Long-term debt due within one year	\$4	\$54
Notes payable	80	96
Accounts payable	104	76
Accounts payable to affiliated companies	10	18
Customer deposits	12	12
Accrued taxes	3	3
Accrued taxes to affiliated companies	—	21
Accrued interest	10	8
Accrued wages	10	10
Fair value of derivative liabilities	6	3
Regulatory liabilities	23	36
System benefit charge	56	53
Other current liabilities	18	22
TOTAL CURRENT LIABILITIES	336	412
NONCURRENT LIABILITIES		
Provision for injuries and damages	6	5
Pensions and retiree benefits	258	305
Superfund and other environmental costs	93	100
Deferred income taxes and unamortized investment tax credits	314	288
Regulatory liabilities	373	348
Other deferred credits and noncurrent liabilities	43	42
TOTAL NONCURRENT LIABILITIES	1,087	1,088
LONG-TERM DEBT	729	607
SHAREHOLDER'S EQUITY (See Statement of Shareholder's Equity)	690	666
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	\$2,842	\$2,773

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

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

<i>(In Millions/Except Share Data)</i>	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
	Shares	Amount				
BALANCE AS OF DECEMBER 31, 2017	1,000	\$—	\$324	\$362	\$(20)	\$666
Net income				52		52
Common stock dividend to parent				(35)		(35)
Other comprehensive income					7	7
BALANCE AS OF SEPTEMBER 30, 2018	1,000	\$—	\$324	\$379	\$(13)	\$690

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

Notes to the Financial Statements (Unaudited)

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 one regulated utility subsidiary: Rockland Electric Company (RECO). For the nine months ended September 30, 2018 and 2017, operating revenues for RECO were 20.9 percent and 20.3 percent, respectively, of O&R's consolidated operating revenues. O&R, along with RECO, provides electric service in southeastern New York and adjacent areas of northern New Jersey and gas service in southeastern New York. 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 State Public Service Commission (NYSPSC) and the New Jersey Board of Public Utilities (NJBPU) with respect to rates and accounting.

The interim consolidated financial statements as of September 30, 2018 and for the three and nine month periods ended September 30, 2018 and 2017 (the Third Quarter Financial Statements) are unaudited but, in the opinion of the Company's management, reflect all adjustments (which include only normally recurring adjustments) necessary for a fair presentation of the results for the interim periods presented. The Third Quarter Financial Statements should be read together with the audited consolidated financial statements of the Company, as of December 31, 2017 and 2016 and for each of the three years ended December 31, 2017, including the notes thereto and their separate unaudited financial statements, including the notes thereto, for the quarterly periods ended March 31, 2018 and June 30, 2018. Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company has, pursuant to the accounting rules for subsequent events, evaluated events or transactions that occurred after September 30, 2018 through the posting on its website (November 13, 2018) of the Third Quarter Financial Statements for potential recognition or disclosure in the Third Quarter Financial Statements.

Note A – Summary of Significant Accounting Policies

Revenues

Adoption of New Standard

On January 1, 2018, the Company adopted Accounting Standards Codification (ASC) Topic 606, "Revenue from Contracts with Customers," using the modified retrospective method applied to those contracts that were not completed. No charge to retained earnings for cumulative impact was required as a result of the Company's adoption of Topic 606.

Notes to the Financial Statements (Unaudited) - continued

Revenue Recognition

The following table presents, for the three and nine months ended September 30, 2018, revenue from contracts with customers as defined in Topic 606, as well as additional revenue from sources other than contracts with customers, disaggregated by major source.

<i>(Millions of Dollars)</i>	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Revenues from contracts with customers	Other revenues (a)	Total operating revenues	Revenues from contracts with customers	Other revenues (a)	Total operating revenues
Electric	\$215	\$(3)	\$212	\$508	(\$3)	\$505
Gas	31	3	34	179	7	186
Total	\$246	\$—	\$246	\$687	\$4	\$691

(a) This includes revenue from alternative revenue programs, such as the revenue decoupling mechanisms under the New York electric and gas rate plans.

O&R has the obligation to deliver electricity and gas energy to its customers. The Company recognizes revenues as this performance obligation is satisfied over time as the Company delivers, and the customers simultaneously receive and consume, the energy. The amount of revenues recognized reflects the consideration the Company expects to receive in exchange for delivering the energy. Under its tariffs, the transaction price for full-service customers includes the Company's energy cost and for all customers includes delivery charges determined based on customer class and in accordance with established tariffs and guidelines of the NYSPSC or the NJBPU, as applicable. Accordingly, there is no unsatisfied performance obligation associated with these customers. The transaction price is applied to the Company's revenue generating activities through the customer billing process. Because energy is delivered over time, the Company uses output methods that recognize revenue based on direct measurement of the value transferred, such as units delivered, which provides an accurate measure of value for the energy delivered. The Company accrues revenues at the end of each month for estimated energy delivered but not yet billed to customers. 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.

Revenues are recorded as energy is delivered, generated or services are provided and billed to customers. Amounts billed are recorded in accounts receivable - customers, with payment generally due the following month. The Company's accounts receivable - customers balance also reflects the Company's purchase of receivables from energy service companies to support retail choice programs. Accrued revenues not yet billed to customers are recorded as accrued unbilled revenues.

Utility Plant

At September 30, 2018, utility plant included \$5 million related to a May 2018 acquisition of software licenses. The software licenses asset is being amortized over a period of 15 years, and the estimated aggregate annual amortization expense is immaterial. At September 30, 2018, the accumulated amortization was immaterial.

Notes to the Financial Statements (Unaudited) - continued

Changes in Accumulated Other Comprehensive Income/(Loss) by Component

For the three and nine months ended September 30, 2018 and 2017, changes to accumulated other comprehensive income/(loss) (OCI) are as follows:

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,	
	2018	2017
Beginning balance, accumulated OCI, net of taxes (a)	\$(15)	\$(21)
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(1) in 2018 and 2017 (a)(b)	2	1
Current period OCI, net of taxes	2	1
Ending balance, accumulated OCI, net of taxes	\$(13)	\$(20)

<i>(Millions of Dollars)</i>	For the Nine Months Ended September 30,	
	2018	2017
Beginning balance, accumulated OCI, net of taxes (a)	\$(20)	\$(21)
OCI before reclassifications, net of tax of \$(1) and \$1 in 2018 and 2017, respectively	3	(2)
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(1) and \$(2) in 2018 and 2017, respectively (a)(b)	4	3
Current period OCI, net of taxes	7	1
Ending balance, accumulated OCI, net of taxes	\$(13)	\$(20)

- (a) Only RECO's portion of unrecognized pension and other postretirement benefit 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 total periodic pension and other postretirement benefit cost.
- (b) Tax reclassified from accumulated OCI is reported in the income tax expense line item of the consolidated income statement.

Reconciliation of Cash, Temporary Cash Investments and Restricted Cash

On January 1, 2018, the Company adopted Accounting Standard Update (ASU) 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash," which was applied retrospectively for each prior period presented. Pursuant to ASU 2016-18, cash, temporary cash investments and restricted cash are presented on a combined basis in the Company's consolidated statement of cash flows. At September 30, 2018 and 2017, cash, temporary cash investments and restricted cash are as follows:

<i>(Millions of Dollars)</i>	At September 30,	
	2018	2017
Cash and temporary cash investments	\$22	\$39
Restricted cash (a)	2	2
Total cash, temporary cash investments and restricted cash	\$24	\$41

- (a) Restricted cash is comprised of RECO transition bond charge collections, net of principal, interest, trustee and service fees, that are restricted until the bonds mature in 2019.

Note B – Regulatory Matters

Rate Plans

In November 2018, O&R, the staff of the NYSPSC and other parties entered into a Joint Proposal for new electric and gas rate plans for the three-year period January 2019 through December 2021 (the Joint Proposal). The Joint Proposal is subject to NYSPSC approval. The following tables contain a summary of the new rate plans.

Notes to the Financial Statements (Unaudited) - continued

O&R New York - Electric

Effective period	January 2019 – December 2021 (b)
Base rate changes (a)	Yr. 1 – \$13.4 million Yr. 2 – \$8.0 million Yr. 3 – \$5.8 million
Amortizations to income of net regulatory (assets) and liabilities (c)	Yr. 1 – \$(1.5) million Yr. 2 – \$(1.5) million Yr. 3 – \$(1.5) million
Other revenue sources	Potential earnings adjustment mechanism incentives for peak reduction, energy efficiency, Distributed Energy Resources utilization and other potential incentives of up to: Yr. 1 - \$3.6 million; Yr. 2 - \$4.0 million; and Yr. 3 - \$4.2 million. Potential incentive if performance target related to service terminations is met: \$0.5 million annually.
Revenue decoupling mechanisms	Continuation of reconciliation of actual to authorized electric delivery revenues.
Recoverable energy costs	Continuation of current rate recovery of purchased power costs.
Negative revenue adjustments	Potential penalties if certain performance targets relating to service, reliability and other matters are not met: Yr. 1 - \$4.4 million; Yr. 2 - \$4.4 million; and Yr. 3 - \$4.5 million.
Cost reconciliations	Reconciliation of expenses for pension and other postretirement benefits, environmental remediation costs, property taxes (d), energy efficiency program (e), major storms, the impact of new laws and certain other costs to amounts reflected in rates.(f)
Net utility plant reconciliations	Target levels reflected in rates were: Electric average net plant target excluding advanced metering infrastructure (AMI): Yr. 1 - \$1,008 million; Yr. 2 - \$1,032 million; Yr. 3 - \$1,083 million AMI (g): Yr. 1 - \$48 million; Yr. 2 - \$58 million; Yr. 3 - \$61 million
Average rate base	Yr. 1 – \$878 million Yr. 2 – \$906 million Yr. 3 – \$948 million
Weighted average cost of capital (after-tax)	Yr. 1 – 6.97 percent Yr. 2 – 6.96 percent Yr. 3 – 6.96 percent
Authorized return on common equity	9.00 percent
Earnings sharing	Most earnings above an annual earnings threshold of 9.6 percent are to be applied to reduce regulatory assets for environmental remediation and other costs accumulated in the rate year.
Cost of long-term debt	Yr. 1 – 5.17 percent Yr. 2 – 5.14 percent Yr. 3 – 5.14 percent
Common equity ratio	48 percent

- (a) The Joint Proposal recommends that these base rate changes may be implemented with increases of: Yr. 1 - \$8.6 million; Yr. 2 - \$12.1 million; and Yr. 3 - \$12.2 million.
- (b) If at the end of any year, Con Edison's investments in its non-utility businesses exceed 15 percent of Con Edison's total consolidated revenues, assets or cash flow, or if the ratio of holding company debt to total consolidated debt rises above 20 percent, O&R is required to notify the NYSPSC and submit a ring-fencing plan or a demonstration why additional ring-fencing measures are not necessary.
- (c) Reflects amortization of, among other things, the Company's net benefits under the TCJA prior to January 1, 2019, amortization of net regulatory liability for future income taxes and reduction of previously incurred regulatory assets for environmental remediation costs. Also, for electric, reflects amortization over a six year period of previously incurred incremental major storm costs. See "Other Regulatory Matters," below, and "Superfund Sites" in Note G.
- (d) Deferrals for property taxes are limited to 90 percent of the difference from amounts reflected in rates, subject to an annual maximum for the remaining difference of not more than a maximum number of basis points impact on return on common equity: Yr. 1 - 10.0 basis points; Yr. 2 - 7.5 basis points; and Yr. 3 - 5.0 basis points.
- (e) Energy efficiency costs are expensed as incurred. Such costs are subject to a downward-only reconciliation over the terms of the electric and gas rate plans. The Company will defer for the benefit of customers any cumulative shortfall over the terms of the electric and gas rate plans between actual expenditures and the levels provided in rates.
- (f) In addition, amounts reflected in rates relating to income taxes and excess deferred federal income tax liability balances will be reconciled (i.e., refunded to or collected from customers) to any final, non-appealable NYSPSC-ordered findings in its investigation of O&R's income tax accounting. See "Other Regulatory Matters," in Note B.
- (g) Net plant reconciliation for AMI expenditures will be implemented for a single category of AMI capital expenditures that includes amounts allocated to both electric and gas customers.

Notes to the Financial Statements (Unaudited) - continued

O&R New York - Gas

Effective period	January 2019 – December 2021 (b)
Base rate changes (a)	Yr. 1 – \$(7.5) million Yr. 2 – \$3.6 million Yr. 3 – \$0.7 million
Amortization to income of net regulatory (assets) and liabilities (c)	Yr. 1 – \$1.8 million Yr. 2 – \$1.8 million Yr. 3 – \$1.8 million
Other revenue sources	Continuation of retention of annual revenues from non-firm customers of up to \$4.0 million, with variances to be shared 80 percent by customers and 20 percent by company. Potential earnings adjustment mechanism incentives of up to \$0.3 million annually. Potential incentives if performance targets related to gas leak backlog, leak prone pipe, emergency response, damage prevention and service terminations are met: Yr. 1 - \$1.2 million; Yr. 2 - \$1.3 million; and Yr. 3 - \$1.3 million.
Revenue decoupling mechanisms	Continuation of reconciliation of actual to authorized gas delivery revenues.
Recoverable energy costs	Continuation of current rate recovery of purchased gas costs.
Negative revenue adjustments	Potential penalties if performance targets relating to service, safety and other matters are not met: Yr. 1 - \$5.5 million; Yr. 2 - \$5.7 million; and Yr. 3 - \$6.0 million.
Cost reconciliations	Reconciliation of expenses for pension and other postretirement benefits, environmental remediation costs, property taxes (d), energy efficiency program (e), the impact of new laws and certain other costs to amounts reflected in rates.(f)
Net utility plant reconciliations	Target levels reflected in rates were: Gas average net plant target excluding AMI: Yr. 1 - \$593 million; Yr. 2 - \$611 million; Yr. 3 - \$632 million AMI (g): Yr. 1 - \$20 million; Yr. 2 - \$24 million; Yr. 3 - \$25 million
Average rate base	Yr. 1 – \$454 million Yr. 2 – \$476 million Yr. 3 – \$498 million
Weighted average cost of capital (after-tax)	Yr. 1 – 6.97 percent Yr. 2 – 6.96 percent Yr. 3 – 6.96 percent
Authorized return on common equity	9.00 percent
Earnings sharing	Most earnings above an annual earnings threshold of 9.6 percent are to be applied to reduce regulatory assets for environmental remediation and other costs accumulated in the rate year.
Cost of long-term debt	Yr. 1 – 5.17 percent Yr. 2 – 5.14 percent Yr. 3 – 5.14 percent
Common equity ratio	48 percent

(a) The Joint Proposal recommends that these base rate changes may be implemented with changes of: Yr. 1 - \$(5.9) million; Yr. 2 - \$1.0 million; and Yr. 3 - \$1.0 million.

Footnotes (b) through (g) to this table are the same as footnotes (b) through (g) to the table under "O&R New York - Electric," above.

Other Regulatory Matters

In December 2017, the NYSPSC issued an order initiating a proceeding to study the potential effects of the federal Tax Cuts and Jobs Act of 2017 (TCJA) on income tax expense and liabilities of New York State utilities and the regulatory treatment to preserve the resulting benefits for customers. Upon enactment of the TCJA in December 2017, O&R re-measured its deferred tax assets and liabilities and accrued net regulatory liabilities for future income taxes of \$161 million. In September 2018, O&R accrued additional net regulatory liabilities for future income tax of \$7 million (see Note I). Under the rate normalization requirements continued by the TCJA, the "protected" portion of its net regulatory liabilities related to certain accelerated tax depreciation benefits (\$133 million) is to be amortized over the remaining lives of the related assets. The remainder of the net regulatory liabilities, or "unprotected portion," (\$35 million) is to be amortized as determined by the NYSPSC.

Pursuant to the Joint Proposal, O&R is to reflect its TCJA net benefits in its electric and gas rates beginning as of January 1, 2019, to amortize its net benefits prior to January 1, 2019 (estimated \$22 million) over a three-

Notes to the Financial Statements (Unaudited) - continued

year period and to amortize the protected portion of its net regulatory liability for future income taxes over the remaining lives of the related assets and the unprotected portion over a fifteen-year period.

For the nine months ended September 30, 2018, O&R deferred as a regulatory liability estimated net benefits of the TCJA of \$21 million.

In January 2018, the NYSPSC issued an order initiating a focused operations audit of the income tax accounting of certain utilities, including O&R.

In January 2018, the NJBPU issued an order initiating a proceeding to consider the TCJA. In June 2018, the NJBPU made permanent its previously approved \$2.9 million interim decrease in RECO's electric base rates, effective April 1, 2018, and ordered RECO to pay to its customers in July 2018 its approximately \$1 million of net benefits of the TCJA for the three-month period ended March 31, 2018 and to begin in July 2018 to refund to its customers the unprotected portion of its net regulatory liability for future income taxes over a three-year period. Also in March 2018, the Federal Energy Regulatory Commission (FERC) issued an order directing RECO to propose revisions to its transmission revenue requirement to reflect the TCJA. RECO's net regulatory liability for future income taxes resulting from its re-measurement of its deferred tax asset and liabilities is \$28 million (including \$16 million subject to the normalization requirements continued by the TCJA).

In March 2018, Winter Storms Riley and Quinn caused damage to the Company's electric distribution systems and interrupted service to approximately 93,000 O&R customers and 44,000 RECO customers. Through September 30, 2018, O&R and RECO had storm-related costs of \$44 million and \$17 million, respectively, most of which were deferred as regulatory assets pursuant to their electric rate plans. In addition pursuant to the November 2018 Joint Proposal for new electric and gas rate plans (see "Rate Plans," above), O&R is to defer and recover a maximum of \$4.5 million of costs incurred relating to Winter Storm Toby. O&R accrued a regulatory asset at September 30, 2018 to defer \$4.5 million of costs incurred relating to Winter Storm Toby that the Company had expensed in March 2018. Recovery of O&R's storm-related costs is subject to review by the NYSPSC, and recovery of RECO storm-related costs is subject to review by the NJBPU. The NYSPSC is investigating the preparation and response to the storms by O&R and other New York electric utilities, including all aspects of their emergency response plans, and may penalize them. In July 2018, the NJBPU adopted NJBPU staff's recommendations to increase requirements for New Jersey utilities, including RECO, relating to pre-storm preparations, restoration of service and communications and outreach. The Company is unable to estimate the amount or range of its possible loss in connection with the storms.

In May 2018, the NYSPSC staff recommended that the NYSPSC disallow approximately \$15 million of environmental site investigation and remediation costs. Pursuant to the Joint Proposal, to resolve all prudence-related claims related to the litigation, O&R is to reduce its regulatory asset for environmental remediation costs by \$9 million (which the Company has reflected in its financial statements effective as of September 30, 2018). See "Superfund Sites" in Note G.

Notes to the Financial Statements (Unaudited) - continued

Regulatory Assets and Liabilities

Regulatory assets and liabilities at September 30, 2018 and December 31, 2017 were comprised of the following items:

<i>(Millions of Dollars)</i>	2018	2017
Regulatory assets		
Unrecognized pension and other postretirement costs	\$120	\$150
Environmental remediation costs	100	116
Deferred storm costs	80	38
Property tax reconciliation	17	26
Pension and other postretirement benefits deferrals	17	22
Revenue taxes	12	11
Recoverable energy costs	5	8
Deferred derivative losses	5	7
Transition bond charges	3	9
Other	15	16
Regulatory assets – noncurrent	374	403
Deferred derivative losses	5	2
Recoverable energy costs	1	2
Regulatory assets – current	6	4
Total Regulatory Assets	\$380	\$407
Regulatory liabilities		
Future federal income tax	\$149	\$145
Allowance for cost of removal less salvage	132	127
Pension and other postretirement benefit deferrals	23	26
TCJA net benefits*	21	—
Carrying charges on deferred tax liability	14	14
Earnings sharing - electric and gas	10	10
Long-term debt interest reconciliation	—	3
Other	24	23
Regulatory liabilities – noncurrent	373	348
Refundable energy costs	20	25
Deferred derivative gains	2	3
Revenue decoupling mechanism	1	8
Regulatory liabilities – current	23	36
Total Regulatory Liabilities	\$396	\$384

* See "Other Regulatory Matters," above.

Notes to the Financial Statements (Unaudited) - continued

Note C – Capitalization

Long-Term Debt

In August 2018, O&R issued \$125 million aggregate principal amount of 4.35 percent debentures, due 2048, and agreed to issue an additional \$25 million aggregate principal amount of debentures in December 2018. In September 2018, O&R redeemed at maturity \$50 million of 6.15 percent 10-year debentures.

The carrying amounts and fair values of long-term debt at September 30, 2018 and December 31, 2017 were:

<i>(Millions of Dollars)</i>	2018		2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-Term Debt (including current portion) (a)	\$733	\$767	\$661	\$759

(a) Amounts shown are net of unamortized debt expense and unamortized debt discount of \$6 million at September 30, 2018 and December 31, 2017.

Fair values of long-term debt have been estimated primarily using available market information and are classified as Level 2 liabilities (see Note K). Long-term debt included \$4 million and \$7 million at September 30, 2018 and December 31, 2017, 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.

Note D – Short-Term Borrowing

At September 30, 2018 and December 31, 2017, O&R had \$80 million and \$96 million of commercial paper outstanding, respectively. The weighted average interest rate at September 30, 2018 and December 31, 2017 was 2.4 percent and 1.8 percent, respectively. At September 30, 2018 and December 31, 2017, an immaterial amount of letters of credit were outstanding for O&R under the Credit Agreement.

Note E – Pension Benefits

Total Periodic Benefit Cost

The components of the Company's total periodic benefit cost for the three and nine months ended September 30, 2018 and 2017 were as follows:

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Service cost – including administrative expenses	\$5	\$4	\$14	\$13
Interest cost on projected benefit obligation	9	9	26	28
Expected return on plan assets	(13)	(12)	(40)	(37)
Recognition of net actuarial loss	9	8	27	23
Recognition of prior service cost	—	—	2	1
TOTAL PERIODIC BENEFIT COST	\$10	\$9	\$29	\$28
Cost capitalized	(2)	(3)	(5)	(10)
Reconciliation to rate level	2	2	6	5
Total expense recognized	\$10	\$8	\$30	\$23

Notes to the Financial Statements (Unaudited) - continued

In March 2017, the Financial Accounting Standards Board (FASB) issued amendments to the guidance for retirement benefits through ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." The Company adopted ASU 2017-07 beginning on January 1, 2018. The guidance requires that components of net periodic benefit cost other than service cost be presented outside of operating income on consolidated income statements, and that only the service cost component is eligible for capitalization. Accordingly, the service cost components are included in the line "Other operations and maintenance" and the non-service cost components are included in the line "Other deductions" in the Company's consolidated income statements. As permitted by a practical expedient under ASU 2017-07, the Company applied the presentation requirements retrospectively for both pension and other postretirement benefit costs using amounts disclosed in prior-period financial statements as appropriate estimates.

Expected Contributions

Based on estimates as of September 30, 2018, O&R expects to make contributions to the pension plans during 2018 of \$39 million. O&R's policy is to fund the total periodic benefit cost of the qualified plan to the extent tax deductible and to also contribute to the non-qualified plan. During the first nine months of 2018, the Company contributed \$39 million to the pension plans.

Note F – Other Postretirement Benefits

Total Periodic Benefit Cost

The components of the Company's total periodic other postretirement benefit cost for the three and nine months ended September 30, 2018 and 2017 were as follows:

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Service cost – including administrative expenses	\$2	\$1	\$5	\$4
Interest cost on projected other postretirement benefit obligation	2	2	6	6
Expected return on plan assets	(3)	(2)	(8)	(6)
Recognition of net actuarial loss	1	1	4	4
Recognition of prior service cost/(credit)	(1)	(1)	(3)	(4)
TOTAL PERIODIC OTHER POSTRETIREMENT BENEFIT COST	\$1	\$1	\$4	\$4
Cost capitalized	(1)	(1)	(2)	(1)
Reconciliation to rate level	—	—	(1)	(2)
Total expense recognized	\$—	\$—	\$1	\$1

For information about the adoption of ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," see Note E.

Contributions

The Company made a contribution of \$0.3 million to the other postretirement benefit plans in 2018. O&R's policy is to fund the total periodic benefit cost of the plans to the extent tax deductible.

Notes to the Financial Statements (Unaudited) - 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 September 30, 2018 and December 31, 2017 were as follows:

<i>(Millions of Dollars)</i>	2018	2017
Accrued Liabilities:		
Manufactured gas plant sites	\$92	\$99
Other Superfund Sites	1	1
Total	\$93	\$100
Regulatory assets	\$100	\$116

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. 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.

Notes to the Financial Statements (Unaudited) - continued

Under its current electric and gas rate plans, the Company is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) prudently incurred site investigation and remediation costs. The amount of site investigation and remediation costs to be recovered is reduced by, among other things, insurance recoveries. Under the Company's current electric and gas rate plans, the NYSPSC may consider and address the amount of any claims for site investigation and remediation costs under third-party liability policies denied by an insurer with which O&R was then engaged in litigation. The insurer has denied coverage of claims submitted by O&R for approximately \$15 million of site investigation and remediation costs (which costs have been deferred as regulatory assets). In September 2015, the New York State Court of Appeals denied O&R's motion for leave to appeal adverse coverage determinations by lower courts. In December 2015, at the NYSPSC's direction, O&R made a filing explaining why the site investigation and remediation costs that were the subject of the litigation over insurance coverage should be recovered through rates. In May 2018, the NYSPSC staff recommended that the NYSPSC disallow approximately \$15 million of site investigation and remediation costs. Pursuant to the Joint Proposal (see "Rate Plans" in Note B), to resolve all prudence-related claims related to the litigation, O&R is to reduce its regulatory asset for environmental remediation costs by \$9 million (which the Company has reflected in its financial statements effective as of September 30, 2018).

Environmental remediation costs incurred related to Superfund Sites for the three and nine months ended September 30, 2018 and 2017 were as follows:

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Remediation costs incurred	\$3	\$2	\$4	\$5

Insurance and other third-party recoveries received by the Company for the nine months ended September 30, 2018 were immaterial, and no insurance or other third-party recoveries were received by the Company for the nine months ended September 30, 2017.

In 2017, 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 \$156 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.

Notes to the Financial Statements (Unaudited) - continued

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 September 30, 2018 and December 31, 2017, 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 as shown in the following table. The estimates were based upon a combination of modeling, historical data analysis and risk factor assessment. Courts have begun, and unless otherwise determined on appeal may continue, to apply different standards 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 September 30, 2018 and December 31, 2017 were as follows:

<i>(Millions of Dollars)</i>	2018	2017
Accrued liability – asbestos suits	\$0.4	\$0.4
Regulatory assets – asbestos suits	0.4	0.4
Accrued liability – workers' compensation	\$4.0	\$4.1

Note H – Income Tax

O&R's income tax expense decreased to \$6 million for the three months ended September 30, 2018, from \$14 million for the three months ended September 30, 2017. The decrease in income tax expense is primarily due to the lower corporate federal income tax rate of 21 percent in 2018 resulting from the enactment of the TCJA, lower income before income tax expense and an increase in the amortization of excess deferred federal income taxes due to the TCJA.

O&R's income tax expense decreased to \$14 million for the nine months ended September 30, 2018, from \$36 million for the nine months ended September 30, 2017. The decrease in income tax expense is primarily due to the lower corporate federal income tax rate of 21 percent in 2018 resulting from the enactment of the TCJA, lower income before income tax expense, higher tax benefits for plant-related flow through items and an increase in the amortization of excess deferred federal income taxes due to the TCJA.

Notes to the Financial Statements (Unaudited) - continued

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 for the three and nine months ended September 30, 2018 and 2017 is as follows:

<i>(% of Pre-tax income)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
STATUTORY TAX RATE				
Federal	21%	35%	21%	35%
Changes in computed taxes resulting from:				
State income tax	5	5	5	4
Cost of removal	1	1	2	2
Other plant-related items	—	(2)	—	—
Research credits	—	—	(1)	—
Amortization of excess deferred federal income taxes	(5)	—	(5)	—
Other	—	(1)	—	(1)
Effective tax rate	22%	38%	22%	40%

O&R deferred as a regulatory liability its estimated net benefits under the TCJA for the nine months ended September 30, 2018. RECO deferred as a regulatory liability its estimated net benefits under the TCJA for the three months ended March 31, 2018. The net benefits include the revenue requirement impact of the reduction in the corporate federal income tax rate to 21 percent and the amortization of excess deferred federal income taxes the utilities collected from their customers that will not need to be paid to the Internal Revenue Service under the TCJA. See “Other Regulatory Matters” in Note B.

At December 31, 2017, O&R made an accounting policy election to apply SEC Staff Accounting Bulletin 118 (SAB 118) and recorded provisional income tax amounts in its accounting for certain effects of the provisions of the TCJA as allowed under SEC Staff Accounting Bulletin 118 (SAB 118). SAB 118 allowed a one year period for companies to finalize the provisional amounts recorded as of December 31, 2017. In August 2018, the Internal Revenue Service and U.S. Department of Treasury issued proposed regulations that clarified provisions in TCJA on the allowance for additional first-year depreciation for qualified property of regulated public utilities placed in service in the fourth quarter of 2017. Under this guidance, O&R deducted \$29 million in additional depreciation in Con Edison’s 2017 federal tax return. The additional depreciation required O&R to re-measure its deferred tax assets and liabilities associated with the filing of its 2017 federal tax return. As a result, O&R decreased its net deferred tax liabilities by \$7 million and accrued a regulatory liability for future income tax of \$7 million. O&R expects to complete its assessment and record any final adjustments to the provisional amounts by the fourth quarter of 2018.

Notes to the Financial Statements (Unaudited) - continued

Uncertain Tax Positions

In March 2018, Con Edison received approval of its tax refunds by the Joint Committee on Taxation for tax years 2012 through 2015. The approval effectively settled an immaterial amount of O&R's uncertain federal tax positions. Federal tax returns for 2016 and 2017 remain under examination.

At September 30, 2018, the estimated liability for uncertain tax positions for O&R was \$3 million. O&R reasonably expects to resolve within the next twelve months approximately \$3 million of various federal and state uncertainties due to the expected completion of ongoing tax examinations, resolution of state refund claims and expiration of statute of limitations, of which the entire amount, if recognized, would reduce O&R's effective tax rate. The total amount of unrecognized tax benefits, if recognized, that would reduce O&R's effective tax rate is \$3 million.

On April 30, 2018, the New Jersey Tax Court rejected RECO's argument that it was not required to add back the transitional energy facility assessment (TEFA) to compute its taxable income in New Jersey. RECO maintains a \$2 million receivable for the claims it filed for tax years 2008 through 2011 and a liability for uncertain tax positions for all open tax years of approximately \$3 million. RECO appealed this decision and filed its brief in October 2018. A decision by the New Jersey Appellate Court is anticipated in the first half of 2019.

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 statement. In the three and nine months ended September 30, 2018, O&R recognized an immaterial amount of interest expense and no penalties for uncertain tax positions in its consolidated income statement. At September 30, 2018 and December 31, 2017, O&R recognized an immaterial amount of accrued interest on its consolidated balance sheet.

Notes to the Financial Statements (Unaudited) - continued

Note I – Financial Information by Business Segment

O&R's principal business segments are its regulated electric and gas utility activities. The financial data for the business segments are as follows:

For the Three Months Ended September 30,						
	Operating revenues		Depreciation and amortization		Operating income	
<i>(Millions of Dollars)</i>	2018	2017	2018	2017	2018	2017
Electric	\$212	\$206	\$14	\$13	\$52	\$60
Gas	34	28	5	5	(10)	(10)
Total	\$246	\$234	\$19	\$18	\$42	\$50

For the Nine Months Ended September 30,						
	Operating revenues		Depreciation and amortization		Operating income	
<i>(Millions of Dollars)</i>	2018	2017	2018	2017	2018	2017
Electric	\$505	\$495	\$41	\$38	\$79	\$94
Gas	186	172	16	15	31	37
Total	\$691	\$667	\$57	\$53	\$110	\$131

Note J – Derivative Instruments and Hedging Activities

The Company hedges market price fluctuations associated with physical purchases and sales of electricity, natural gas and, to a lesser extent, refined fuels by using derivative instruments including futures, forwards and options. Derivatives are recognized on the consolidated balance sheet at fair value (see Note K), 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.

Notes to the Financial Statements (Unaudited) - continued

The fair values of the Company's commodity derivatives including the offsetting of assets and liabilities on the consolidated balance sheet at September 30, 2018 and December 31, 2017 were:

<i>(Millions of Dollars)</i>	2018			2017		
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	\$(1)	\$1 (b)	\$5	\$(2)	\$3
Noncurrent	2	(1)	1	1	—	1
Total fair value of derivative assets	\$4	\$(2)	\$2 (b)	\$6	\$(2)	\$4
Fair value of derivative liabilities						
Current	\$(6)	\$—	\$(6)	\$(4)	\$1	\$(3)
Noncurrent	(5)	2	(3)	(7)	—	(7)
Total fair value of derivative liabilities	\$(11)	\$2	\$(9)	\$(11)	\$1	\$(10)
Net fair value derivative assets/(liabilities)	\$(7)	\$—	\$(7) (b)	\$(5)	\$(1)	\$(6)

(a) Derivative instruments and collateral were offset 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 offset in the event of contract termination. In such case, generally the non-defaulting party's payable will be offset 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 September 30, 2018, margin deposits of \$1 million were classified as derivative assets on the consolidated 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. In accordance with the accounting rules for regulated operations, the Company records a regulatory asset or regulatory 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 Consolidated Edison Company of New York, Inc. (CECONY, and 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 NYSPSC. See Note L.

Notes to the Financial Statements (Unaudited) - continued

The following table presents the realized and unrealized gains or losses on commodity derivatives that have been deferred for the three and nine months ended September 30, 2018 and 2017:

<i>(Millions of Dollars)</i>	Balance Sheet Location	For the Three Months Ended September 30,	
		2018	2017
Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations:			
Current	Deferred derivative gains	\$1	\$(1)
Noncurrent	Deferred derivative gains	(2)	—
Total deferred gains/(losses)		\$(1)	\$(1)
Current	Deferred derivative losses	\$(1)	\$(1)
Current	Recoverable energy costs	2	(2)
Noncurrent	Deferred derivative losses	1	(4)
Total deferred gains/(losses)		\$2	\$(7)
Net deferred gains/(losses)		\$1	\$(8)

<i>(Millions of Dollars)</i>	Balance Sheet Location	For the Nine Months Ended September 30,	
		2018	2017
Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations:			
Current	Deferred derivative gains	\$—	\$(3)
Noncurrent	Deferred derivative gains	1	—
Total deferred gains/(losses)		1	\$(3)
Current	Deferred derivative losses	\$(3)	\$(1)
Current	Recoverable energy costs	2	(9)
Noncurrent	Deferred derivative losses	2	(4)
Total deferred gains/(losses)		\$1	\$(14)
Net deferred gains/(losses)		\$2	\$(17)

The following table presents the hedged volume of the Company's derivative transactions at September 30, 2018:

Electric Energy (MWh) (a)	Capacity (MW) (a)	Natural Gas (Dt) (a)
2,650,140	3,660	13,120,000

(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 offset.

At September 30, 2018, the Company had \$2 million of credit exposure in connection with energy supply and hedging activities, net of collateral related to investment-grade counterparties and exchange brokers.

Notes to the Financial Statements (Unaudited) - continued

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 September 30, 2018:

(Millions of Dollars)

Aggregate fair value – net liabilities (a)	\$8
Collateral posted	3
Additional collateral (b) (downgrade one level from current ratings)	—
Additional collateral (b) (downgrade to below investment grade from current ratings)	2 (c)

- (a) Non-derivative transactions for the purchase and sale of electricity, 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 not be required to post collateral at September 30, 2018. 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 offset.
- (c) Derivative instruments that are net assets have been excluded from the table. At September 30, 2018, if the Company had been downgraded to below investment grade, it would not have been required to post additional collateral for such derivative instruments.

Note K – 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

Notes to the Financial Statements (Unaudited) - continued

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 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 as of September 30, 2018 and December 31, 2017 are summarized below.

<i>(Millions of Dollars)</i>	2018					2017				
	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)	\$—	\$2	\$1	\$—	\$3	\$—	\$3	\$1	\$—	\$4
Other (a)(b)(d)	21	6	—	—	27	23	6	—	—	29
Total assets	\$21	\$8	\$1	\$—	\$30	\$23	\$9	\$1	\$—	\$33
Derivative liabilities:										
Commodity (a)(b)(c)	\$—	\$2	\$7	\$—	\$9	\$—	\$4	\$5	\$1	\$10

(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 and 2 for the nine months ended September 30, 2018. There was an immaterial amount of commodity derivative assets transferred from level 3 to level 2 during the nine months ended September 30, 2018 because of availability of observable market data due to the decrease in the terms of certain contracts from beyond three years as of December 31, 2017 to less than three years as of September 30, 2018. There were \$1 million of commodity derivative liabilities transferred from level 3 to level 2 during the year ended December 31, 2017 because of availability of observable market data due to the decrease in the terms of certain contracts from beyond three years as of September 30, 2017 to less than three years as of December 31, 2017.

(b) Level 2 assets and liabilities include investments held in the deferred compensation plan and/or non-qualified retirement plans, 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.

Notes to the Financial Statements (Unaudited) - continued

- (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 September 30, 2018 and December 31, 2017, 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.

CECONY's risk management group develops and maintains the valuation policies and procedures for, and verifies 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.

Commodity	Fair Value of Level 3 at September 30, 2018 (Millions of Dollars)	Valuation Techniques	Unobservable Inputs	Range
Electricity	\$(6)	Discounted Cash Flow	Forward energy prices (a)	\$24.50-\$70.00 per MWh
		Discounted Cash Flow	Forward capacity prices (a)	\$1.70-\$7.20 per KW-month

(a) Generally, increases/(decreases) in this input in isolation would result in a higher/(lower) fair value measurement.

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the three and nine months ended September 30, 2018 and 2017 and classified as Level 3 in the fair value hierarchy:

(Millions of Dollars)	For The Three Months Ended September 30,	
	2018	2017
Beginning balance as of July 1,	\$(1)	\$(1)
Included in earnings	3	2
Included in regulatory assets and liabilities	(4)	(5)
Settlements	(4)	(3)
Ending balance as of September 30,	\$(6)	\$(7)

(Millions of Dollars)	For The Nine Months Ended September 30,	
	2018	2017
Beginning balance as of January 1,	\$(4)	\$1
Included in earnings	4	4
Included in regulatory assets and liabilities	(2)	(7)
Settlements	(4)	(5)
Ending balance as of September 30,	\$(6)	\$(7)

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. Unrealized gains and losses for commodity derivatives are generally deferred on the consolidated balance sheet in accordance with the accounting rules for regulated operations.

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Note L – 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 technology, 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 three and nine months ended September 30, 2018 and 2017 were as follows:

<i>(Millions of Dollars)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of services provided	\$4	\$4	\$21	\$13
Cost of services received	\$13	\$12	\$41	\$38

At September 30, 2018 and December 31, 2017, O&R's payable to Con Edison and its other subsidiaries associated with these services were \$2 million and \$6 million, respectively. In addition, at September 30, 2018, the Company's receivable from CECONY related to aid provided for storm restoration activities was \$5 million.

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY \$13 million and \$12 million of natural gas for the three months ended September 30, 2018 and 2017, respectively, and \$60 million and \$47 million for the nine months ended September 30, 2018 and 2017, respectively. These amounts are net of the effect of related hedging transactions. At September 30, 2018 and December 31, 2017, O&R's net payable to CECONY associated with these gas purchases was \$4 million and \$10 million, respectively.

At September 30, 2018, the Company's net receivable from Con Edison for income taxes was \$15 million. At December 31, 2017, the Company's payable to Con Edison for income taxes was \$20 million.

FERC has authorized CECONY through 2019 to periodically lend funds to O&R, for periods of not more than 12 months, in amounts not to exceed \$250 million outstanding at any time, at prevailing market rates. At September 30, 2018 and December 31, 2017, there were no loans outstanding for O&R.

Note M – New Financial Accounting Standards

In February 2016, the FASB issued amendments on financial reporting of leasing transactions through Accounting Standards Update (ASU) No. 2016-02, "Leases (Topic 842)." The amendments require lessees to recognize assets and liabilities on the balance sheet and disclose key information about leasing arrangements. Lessees will need to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than

Notes to the Financial Statements (Unaudited) - continued

leases that meet the definition of a short-term lease). The Company, as a regulated entity, is permitted to continue to recognize expense using the timing that conforms to the regulatory rate treatment. Lessor accounting is similar to the current model, but updated to align with "Revenue from Contracts with Customers (Topic 606)." The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, and the Company plans to adopt the amendments for reporting periods beginning after December 15, 2018. The amendments must be adopted using a modified retrospective transition and provide for certain practical expedients.

Upon adoption of the amendments, the Company expects to elect the following practical expedients: (1) for leases commenced prior to adoption date, the following three transition expedients that will allow the Company to not reassess: (a) whether expired contracts contain leases; (b) the lease classification for expired leases and (c) the initial direct costs for existing leases; (2) if elected for an underlying asset class, an expedient that will allow the Company to not apply the recognition requirements to short-term leases and an expedient that will allow the Company to account for lease and associated non-lease components as a single lease component; (3) an expedient that allows the use of hindsight to determine lease term; and (4) an expedient that will allow the Company to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under the current lease standard. For leases currently classified as operating leases, upon adoption of the amendments, the Company expects to recognize on its balance sheet right-of-use assets and lease liabilities. The adoption of the amendments is not expected to have a material effect on the Company's liquidity. The Company is continuing to evaluate the potential impact of the amendments on the Company's results of operations and the additional disclosures required.

In August 2017, the FASB issued amendments to the guidance for derivatives and hedging through ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The amendments in this update provide greater clarification on hedge accounting for risk components, presentation and disclosure of hedging instruments, and overall targeted improvements to simplify hedge accounting. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, and the Company plans to adopt the amendments for reporting periods beginning after December 15, 2018. The Company is in the process of evaluating the potential impact of the new guidance on the Company's financial position, results of operations and liquidity.

In February 2018, the FASB issued amendments to the guidance for reporting comprehensive income through ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company is electing to adopt the amendments in the

Notes to the Financial Statements (Unaudited) - continued

fourth quarter of 2018. The impact of adoption on the Company's financial position, results of operations and liquidity is expected to be immaterial.

In August 2018, the FASB issued amendments to the guidance for internal use software through ASU 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract." The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments are effective for fiscal years beginning after December 15, 2020, and interim periods beginning after December 15, 2021, with early adoption permitted. The Company elected to adopt the amendments in the third quarter of 2018, prospectively for all in-scope implementation costs incurred after the date of adoption. The impact of adoption on the Company's financial position, results of operations and liquidity was immaterial.