

Orange and Rockland Utilities, Inc.
2012 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 Stockholder and 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, 2012 and 2011, 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, 2012.

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 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, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP
New York, New York
March 8, 2013

Orange and Rockland Utilities, Inc.
CONSOLIDATED INCOME STATEMENT

	For the Years Ended December 31,		
	2012	2011	2010
	(Millions of Dollars)		
OPERATING REVENUES			
Electric	\$ 592	\$ 641	\$ 692
Gas	203	214	218
TOTAL OPERATING REVENUES	795	855	910
OPERATING EXPENSES			
Purchased power	198	267	335
Gas purchased for resale	69	87	99
Other operations and maintenance	291	284	275
Depreciation and amortization	53	48	44
Taxes, other than income taxes	61	55	49
TOTAL OPERATING EXPENSES	672	741	802
OPERATING INCOME	123	114	108
OTHER INCOME (DEDUCTIONS)			
Investment and other income	-	2	-
Allowance for equity funds used during construction	2	3	3
Other deductions	-	(1)	(1)
TOTAL OTHER INCOME (DEDUCTIONS)	2	4	2
INCOME BEFORE INTEREST AND INCOME TAX EXPENSE	125	118	110
INTEREST EXPENSE			
Interest on long-term debt	33	32	32
Other interest	(2)	3	5
Allowance for borrowed funds used during construction	(1)	(1)	(2)
NET INTEREST EXPENSE	30	34	35
INCOME BEFORE INCOME TAX EXPENSE	95	84	75
INCOME TAX EXPENSE	31	31	26
NET INCOME	\$ 64	\$ 53	\$ 49

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,		
	2012	2011	2010
	(Millions of Dollars)		
NET INCOME	\$ 64	\$ 53	\$ 49
OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES			
Pension plan liability adjustments, net of \$5, \$(11) and \$6 taxes in 2012, 2011 and 2010, respectively	6	(16)	4
TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES	6	(16)	4
COMPREHENSIVE INCOME	\$ 70	\$ 37	\$ 53

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

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

	For the Twelve Months Ended December 31,		
	2012	2011	2010
	(Millions of Dollars)		
OPERATING ACTIVITIES			
Net income	\$ 64	\$ 53	\$ 49
PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME			
Depreciation and amortization	53	48	44
Deferred income taxes	90	30	19
Other non-cash items (net)	26	(23)	17
CHANGES IN ASSETS AND LIABILITIES			
Accounts receivable - customers, less allowance for uncollectibles	2	13	(13)
Accounts receivable from affiliated companies	(61)	17	(17)
Materials and supplies, including gas in storage	8	(3)	4
Prepayments, other receivables and other current assets	-	15	20
Recoverable energy costs	(5)	12	6
Accounts payable	44	(3)	-
Accounts payable to affiliated companies	9	(21)	10
Pensions and retiree benefits obligations	85	94	53
Pensions and retiree benefits contributions	(66)	(52)	(48)
Superfund and environmental remediation costs (net)	(1)	1	4
Accrued taxes	2	5	-
Accrued interest	(3)	2	3
Deferred charges, noncurrent assets and other regulatory assets	(105)	(33)	(9)
Deferred credits and other regulatory liabilities	(9)	15	(3)
Other liabilities	6	5	7
NET CASH FLOWS FROM OPERATING ACTIVITIES	139	175	146
INVESTING ACTIVITIES			
Utility construction expenditures	(131)	(105)	(135)
Increase in restricted cash	-	-	(1)
Cost of removal less salvage	(5)	(4)	(4)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(136)	(109)	(140)
FINANCING ACTIVITIES			
Net proceeds of short-term debt	3	-	-
Issuance of long-term debt	-	-	170
Retirement of long-term debt	(3)	(3)	(158)
Dividend to parent	(34)	(32)	(32)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	(34)	(35)	(20)
CASH AND TEMPORARY CASH INVESTMENTS:			
NET CHANGE FOR THE PERIOD	(31)	31	(14)
BALANCE AT BEGINNING OF PERIOD	69	38	52
BALANCE AT END OF PERIOD	\$ 38	\$ 69	\$ 38
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid/(refunded) during the period for:			
Interest	\$31	\$31	\$30
Income taxes	(\$5)	(\$16)	\$7

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2012	December 31, 2011
	(Millions of Dollars)	
ASSETS		
CURRENT ASSETS		
Cash and temporary cash investments	\$ 38	\$ 69
Accounts receivable - customers, less allowance for uncollectible accounts of \$5 and \$6 in 2012 and 2011, respectively	56	58
Accrued unbilled revenue	38	32
Other receivables, less allowance for uncollectible accounts of \$2 and \$1 in 2012 and 2011, respectively	3	9
Accounts receivable from affiliated companies	73	12
Gas in storage, at average cost	19	29
Materials and supplies, at average cost	13	11
Prepayments	24	21
Deferred tax assets - current	51	29
Regulatory assets	13	24
Other current assets	11	12
TOTAL CURRENT ASSETS	339	306
INVESTMENTS	16	10
UTILITY PLANT, AT ORIGINAL COST		
Electric	1,297	1,228
Gas	573	534
General	175	159
Total	2,045	1,921
Less: Accumulated depreciation	563	528
Net	1,482	1,393
Construction work in progress	80	76
NET UTILITY PLANT	1,562	1,469
DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS		
Regulatory assets	733	681
Other deferred charges and noncurrent assets	21	20
TOTAL DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS	754	701
TOTAL ASSETS	\$ 2,671	\$ 2,486

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2012	December 31, 2011
	(Millions of Dollars)	
LIABILITIES AND SHAREHOLDER'S EQUITY		
CURRENT LIABILITIES		
Long-term debt due within one year	\$ 3	\$ 3
Notes payable	3	-
Accounts payable	135	85
Accounts payable to affiliated companies	21	13
Customer deposits	12	13
Accrued taxes	3	1
Accrued taxes to affiliated companies	5	4
Accrued interest	8	11
Accrued wages	10	10
Fair value of derivative liabilities	6	22
Regulatory liabilities	38	39
Other current liabilities	36	38
TOTAL CURRENT LIABILITIES	280	239
NONCURRENT LIABILITIES		
Provision for injuries and damages	7	7
Pensions and retiree benefits	458	498
Superfund and other environmental costs	113	116
Fair value of derivative liabilities	18	14
Other noncurrent liabilities	3	4
TOTAL NONCURRENT LIABILITIES	599	639
DEFERRED CREDITS AND REGULATORY LIABILITIES		
Deferred income taxes and investment tax credits	493	350
Regulatory liabilities	124	116
Other deferred credits	3	3
TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES	620	469
LONG-TERM DEBT	604	607
SHAREHOLDER'S EQUITY		
Common shareholder's equity (See Statement of Common Shareholder's Equity)	568	532
TOTAL SHAREHOLDER'S EQUITY	568	532
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	\$ 2,671	\$ 2,486

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

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

(Millions of Dollars/Except Share Data)	<u>Common Stock</u>		Additional	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Paid-In Capital	Earnings	Income/(Loss)	
BALANCE AS OF DECEMBER 31, 2009	1,000	\$ -	\$ 304	\$ 239	\$ (37)	\$ 506
Net Income				49		49
Common stock dividend to parent				(32)		(32)
Other comprehensive income					4	4
BALANCE AS OF DECEMBER 31, 2010	1,000	\$ -	\$ 304	\$ 256	\$ (33)	\$ 527
Net Income				53		53
Common stock dividend to parent				(32)		(32)
Other comprehensive loss					(16)	(16)
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

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, 2012	2011	2012	2011
	(Millions of Dollars)			
TOTAL COMMON SHAREHOLDER'S EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS	1,000	1,000	\$ 611	\$ 581
TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, PENSION PLAN LIABILITY ADJUSTMENTS, NET OF TAXES			(43)	(49)
TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF COMMON SHAREHOLDER'S EQUITY)			\$ 568	\$ 532
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	25	29
TOTAL TRANSITION BONDS			25	29
TAX-EXEMPT DEBT - Notes Issued to New York State Energy Research and Development Authority for Pollution Control Refunding Revenue Bonds**:				
2015	0.21%	1995	44	44
TOTAL TAX-EXEMPT DEBT			44	44
Unamortized debt discount			-	(1)
TOTAL			607	610
Less: long-term debt due within one year			3	3
TOTAL LONG-TERM DEBT			604	607
TOTAL CAPITALIZATION			\$ 1,172	\$ 1,139

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

** Rate reset weekly; December 31, 2012 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 year ended December 31, 2012, 2011, and 2010, operating revenues for RECO and Pike were 23.8 percent and 0.9 percent, 24.3 percent and 0.9 percent, and 25.6 percent and 0.8 percent, respectively, of O&R's consolidated operating revenues. O&R, along with its regulated utility subsidiaries, provides electric service in southeastern New York and adjacent areas of northern New Jersey and eastern Pennsylvania and gas service in southeastern New York and adjacent areas of eastern Pennsylvania. RECO owns Rockland Electric Company Transition Funding LLC (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, 2012 through the posting on its website (March 8, 2013) 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, including Transition Funding. All intercompany balances and transactions have been eliminated.

Accounting Policies

The accounting policies of the Company conform to accounting principles generally accepted in the United States of America. These accounting principles include the accounting rules for regulated operations and the accounting requirements of the FERC and the state public utility regulatory commissions 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 accounting rules for regulated operations. If revenues are recorded for costs that are expected to be incurred in the future, these revenues would be recorded as deferred credits or "regulatory liabilities" under the accounting rules for regulated operations.

Notes to the Financial Statements - Continued

The Company's principal regulatory assets and liabilities are detailed in Note B. The Company is receiving or being credited with a return on all of its regulatory assets for which a cash outflow has been made, and is paying or being charged with a return on all of its regulatory liabilities for which a cash inflow has been received. The Company's regulatory assets and liabilities will be recovered from customers, or applied for customer benefit, in accordance with rate provisions approved by the applicable public utility regulatory commission.

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

Plant and Depreciation

Utility Plant

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

Rates used for AFDC include the cost of borrowed funds and a reasonable rate of return on the Company's own funds when so used, determined in accordance with regulations of the FERC or the state public utility regulatory authority having jurisdiction. The rate is compounded semiannually, and the amounts applicable to borrowed funds are treated as a reduction of interest charges, while the amounts applicable to the Company's own funds are credited to other income (deductions). The AFDC rates for the Company were 7.0 percent, 6.6 percent and 5.8 percent for 2012, 2011 and 2010, 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 rate for the Company was 2.9 percent for 2012 and 2.8 percent for 2011 and 2010.

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

At December 31, 2012 and 2011, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

Notes to the Financial Statements - Continued

(Millions of Dollars)	2012	2011
Electric		
Transmission	\$180	\$178
Distribution	728	680
Gas*	435	403
General	128	120
Held for future use	11	12
Construction work in progress	80	76
NET UTILITY PLANT	\$1,562	\$1,469

* Primarily distribution.

Under O&R's current rate plans, the aggregate annual depreciation allowance in effect at December 31, 2012 was \$47 million.

Impairments

In accordance with the accounting rules for impairment or disposal of long-lived assets, the Company evaluates the impairment of long-lived assets, based on projections of undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. In the event an evaluation indicates that such cash flows cannot be expected to be sufficient to fully recover the assets, the assets are written down to their estimated fair value.

Revenues

The Company recognizes revenues for energy service on a monthly billing cycle basis. The Company generally defers over a 12-month period net interruptible gas revenues, other than those authorized by the 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, 2012 and 2011 were \$38 million and \$32 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 on a periodic basis, with the authorized delivery revenues and the difference accrued, with interest, for refund to, or recovery from, customers, as applicable. See "Rate Agreements" in Note B.

O&R and Pike are required to record gross receipts tax and RECO is required to record transitional energy facilities assessment (TEFA) tax as revenues and expenses on a gross income statement presentation basis (i.e., included in both revenue and expense). The recovery of these taxes is included in the revenue requirement within each of the respective approved rate plans. O&R and Pike recorded \$8.3 million and \$0.3 million, \$8.6 million and \$0.3 million, and \$7.8 million and \$0.3 million, of gross receipts tax in 2012, 2011 and 2010, respectively. RECO recorded \$4.6 million, \$6.3 million and \$6.4 million in TEFA tax in 2012, 2011 and 2010, respectively.

Notes to the Financial Statements - Continued

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 Pennsylvania-Jersey-Maryland (PJM) Independent System Operator. 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

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 New York Independent System Operator (NYISO). The difference between purchased power and related costs initially billed to the Company by the NYISO and the actual cost of power subsequently calculated by the NYISO is refunded by the NYISO to the Company, or paid to the NYISO by the Company. Certain other payments to or receipts from the NYISO are also subject to reconciliation, with shortfalls or amounts in excess of specified rate allowances recoverable from or refundable to customers.

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.

Notes to the Financial Statements - Continued

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, but not RECO and Pike, regulatory accounting treatment is applied in accordance with the accounting rules for regulated operations. Unrecognized prior service costs or credits and unrecognized 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 agreements, 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. The rate plans for RECO and Pike do not have comparable deferral provisions. See "Rate Agreements," in Note B.

The Company calculates the expected return on pension and other retirement 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.

Notes to the Financial Statements - Continued

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 agreements, 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 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's federal income tax return reflects certain tax positions with which the Internal Revenue Service (IRS) does not or may not agree. See “Uncertain Tax Positions” in Note I.

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.

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 of the group pays or receives an amount 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.

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.

Notes to the Financial Statements - Continued

Estimates

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

Note B – Regulatory Matters

Rate Agreements

Electric

In July 2008, the NYSPSC approved a Joint Proposal among O&R, the NYSPSC staff and other parties for the rates O&R can charge its New York customers for electric service from July 2008 through June 2011. The rate plan approved by the NYSPSC provides for electric rate increases of \$15.6 million, \$15.6 million and \$5.7 million effective July 1, 2008, 2009 and 2010, respectively, and the collection of an additional \$9.9 million during the 12-month period beginning July 1, 2010.

The Joint Proposal reflected the following major items:

- an annual return on common equity of 9.4 percent;
- most of any actual earnings above a 10.2 percent return on equity (based on actual average common equity ratio, subject to a 50 percent maximum) are to be applied to reduce regulatory assets for pension and other postretirement benefit expenses (the Company did not reduce regulatory assets under this provision in 2011, 2010 or 2009);
- deferral as a regulatory asset or regulatory liability, as the case may be, of the difference between actual pension and other postretirement benefit expenses, environmental remediation expenses, property taxes, tax-exempt debt costs and certain other expenses and amounts for those expenses reflected in rates (the Company deferred recognition of \$0.3 million of expenses, \$0.7 million of revenue and \$3 million of expenses under this provision in 2011, 2010 and 2009, respectively);
- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which actual transmission and distribution related capital expenditures are less than amounts reflected in rates (the Company deferred \$7 million, \$12 million and \$8 million of revenues under this provision in 2011, 2010 and 2009, respectively);

Notes to the Financial Statements - Continued

- deferral as a regulatory asset of increases, if any, in certain expenses above a 4 percent annual inflation rate, but only if the actual annual return on common equity is less than 9.4 percent (the Company did not defer any expenses under this provision in 2011, 2010 or 2009);
- potential negative earnings adjustments of up to \$3 million annually if certain customer service and system reliability performance targets are not met (the Company met the performance targets in 2011 and 2009; the Company reduced revenues by \$1 million under this provision in 2010);
- implementation of a revenue decoupling mechanism under which actual energy delivery revenues would be compared, on a periodic basis, with the authorized delivery revenues with the difference accrued, with interest, for refund to, or recovery from, customers, as applicable (the Company accrued \$3.3 million, \$5.1 million and \$12.5 million of revenues pursuant to this provision in 2011, 2010 and 2009, respectively);
- continuation of the rate provisions pursuant to which the Company recovers its purchased power costs from customers; and
- withdrawal of the litigation O&R commenced seeking to annul the NYSPSC's March and October 2007 orders relating to O&R's electric rates.

In June 2011, the NYSPSC adopted an order granting O&R an electric rate increase, effective July 1, 2011, of \$26.6 million. The NYSPSC ruling reflects the following major items:

- a weighted average cost of capital of 7.22 percent, reflecting:
 - a return on common equity of 9.2 percent, assuming achievement by the Company of \$825,000 of austerity measures;
 - cost of long-term debt of 5.50 percent; and
 - common equity ratio of 48 percent.
- continuation of a revenue decoupling mechanism;
- a provision for reconciliation of certain differences in actual average net utility plant to the amount reflected in rates (\$718 million) and continuation of rate provisions under which pension and other postretirement benefit expenses, environmental remediation expenses, tax-exempt debt costs and certain other expenses are reconciled to amounts for those expenses reflected in rates;

Notes to the Financial Statements - Continued

- continuation of the rate provisions pursuant to which the Company recovers its purchased power costs from customers;
- discontinuation of the provisions under which property taxes were reconciled to amounts reflected in rates;
- discontinuation of the inclusion in rates of funding for the Company's annual incentive plan for non-officer management employees;
- continuation of provisions for potential operations penalties of up to \$3 million annually if certain customer service and system reliability performance targets are not met (in 2011, O&R did not recognize any operations penalties under these provisions or the corresponding provisions of the Joint Proposal discussed above); and
- O&R is directed to produce a report detailing its implementation plans for the recommendations made in connection with the NYSPSC's management audit of Con Edison's other utility subsidiary, Consolidated Edison Company of New York (CECONY), with a forecast of costs to achieve and expected savings.

In February 2012, O&R, the staff of the NYSPSC and the Utility Intervention Unit of the New York State Department of State Division of Consumer Protection entered into a Joint Proposal with respect to the Company's rates for electric delivery service rendered in New York. The Joint Proposal, which the NYSPSC approved in June 2012, covers the three-year period from July 2012 through June 2015. The Joint Proposal provides for electric base rate increases of \$19.4 million, \$8.8 million and \$15.2 million, effective July 2012, 2013 and 2014, respectively, which is being implemented, at the NYSPSC's option, with increases of \$15.2 million effective July 2012 and 2013 and an increase of \$13.1 million, together with a surcharge of \$2.1 million, effective July 2014. The Joint Proposal reflects the following major items:

- a weighted average cost of capital of 7.61 percent, 7.65 percent and 7.48 percent for the rate years ending June 30, 2013, 2014 and 2015, respectively, reflecting:
 - a return on common equity of 9.4 percent, 9.5 percent and 9.6 percent for the rate years ending June 30, 2013, 2014 and 2015, respectively;
 - cost of long-term debt of 6.07 percent for each of the rate years ending June 30, 2013 and 2014 and 5.64 percent for the rate year ending June 30, 2015;
 - common equity ratio of 48 percent for each of the rate years ending June 30, 2013, 2014 and 2015; and
 - average rate base of \$671 million, \$708 million and \$759 million for the rate years ending June 30, 2013, 2014 and 2015, respectively;

Notes to the Financial Statements - Continued

- sharing with electric customers of any actual earnings, excluding the effects of any penalties and certain other items, above specified percentage returns on common equity (based on the actual average common equity ratio, subject to a 50 percent maximum):
 - the company will allocate to customers the revenue requirement equivalent of 50 percent, 75 percent and 90 percent of any such earnings for each rate year in excess of 80 basis points, 180 basis points and 280 basis points, respectively, above the return on common equity for that rate year indicated above; and
 - the earnings sharing allocation between the company and customers will be on a cumulative basis at the end of rate year three.

- continuation of a revenue decoupling mechanism;
- continuation of a provision which defers as a regulatory liability for the benefit of customers or, subject to certain limitations, a regulatory asset for recovery from customers, as the case may be, the revenue requirement impact of the amount by which actual average net utility plant for each rate year is different than the average net utility plant reflected in rates (\$678 million, \$704 million and \$753 million for the rate years ending June 30, 2013, 2014 and 2015, respectively);
- continuation of the rate provisions pursuant to which the company recovers its purchased power costs from customers;
- continuation of rate provisions under which pension and other postretirement benefit expenses, environmental remediation expenses, tax-exempt debt costs and certain other expenses are reconciled to amounts for those expenses reflected in rates;
- provisions under which property taxes are reconciled to amounts reflected in rates; and
- continuation of provisions for potential operations penalties of up to \$3 million annually if certain customer service and system reliability performance targets are not met (in 2012, the Company did not recognize any operations penalties).

In March 2007, the New Jersey Board of Public Utilities (NJBPU) approved a three-year electric base rate plan for RECO, O&R's New Jersey regulated utility subsidiary that went into effect on April 1, 2007. The plan provides for a \$6.4 million rate increase during the first year, with no further increase during the final two years. The plan reflects a return on common equity of 9.75 percent and a common equity ratio of 46.5 percent of capitalization.

In May 2010, RECO, the Division of Rate Counsel, Staff of the NJBPU and certain other parties entered into a stipulation of settlement with respect to the company's August 2009 request to increase the rates that it can charge its customers for electric delivery service. The stipulation, which was approved by the Board of the NJBPU, provides for an electric rate increase, effective May 17, 2010, of \$9.8 million. The stipulation reflects a return on common equity of 10.3 percent and a common equity ratio of approximately 50 percent. The stipulation continues current provisions with respect to recovery from customers of the cost of purchased power and does

Notes to the Financial Statements - Continued

not provide for reconciliation of actual expenses to amounts reflected in electric rates for pension and other postretirement benefit costs. The stipulation requires RECO to file a base rate case by December 1, 2013.

Gas

In October 2009, the NYSPSC adopted a June 2009 Joint Proposal among O&R, NYSPSC staff and other parties. As approved, the Joint Proposal establishes a gas rate plan that covers the three-year period November 1, 2009 through October 31, 2012 and provides for increases in base rates of \$9 million in each of the first two years and \$4.6 million in the third year, with an additional \$4.3 million to be collected through a surcharge in the third rate year. The rate plan reflects the following major items:

- an annual return on common equity of 10.4 percent;
- most of any actual earnings above an 11.4 percent annual return on common equity (based upon the actual average common equity ratio, subject to a maximum 50 percent of capitalization) are to be applied to reduce regulatory assets (in 2012, 2011 and 2010, the Company did not defer any revenues under this provision);
- deferral as a regulatory asset or liability, as the case may be, of differences between the actual level of certain expenses, including expenses for pension and other postretirement benefits, environmental remediation, property taxes and taxable and tax-exempt long-term debt, and amounts for those expenses reflected in rates (in 2012, 2011 and 2010, the Company deferred \$0.7 million, \$2.9 million and \$3.1 million, respectively, of expenses under this provision);
- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which average gas net plant balances are less than balances reflected in rates (in 2012, 2011 and 2010, the Company deferred of \$0.7 million and \$1 million of expenses and \$1.5 million of revenues , respectively, under this provision);
- deferral as a regulatory asset of increases, if any over the course of the rate plan, in certain expenses above a 4 percent annual inflation rate, but only if the actual annual return on common equity is less than 10.4 percent (in 2012, 2011 and 2010, the Company did not defer any revenues under this provision);
- implementation of a revenue decoupling mechanism (in 2012, 2011 and 2010, the Company accrued \$4.7 million, \$2.8 million and \$0.8 million, respectively, of revenues under this provision);
- continuation of the provisions pursuant to which the Company recovers its cost of purchasing gas and the provisions pursuant to which the effects of weather on gas income are moderated; and

Notes to the Financial Statements - Continued

- potential negative earnings adjustments of up to \$1.4 million annually if certain operations and customer service requirements are not met (in 2012, 2011 and 2010, the Company did not have any potential negative earnings adjustments under this provision).
- because the Company did not file for a rate increase to take effect in November 2012, the earnings sharing levels for the rate year ending October 2012 will continue in effect until base rates are reset by the NYSPSC.

Other Regulatory Matters

In April 2010, the NJBPU approved a March 2010 stipulation among RECO, the Division of Rate Counsel and Staff of the NJBPU, authorizing RECO to recover, through a customer bill surcharge, the revenue requirement impact associated with 50 percent of up to \$19.4 million of the costs of certain RECO smart electric grid projects for which RECO receives grants for the remaining 50 percent of such costs from the United States Department of Energy under the American Recovery and Reinvestment Act of 2009. The revenue requirement recovered through the bill surcharge includes a return on investment based upon a return on common equity of 10.3 percent. Pursuant to the stipulation, in the company's next base rate proceeding, the NJBPU will review the projects' costs, require the company to refund to customers amounts collected for costs, if any, that were not prudent, reasonable and incremental, and include in the company's rate base the remaining projects' costs.

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. In 2012 O&R incurred response and restoration costs for Superstorm Sandy of \$98 million (including capital expenditures of \$14 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. The New York electric rate plan includes provisions for revenue decoupling, as a result of which delivery revenues generally are not affected by changes in delivery volumes from levels assumed when rates were approved. The provisions of the New York electric plan that impose penalties for operating performance provide for exceptions for major storms and catastrophic events beyond the control of the Company, including natural disasters such as hurricanes and floods. See "Rate Agreements - Electric," above. The NYSPSC, the New York State Attorney General and a commission appointed by the Governor of New York are investigating the preparation and performance of the Company in connection with Superstorm Sandy and other major storms.

Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2012 and 2011 were comprised of the following items:

Notes to the Financial Statements - Continued

(Millions of Dollars)	2012	2011
Regulatory assets		
Unrecognized pension and other postretirement costs	\$270	\$298
Deferred storm costs	124	48
Environmental remediation costs	115	117
Future federal income tax	91	74
Transition bond charges	39	44
Pension and other postretirement benefits deferrals	29	41
Deferred derivative losses – long-term	20	16
Surcharge for New York State assessment	5	8
Other	40	35
Regulatory assets – long-term	733	681
Deferred derivative losses - current	8	24
Recoverable energy costs - current	5	-
Regulatory assets - current	13	24
Total regulatory assets	\$746	\$705
Regulatory liabilities		
Allowance for cost of removal less salvage	\$82	\$76
Carrying charges on transmission and distribution net plant	18	24
Other	24	16
Regulatory liabilities – long-term	124	116
Refundable energy cost – current	34	39
Revenue decoupling mechanism	4	-
Regulatory liabilities – current	38	39
Total regulatory liabilities	\$162	\$155

“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, 2012 and 2011, all of the outstanding common stock 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.

Long-Term Debt

Long-term debt maturing in the period 2013-2017 is as follows:

Notes to the Financial Statements - Continued

(Millions of Dollars)	
2013	\$ 3
2014	4
2015	143
2016	79
2017	4

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 are:

(Millions of Dollars)	December 31,			
	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-Term Debt (including current portion)	\$607	\$717	\$610	\$715

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

At December 31, 2012 and 2011, 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 \$25 million and \$29 million at December 31, 2012 and 2011, 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 believes that it was in compliance with its significant debt covenants at December 31, 2012.

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, the failure to comply with which would, except as otherwise provided, constitute an event of default with respect to the debt. If an event of default were to occur, the principal and accrued interest on the debt might and, in certain circumstances would, become due and payable immediately.

Notes to the Financial Statements - Continued

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. Under the Credit Agreement, which expires in October 2016, there is a maximum of \$200 million available to O&R (subject to increase to \$250 million if the necessary regulatory approvals are requested and obtained). The Credit Agreement supports the Company's commercial paper program. The Company has not borrowed 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, 2012 this ratio was 0.51 to 1 for O&R); having liens on its assets in an aggregate amount exceeding 5 percent of its consolidated total capital, subject to certain exceptions; and the failure by the Company, 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.

At December 31, 2012, O&R had \$3 million of commercial paper outstanding. At December 31, 2011, O&R had no commercial paper outstanding. At December 31, 2012 and 2011, \$10 million and \$23 million of letters of credit, respectively, and no other borrowings were outstanding for O&R under the Credit Agreement.

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

Note E – Pension Benefits

Substantially all employees of O&R are covered by a tax-qualified, non-contributory pension plan maintained by Con Edison, which also covers substantially all employees of 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.

Notes to the Financial Statements - Continued

Net Periodic Benefit Cost

The components of the Company's net periodic benefit costs for 2012, 2011 and 2010 were as follows:

(Millions of Dollars)	2012	2011	2010
Service cost – including administrative expenses	\$ 16	\$13	\$11
Interest cost on projected benefit obligation	34	35	35
Expected return on plan assets	(34)	(35)	(33)
Recognition of net actuarial loss	38	29	24
Recognition of prior service costs	2	2	2
NET PERIODIC BENEFIT COST	\$ 56	\$44	\$39
Cost capitalized	(17)	(13)	(11)
Reconciliation to rate level	4	3	(2)
Cost charged to operating expenses	\$ 43	\$34	\$26

Funded Status

The funded status at December 31, 2012, 2011 and 2010 was as follows:

(Millions of Dollars)	2012	2011	2010
CHANGE IN PROJECTED BENEFIT OBLIGATION			
Projected benefit obligation at beginning of year	\$748	\$651	\$602
Service cost – excluding administrative expenses	15	12	11
Interest cost on projected benefit obligation	35	36	35
Plan amendments	-	-	6
Net actuarial loss	67	83	29
Benefits paid	(35)	(34)	(32)
PROJECTED BENEFIT OBLIGATION AT END OF YEAR	\$830	\$748	\$651
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	\$389	\$377	\$330
Actual return on plan assets	54	3	41
Employer contributions	56	44	39
Benefits paid	(35)	(34)	(32)
Administrative expenses	(1)	(1)	(1)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	\$463	\$389	\$377
FUNDED STATUS	\$(367)	\$(359)	\$(274)
Unrecognized net loss	\$295	\$285	\$198
Unrecognized prior service costs	12	15	16
Accumulated benefit obligation	790	715	621

The increase in the pension plan's projected benefit obligation was a primary driver in the increased pension liability at O&R of \$8 million compared with December 31, 2011. This also 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, and an immaterial change to OCI for the unrecognized net losses and unrecognized prior service costs associated with RECO and Pike.

A portion of the unrecognized net loss and prior service cost for the pension plan, equal to \$44 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, 2012 and 2011, the Company's investments include \$16 million and \$9 million, respectively, held in an external trust account for benefit payments pursuant to the supplemental retirement plans. The accumulated benefit obligations for the supplemental retirement plans for O&R were \$39 million and \$37 million as of December 31, 2012 and 2011.

Notes to the Financial Statements - Continued

Assumptions

The actuarial assumptions were as follows:

	2012	2011	2010
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount rate	4.10%	4.70%	5.60%
Rate of compensation increase	4.25%	4.25%	4.25%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount rate	4.70%	5.60%	6.05%
Expected return on plan assets	8.00%	8.50%	8.50%
Rate of compensation increase	4.25%	4.25%	4.00%

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

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 (Moody's) or Standard & Poor's (S&P)) corporate bonds. Bonds with insufficient liquidity, bonds with questionable pricing information and bonds that are not representative of the overall market are excluded from consideration. For example, the bonds used in the model cannot be callable, they must have a price between 50 and 200, the yield must lie between 1 percent and 20 percent, and the amount of the 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.

Expected Benefit Payments

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

(Millions of Dollars)	2013	2014	2015	2016	2017	2018-2022
O&R	\$38	\$39	\$41	\$43	\$44	\$240

Expected Contributions

Based on estimates as of December 31, 2012, O&R expects to make contributions to the pension plan during 2013 of \$59 million. O&R's policy is to fund its accounting cost to the extent tax deductible.

Plan Assets

The asset allocations for the pension plan at the end of 2012, 2011 and 2010, and the target allocation for 2013 are as follows:

Notes to the Financial Statements - Continued

ASSET CATEGORY	Target Allocation Range	Plan Assets at December 31,		
	2013	2012	2011	2010
Equity Securities	55%-65%	60%	61%	67%
Debt Securities	27%-33%	31%	32%	28%
Real Estate	8%-12%	9%	7%	5%
Total	100%	100%	100%	100%

Con Edison has established a pension trust for the investment of assets to be used for the exclusive purpose of providing retirement benefits to 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 plans' named fiduciaries have been granted the authority to control and manage the operation and administration of the plans, including overall responsibility for the investment of assets in the trust and the power to appoint and terminate investment managers.

The 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 investment risk of the asset allocation and determines the optimal asset allocation for the plan. The target asset allocation for 2013 reflects the results of such a study conducted in 2011.

Individual fund managers operate under written guidelines provided by Con Edison, which cover such topics 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.

Notes to the Financial Statements - Continued

Assets measured at fair value on a recurring basis are summarized below under a three-level hierarchy established by the accounting rules which define the levels within the hierarchy as follows:

- Level 1 – Consists of fair value measurements whose value is based on quoted prices in active markets for identical assets or liabilities.
- Level 2 – Consists of fair value measurements whose value is based on significant other observable inputs.
- Level 3 – Consists of fair value measurements whose value is based on significant unobservable inputs.

The fair values of the pension plan assets at December 31, 2012 by asset category are as follows:

(Millions of Dollars)	Level 1	Level 2	Level 3	Total
U.S. Equity (a)	\$2,637	\$ -	\$-	\$2,637
International Equity (b)	2,242	753	-	2,995
Private Equity (c)	-	-	20	20
U.S. Government Issues (d)	-	1,626	-	1,626
Corporate Bonds (e)	-	993	-	993
Structured Assets (f)	-	30	-	30
Other Fixed Income (g)	-	123	-	123
Real Estate (h)	-	-	833	833
Cash and Cash Equivalents (i)	83	328	-	411
Futures (j)	210	-	-	210
Total investments	\$5,172	\$3,853	\$853	\$9,878
Funds for retiree health benefits (k)	(185)	(137)	(31)	(353)
Investments (excluding funds for retiree health benefits)	\$4,987	\$3,716	\$822	\$9,525
Pending activities (l)				(390)
Total fair value of plan net assets				\$9,135

- (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 Issues include agency and treasury securities.
- (e) Corporate Bonds consist of debt issued by various corporations.
- (f) Structured Assets include commercial-mortgage-backed securities and collateralized mortgage obligations.
- (g) Other Fixed Income 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) 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 Companies' other postretirement benefit obligation. See Note F.
- (l) 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, 2012 classified as Level 3 in the fair value hierarchy.

Notes to the Financial Statements - Continued

(Millions of Dollars)	Beginning Balance as of January 1, 2012	Assets Still Held at Reporting Date - Unrealized Gains/ (Losses)	Assets Sold During the Period - Realized Gains	Purchases Sales and Settlements	Transfer in/(out) of Level 3	Ending Balance as of December 31, 2012
Real Estate	\$572	\$48	\$ 1	\$212	\$ -	\$833
Private Equity	-	1	-	19	-	20
Corporate Bonds	94	-	-	(33)	(61)	-
Structured Assets	13	-	(6)	-	(7)	-
Other Fixed Income	29	-	-	(6)	(23)	-
Total investments	\$708	\$49	\$(5)	\$192	\$(91)	\$853
Funds for retiree health benefits	(28)	(2)	-	(4)	3	(31)
Investments (excluding funds for retiree health benefits)	\$680	\$47	\$(5)	\$188	\$(88)	\$822

The fair values of the pension plan assets at December 31, 2011 by asset category are as follows:

(Millions of Dollars)	Level 1	Level 2	Level 3	Total
U.S. Equity (a)	\$2,467	\$ -	\$ -	\$2,467
International Equity (b)	1,850	637	-	2,487
U.S. Government Issues (c)	-	1,570	-	1,570
Corporate Bonds (d)	-	668	94	762
Structured Assets (e)	-	-	13	13
Other Fixed Income (f)	-	67	29	96
Real Estate (g)	-	-	572	572
Cash and Cash Equivalents (h)	13	395	-	408
Futures (i)	93	48	-	141
Total investments	\$4,423	\$3,385	\$708	\$8,516
Funds for retiree health benefits (j)	(174)	(134)	(28)	(336)
Investments (excluding funds for retiree health benefits)	\$4,249	\$3,251	\$680	\$8,180
Pending activities (k)	-	-	-	(380)
Total fair value of plan net assets	\$7,800	\$7,800	\$7,800	\$7,800

- (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) U.S. Government Issues include agency and treasury securities.
- (d) Corporate Bonds classified as Level 3 include 144A illiquid securities.
- (e) Structured Assets include commercial-mortgage-backed securities and collateralized mortgage obligations.
- (f) Other Fixed Income includes municipal bonds, sovereign debt and regional governments.
- (g) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.
- (h) Cash and Cash Equivalents include short term investments, money markets, foreign currency and cash collateral.
- (i) Futures consist of exchange-traded financial contracts encompassing U.S. Equity, International Equity and U.S. Government indices.
- (j) 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 Companies' other postretirement benefit obligation. See Note F.
- (k) 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, 2011 classified as Level 3 in the fair value hierarchy.

Notes to the Financial Statements - Continued

(Millions of Dollars)	Beginning Balance as of January 1, 2011	Assets Still Held at Reporting Date - Unrealized Gains/ (Losses)	Assets Sold During the Period – Realized Gains	Purchases Sales and Settlements	Ending Balance as of December 31, 2011
Real Estate	\$398	\$65	\$ -	\$109	\$572
Corporate Bonds	129	(9)	11	(37)	94
Other Fixed Income	66	(1)	3	(39)	29
Structured Assets	87	(1)	2	(75)	13
Total investments	\$680	\$54	\$16	\$(42)	\$708
Funds for retiree health benefits	(30)	3	1	(2)	(28)
Investments (excluding funds for retiree health benefits)	\$650	\$57	\$17	\$(44)	\$680

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

(Millions of Dollars)	For the Years Ended December 31		
	2012	2011	2010
O&R	\$2	\$2	\$2

Note F – Other Postretirement Benefits

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

Net Periodic Benefit Cost

The components of the Company's net periodic postretirement benefit costs for 2012, 2011 and 2010 were as follows:

(Millions of Dollars)	2012	2011	2010
Service cost	\$ 5	\$ 5	\$ 4
Interest cost on accumulated other postretirement benefit obligation	10	11	11
Expected return on plan assets	(10)	(9)	(8)
Recognition of net actuarial loss	11	8	7
Recognition of prior service costs	(3)	2	2
NET PERIODIC POSTRETIREMENT BENEFIT COST	\$ 13	\$17	\$16
Cost capitalized	(6)	(6)	(6)
Reconciliation to rate level	4	2	3
Cost charged to operating expenses	\$ 11	\$13	\$13

Funded Status

The funded status of the programs at December 31, 2012, 2011 and 2010 were as follows:

(Millions of Dollars)	2012	2011	2010
CHANGE IN BENEFIT OBLIGATION			
Benefit obligation at beginning of year	\$244	\$215	\$201
Service cost	5	5	4
Interest cost on accumulated postretirement benefit obligation	10	11	11
Amendments	(39)	-	-
Net actuarial loss/(gain)	4	23	9
Benefits paid and administrative expenses	(12)	(12)	(12)
Participant contributions	1	1	1
Medicare prescription subsidy	1	1	1
BENEFIT OBLIGATION AT END OF YEAR	\$214	\$244	\$215

Notes to the Financial Statements - Continued

CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	\$106	\$102	\$88
Actual return on plan assets	14	1	12
Employer contributions	12	10	10
Participant contributions	1	1	1
Benefits paid	(10)	(8)	(9)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	\$123	\$106	\$102
FUNDED STATUS			
	\$ (91)	\$(138)	\$(113)
Unrecognized net loss	\$ 55	\$66	\$43
Unrecognized prior service costs	(21)	14	16

During the first quarter of 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 will allow 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 is effective January 2013 and, as a result, the Company recognized a decrease in its postretirement health benefit obligations of \$12 million as of December 31, 2012, which was recorded as an actuarial gain.

The increase in the value of other postretirement benefit plan assets and the decrease in the other postretirement benefit plan obligation resulted in a decrease to the liability for other postretirement benefits of \$47 million at O&R compared with December 31, 2011. This also resulted in a decrease to regulatory assets of \$36 million for unrecognized net losses and unrecognized prior service costs associated with O&R consistent with accounting rules for regulated operations and a credit to OCI of \$6 million (net of taxes) for the unrecognized net losses and unrecognized prior service costs associated with RECO and Pike.

A portion of the unrecognized net loss and prior service costs for the other postretirement benefits, equal to \$9 million and \$(4) million, respectively, will be recognized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R.

Assumptions

The actuarial assumptions were as follows:

	2012	2011	2010
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount Rate	4.05%	4.55%	5.40%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount Rate	4.55%	5.40%	5.95%
Expected Return on Plan Assets	8.50%	8.50%	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.

Notes to the Financial Statements - Continued

The health care cost trend rate used to determine net periodic benefit cost for the year ended December 31, 2012 was 6.00 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, 2012 was 5.75 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 at December 31, 2012:

(Millions of Dollars)	1-Percentage-Point	
	Increase	Decrease
Effect on accumulated other postretirement benefit obligation	\$19	\$(15)
Effect on service cost and interest cost components for 2012	2	(2)

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)	2013	2014	2015	2016	2017	2018-2022
Net Benefit Payments	\$11	\$11	\$11	\$11	\$12	\$62

Expected Contributions

Based on estimates as of December 31, 2012, O&R expects to make a contribution of \$0.2 million to the other postretirement benefit plans in 2013.

Plan Assets

The asset allocations for O&R's other postretirement benefit plans at the end of 2012, 2011 and 2010, and the target allocation for 2013 are as follows:

ASSET CATEGORY	Target Allocation Range	Plan Assets at December 31		
	2013	2012	2011	2010
Equity Securities	57%-73%	62%	62%	67%
Debt Securities	26%-44%	38%	38%	33%
Total	100%	100%	100%	100%

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

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

The fair values of the plan assets at December 31, 2012 by asset category (see description of levels in Note E) are as follows:

Notes to the Financial Statements - Continued

(Millions of Dollars)	Level 1	Level 2	Level 3	Total
U.S. Equity (a)	\$20	\$36	\$-	\$56
International Equity (b)	-	23	-	23
Other Fixed Income (c)	-	41	-	41
Cash and Cash Equivalents (d)	-	3	-	3
Total investments	\$20	\$103	\$-	\$123
Total fair value of plan net assets				\$123

- (a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and commingled funds.
- (b) International Equity includes commingled international equity funds.
- (c) Other Fixed Income includes commingled funds, which are valued at Net Asset Value.
- (d) Cash and Cash Equivalents include short term investments and money markets.

The fair values of the plan assets at December 31, 2011 by asset category (see description of levels in Note E) are as follows:

(Millions of Dollars)	Level 1	Level 2	Level 3	Total
U.S. Equity (a)	\$17	\$33	\$-	\$50
International Equity (b)	-	17	-	17
Other Fixed Income (c)	-	37	-	37
Cash and Cash Equivalents (d)	-	2	-	2
Total investments	\$17	\$89	\$-	\$106
Total fair value of plan net assets				\$106

- (a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and commingled funds.
- (b) International Equity includes commingled international equity funds.
- (c) Other Fixed Income includes commingled funds, which are valued at Net Asset Value.
- (d) Cash and Cash Equivalents include short term investments and money markets.

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2011 classified as Level 3 in the fair value hierarchy.

(Millions of Dollars)	Beginning Balance as of January 1, 2011	Assets Still Held at Reporting Date – Unrealized Gains/ (Losses)	Assets Sold During the Period - Realized (Losses)	Purchases Sales and Settlements	Transfers Out of Level 3	Ending Balance as of December 31, 2011
Other Fixed Income	\$34	\$-	\$-	\$-	\$(34)	\$-
Insurance Contracts	-	-	-	-	-	-
Total investments	\$34	-	-	-	(34)	\$-
Investments (including funds for retiree health benefits)	\$34	\$-	\$-	\$-	\$(34)	\$-

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 seven 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

Notes to the Financial Statements - Continued

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 undiscounted cost to investigate and remediate the sites. Remediation costs are estimated based on the information available, applicable remediation standards, and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at December 31, 2012 and 2011 were as follows:

(Millions of Dollars)	2012	2011
Accrued Liabilities:		
Manufactured gas plant sites	\$112	\$115
Other Superfund Sites	1	1
Total	\$113	\$116
Regulatory assets	\$115	\$117

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. Under its current rate plans for provision of electric and gas service in New York, O&R is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs.

Insurance recoveries related to Superfund Sites for the years ended December 31, 2012 and 2011 were immaterial. Environmental remediation costs incurred related to Superfund Sites at December 31, 2012 and 2011 were as follows:

(Millions of Dollars)	2012	2011
Remediation costs incurred	\$5	\$4

In 2010, 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 manufactured gas plant related environmental contaminants could range up to \$200 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 - 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, but the Company believes that these amounts are greatly exaggerated, based on the disposition of previous claims.

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

The Company's accrued liability for asbestos suits and workers' compensation proceedings (including those related to asbestos exposure) at December 31, 2012 and 2011 were as follows:

(Millions of Dollars)	2012	2011
Accrued liability – asbestos suits	\$0.3	\$0.3
Regulatory assets – asbestos suits	0.3	0.3
Accrued liability – workers' compensation	\$4.8	\$4.7
Regulatory assets – workers' compensation	0.1	0.3

Note H – Leases

O&R's leases include rights of way for electric and gas distribution facilities, office buildings and automobiles. In accordance with 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 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, 2012 and 2011:

(Millions of Dollars)	2012	2011
UTILITY PLANT		
Common	\$1.4	\$1.6
TOTAL	\$1.4	\$1.6

The accumulated amortization of the capital lease was \$0.7 million and \$0.5 million at December 31, 2012 and 2011, respectively.

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

Notes to the Financial Statements - Continued

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

(Millions of Dollars)	
2013	\$0.6
2014	0.6
2015	0.6
2016	0.6
2017	0.6
All years thereafter	2.9
Total	\$5.9

Note I – Income Tax

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

(Millions of Dollars)	2012	2011	2010
State			
Current	\$(14)	\$5	\$8
Deferred	24	2	(1)
Federal			
Current	(45)	(4)	(1)
Deferred	66	28	20
Total charge to income tax expense	\$31	\$31	\$26

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

(Millions of Dollars)	2012	2011
Deferred tax liabilities:		
Unrecognized pension and other postretirement costs	\$270	\$298
Depreciation	180	165
Regulatory asset – future income tax	99	80
State income tax	85	48
Capitalized overheads	69	66
Storm damage	62	17
Asset retirement obligation	27	24
Pension	6	(27)
Investment tax credits	2	3
Other	53	55
Total deferred tax liabilities	853	729
Deferred tax assets:		
Unrecognized pension and other postretirement costs	270	298
Asset retirement obligation	27	24
State income tax	25	27
Regulatory liability – future income tax	8	6
Other	81	53
Total deferred tax assets	411	408
Net deferred tax liabilities and investment tax credits	\$442	\$321
Deferred tax liabilities and investment tax credits – Noncurrent	\$493	\$350
Deferred tax assets – Current	(51)	(29)
Net deferred tax liabilities and investment tax credits	\$442	\$321

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:

Notes to the Financial Statements - Continued

(% of Pre-tax income)	2012	2011	2010
STATUTORY TAX RATE			
Federal	35%	35%	35%
Changes in computed taxes resulting from:			
State income tax	6	5	6
Depreciation related differences	1	2	(1)
AFDC	(1)	(2)	(2)
Cost of removal	(2)	(3)	(2)
Employee benefit plans	(2)	-	(2)
Capitalized interest	(3)	(1)	(1)
Other	(1)	-	2
Effective Tax Rate	33%	36%	35%

For federal income tax purposes, O&R has a net operating loss carryforward available of \$120 million and \$124 million from 2012 and 2011, respectively, primarily as a result of accelerated depreciation and for 2012 storm related deductions, which if unused will expire in 2032 and 2031, respectively. O&R has recorded a deferred tax asset for its loss carryforward from 2011, and no valuation allowance has been provided, as it is more likely than not that the deferred tax asset will be realized.

Uncertain Tax Positions

Under the accounting rules for income taxes, an enterprise shall not 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.

The IRS has essentially completed its field audits of Con Edison's federal income tax returns through 2011. Con Edison's federal income tax returns for 1998 through 2011 reflect certain tax positions with which the IRS does not or may not agree. Any adjustments to federal income tax returns would result in changes to Con Edison's state income tax returns. In addition, Con Edison's New York state income tax returns for years beginning with 2006 remain open for examination.

Con Edison's 2011 and 2010 federal income tax returns reflect, among other things, an incremental current deduction for the costs of certain repairs to utility plant (the "repair allowance deductions"). Prior to 2009, Con Edison capitalized such costs and included these costs in depreciation expense in its federal income tax returns. At December 31, 2012, with respect to the repair allowance deductions, Con Edison recorded a liability for uncertain tax positions of \$72 million (\$7 million attributable to O&R).

In August 2011, the IRS issued guidance regarding the use and evaluation of statistical samples and sampling estimates. This guidance provides a safe harbor method of determining whether certain expenditures for electric transmission and distribution property can be currently deducted for federal income tax purposes. No guidance was issued related to gas property.

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

Notes to the Financial Statements - Continued

(Millions of Dollars)	2012	2011	2010
Balance at January 1	\$10	\$ 8	\$(11)
Additions based on tax positions of prior years	1	3	18
Reductions for tax positions of prior years	(4)	(1)	-
Settlements	-	-	1
Balance at December 31	\$ 7	\$10	\$ 8

At December 31, 2012, O&R's estimated liabilities for uncertain tax positions were classified on its consolidated balance sheet either as current liabilities (\$3 million) or as a reduction to current deferred tax assets (\$4 million). The Company reasonably expects to resolve these uncertain tax positions with the IRS in the next 12 months.

O&R recognizes interest accrued related to the liability for uncertain tax positions in interest expense and would recognize penalties, if any, in operating expenses in O&R's consolidated income statements. In 2012, 2011 and 2010, O&R recognized an immaterial amount of interest and no penalties for uncertain tax positions in its consolidated income statements. At December 31, 2012 and 2011, O&R recognized an immaterial amount of interest and no penalties in its consolidated balance sheets.

At December 31, 2012, there are no unrecognized tax benefits that if recognized would materially affect O&R's effective tax rate.

Note J – Stock-Based Compensation

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

Shares of Con Edison common stock used to satisfy the obligations with respect to O&R's stock-based compensation may be new (authorized, but unissued) shares, treasury shares or shares purchased in the open market. The Company intends to use treasury shares to fulfill their stock-based compensation obligations for 2013.

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 period ended December 31, 2012, 2011 and 2010:

Notes to the Financial Statements - Continued

(Millions of Dollars)	2012	2011	2010
Performance-based restricted stock	\$1.1	\$2.9	\$1.7
Restricted stock units	0.1	0.1	0.1
Total	\$1.2	\$3.0	\$1.8
Income Tax Benefit	\$0.5	\$1.2	\$0.7

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 Con Edison common share when the option was granted. The Company generally recognizes compensation expense (based on the fair value of stock option awards) over the continuous period in which the options vest. Awards to employees currently eligible for retirement are expensed in the month awarded.

The outstanding options are "equity awards" because shares of Con Edison common stock are delivered upon exercise of the options. As equity awards, the fair value of the options is measured at the grant date.

A summary of changes in the status of stock options awarded to O&R employees as of December 31, 2012 is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at 12/31/11	83,500	\$42.976
Exercised	(26,000)	\$42.743
Forfeited	(1,000)	\$40.325
Outstanding at 12/31/12	56,500	\$43.130

The changes in the fair value of all outstanding options from their grant dates to December 31, 2012 and 2011 (aggregate intrinsic value) for O&R were \$1 million and \$2 million, respectively. The aggregate intrinsic value of options exercised was immaterial in 2012 and \$2 million in 2011, and the cash received by Con Edison for payment of the exercise price was \$1 million and \$10 million, respectively. The weighted average remaining contractual life of options outstanding is two years as of December 31, 2012.

The following table summarizes O&R employees' stock options outstanding at December 31, 2012 for each plan year:

Plan Year	Remaining Contractual Life	Options Outstanding/ Exercisable	Weighted Average Exercise Price
2006	3	22,000	\$44.422
2005	2	13,000	\$42.180
2004	1	15,500	\$43.899
2003	<1	6,000	\$38.470
Total		56,500	\$43.130

Restricted Stock Units

Restricted stock unit awards under the LTIP have been made to O&R officers and certain employees, including awards that provide for adjustment of the number of units (performance-restricted stock units or Performance

Notes to the Financial Statements - Continued

RSUs). 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.

In accordance with accounting rules for stock compensation, for outstanding restricted stock awards other than Performance RSUs, the Company has accrued a liability based on the market value of a common share on the grant date and is recognizing compensation expense over the vesting period. The vesting period for awards is three years and is based on the employees' continuous service to O&R. Prior to vesting, the awards are subject to forfeiture in whole or in part under certain circumstances. The awards are "liability awards" because each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, prior to vesting, changes in the fair value of the units are reflected in net income.

A summary of changes in the status of restricted stock (other than Performance RSUs or awards under the directors' deferred compensation plan) during the period ended December 31, 2012 is as follows:

	Units	Weighted Average Grant Date Fair Value
Non-vested at 12/31/11	3,500	\$45.039
Granted	1,200	\$58.420
Vested	(1,150)	\$39.610
Forfeited	(100)	\$47.630
Non-vested at 12/31/12	3,450	\$51.428

The total expense to be recognized by the Company in future periods for unvested awards outstanding as of December 31, 2012 was \$0.1 million and is expected to be recognized over a weighted average period of one year.

The number of units in each annual Performance RSU is subject to adjustment as follows: (i) 50 percent of the units awarded will be multiplied by a factor that may range from 0 to 150 percent based on Con Edison's total shareholder return relative to a peer group of utilities for 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 200 percent based on determinations made in connection with the O&R Annual Team Incentive Plan (the EIP portion). Units generally vest when the performance period ends.

For the TSR portion of Performance RSU, the Company uses a Monte Carlo simulation model to estimate the fair value of the awards. The fair value is recomputed each reporting period as of the earlier of the reporting date and the vesting date. For the EIP portion of Performance RSU, the fair value of the awards is determined using the market price as of the earlier of the reporting date or the vesting date multiplied by the average EIP determination over the vesting period. Performance RSU awards are "liability awards" because each Performance RSU represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share

Notes to the Financial Statements - Continued

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:

	2012
Risk-free interest rate	0.15% - 3.69%
Expected term	3 years
Expected volatility	15.27%

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

A summary of changes in the status of the Performance RSUs TSR portion during the period ended December 31, 2012 is as follows:

	Units	Weighted Average Grant Date Fair Value*
Non-vested at 12/31/11	35,752	\$42.511
Granted	13,735	\$49.498
Vested	(2,499)	\$41.860
Forfeited	(1,938)	\$42.789
Non-vested at 12/31/12	45,050	\$44.665

* 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.

A summary of changes in the status of the Performance RSUs' EIP portion during the period ended December 31, 2012 is as follows:

	Units	Weighted Average Grant Date Fair Value*
Non-vested at 12/31/11	35,752	\$46.709
Granted	13,735	\$58.851
Vested	(2,499)	\$39.610
Forfeited	(1,938)	\$47.946
Non-vested at 12/31/12	45,050	\$50.751

*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 in future periods for unvested Performance RSUs outstanding as of December 31, 2012 is \$1.7 million, and is expected to be recognized over a weighted average period of one year.

Stock Purchase Plan

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

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 2012, 2011 and 2010, 665,718, 721,520 and 738,951 shares were purchased under the Stock Purchase Plan at a weighted average price of \$59.72, \$52.50 and \$45.52 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, 2012 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Interest charges	Income tax expense	Total assets*	Construction expenditures
Electric	\$592	\$-	\$38	\$83	\$19	\$17	\$1,960	\$98
Gas	203	-	15	40	10	11	706	39
Other*	-	-	-	-	1	-	5	-
Total	\$795	\$-	\$53	\$123	\$30	\$28	\$2,671	\$137

As of and for the Year Ended December 31, 2011 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Interest charges	Income tax expense	Total assets*	Construction expenditures
Electric	\$641	\$-	\$35	\$81	\$20	\$21	\$1,755	\$79
Gas	214	-	13	33	12	9	722	32
Other*	-	-	-	-	2	-	8	-
Total	\$855	\$-	\$48	\$114	\$34	\$30	\$2,485	\$111

As of and for the Year Ended December 31, 2010 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Interest charges	Income tax expense	Total assets*	Construction expenditures
Electric	\$692	\$-	\$32	\$74	\$22	\$18	\$1,630	\$99
Gas	218	-	12	34	12	8	686	36
Other*	-	-	-	-	1	-	32	-
Total	\$910	\$-	\$44	\$108	\$35	\$26	\$2,348	\$135

* Includes amounts related to the RECO securitization.

Notes to the Financial Statements - Continued

Note L – Derivative Instruments and Hedging Activities

Under the accounting rules for derivatives and hedging, derivatives are recognized on the balance sheet at fair value, unless an exception is available under the accounting rules. Certain qualifying derivative contracts have been designated as normal purchases or normal sales contracts. These contracts are not reported at fair value under the accounting rules.

Energy Price Hedging

The Company hedges market price fluctuations associated with physical purchases of electricity by using electric and gas derivative instruments including futures, forwards, and options. The fair values of these hedges at December 31, 2012 and 2011 were as follows:

(Millions of Dollars)	2012	2011
Fair value of net derivative assets/(liabilities) – gross	\$(20)	\$(28)
Impact of netting of cash collateral	4	2
Fair value of net derivative assets/(liabilities) – net	\$(16)	\$(26)

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 NYSPSC. See Note O.

Credit Exposure

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

The Company had \$2 million of credit exposure in connection with electricity supply and hedging activities, net of collateral, at December 31, 2012. The Company's net credit exposure consisted of \$1 million with investment-grade counterparties and \$1 million with commodity exchange brokers.

Economic Hedges

The Company enters into certain derivative instruments that do not qualify or are not designated as hedges under the accounting rules for derivatives and hedging. However, management believes these instruments represent economic hedges that mitigate exposure to fluctuations in commodity prices.

Notes to the Financial Statements - Continued

The fair values of the Company's commodity derivatives at December 31, 2012 and 2011 were:

Fair Value of Commodity Derivatives^(a)			
(Millions of Dollars)	Balance Sheet Location	2012	2011
Derivative Assets			
Current	Other current assets	\$1	\$-
Long-term	Other deferred charges and non-current assets	2	1
Total derivative assets		\$3	\$1
Impact of netting		-	-
Net derivative assets		\$3	\$1
Derivative Liabilities			
Current	Fair value of derivative liabilities	\$ 8	\$22
Long-term	Fair value of derivative liabilities	15	7
Total derivative liabilities		23	\$29
Impact of netting		(4)	(2)
Net derivative liabilities		\$19	\$27

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivative and hedging and, therefore, are excluded from the table.

The Company 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 utility commissions. 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 commodity derivatives. As gains and losses are realized in future periods, they will be recognized as purchased power costs in the Company's consolidated income statement.

The following table presents the changes in the fair values of commodity derivatives that have been deferred for the year ended December 31, 2012 and 2011:

Realized and Unrealized Gains/(Losses) on Commodity Derivatives^(a)			
(Millions of Dollars)	Balance Sheet Location	Year Ended December 31, 2012	Year Ended December 31, 2011
Pre-tax gains/(losses) deferred in accordance with the accounting rules for regulated operations:			
Current	Deferred derivative gains	\$-	\$(1)
Long-term	Deferred derivative gains	-	(1)
Total deferred gains/(losses)		\$-	\$(2)
Current	Deferred derivative losses	\$16	\$15
Current	Recoverable energy costs ^(b)	(28)	(73)
Long-term	Deferred derivative losses	(8)	7
Total deferred gains/(losses)		\$(20)	\$(51)
Net deferred gains/(losses)		\$(20)	\$(53)

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

(b) Includes payments of \$11 million to Con Edison's competitive energy businesses for the year ended December 31, 2011. See Note O.

As of December 31, 2012, the Company had 82 electric or gas derivative contracts hedging electric energy or capacity market prices, which were considered to be derivatives under the accounting rules for derivatives and

Notes to the Financial Statements - Continued

hedging (excluding qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts). The following table presents the number of contracts by commodity type:

Electric Derivatives		Gas Derivatives		Total Number of Contracts ^(a)	
Number of Energy Contracts ^(a)	MWHs ^(b)	Number of Capacity Contracts ^(a)	MWhs ^(b)	Number of Contracts ^(a)	Dths ^(b)
26	1,422,313	3	5,039	53	5,140,000
					82

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivative and hedging and, therefore, are excluded from the table.

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

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 the Company to provide collateral on derivative instruments in net liability positions. The Utilities enter into separate derivative instruments for electric energy or capacity, and CECONY enters into derivative instruments in connection with the Utilities' joint gas supply arrangements (See Note O). The amount of collateral to be provided will depend on the fair value of the derivative instruments and the Utilities' credit ratings.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position, and collateral posted at December 31, 2012, 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 were:

(Millions of Dollars)	
Aggregate fair value – net liabilities ^(a)	\$6
Collateral posted	-
Additional collateral ^(b) (downgrade one level from current rating ^(c))	-
Additional collateral ^(b) (downgrade to below investment grade from current rating ^(c))	9 ^(d)

(a) Non-derivative transactions for the purchase and sale of electricity 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. 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 liability 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 Utilities have a legally enforceable right of setoff.

(c) The current long-term ratings of O&R are Baa1/A-/A- by Moody's, S&P, and Fitch, respectively. Credit ratings assigned by rating agencies are expressions of opinions that are subject to revision or withdrawal at any time by the assigning rating agency.

(d) Derivative instruments that are net assets have been excluded from the table. At December 31, 2012, if O&R had been downgraded to below investment grade, it would have been required to post additional collateral for such derivative instruments of \$1 million.

Interest Rate Swaps

O&R has an interest rate swap pursuant to which it pays a fixed-rate of 6.09 percent and receives a LIBOR-based variable rate. The fair value of this interest rate swap at December 31, 2012 was an unrealized loss of \$6 million,

Notes to the Financial Statements - Continued

which has been included in the company's consolidated balance sheet as a noncurrent liability/fair value of derivative liabilities and a regulatory asset. The increase in the fair value of the swap for the year ended December 31, 2012 was \$2 million. In the event O&R's credit rating was downgraded to BBB- or lower by S&P or Baa3 or lower by Moody's, the swap counterparty could elect to terminate the agreement and, if it did so, the parties would then be required to settle the transaction.

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

Notes to the Financial Statements - Continued

- 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.

Effective January 1, 2012, the Company adopted Accounting Standards Update (ASU) No. 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” The amendments expand existing disclosure requirements for fair value measurements and make other amendments. For fair value measurements in Level 3, this update requires the Company to provide a description of the valuation process in place, a quantitative disclosure of unobservable inputs and assumptions used in the measurement as well as a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs. The update also requires the Company to disclose any transfers between Levels 1 and 2 of fair value hierarchy measurements and the reasons for the transfers.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 are summarized below.

(Millions of Dollars)	Level 1	Level 2	Level 3	Netting Adjustments ⁽⁴⁾	Total
Derivative assets:					
Commodity	\$-	\$ 3	\$ -	\$-	\$ 3
Other assets	7	(1)	10	-	16
Transfer in ⁽⁵⁾⁽⁶⁾	-	10	-	-	10
Transfer out ⁽⁵⁾⁽⁶⁾	-	-	(10)	-	(10)
Other assets Total ⁽³⁾	\$7	\$ 9	\$ -	\$-	\$ 16
Total	\$7	\$12	\$ -	\$-	\$ 19
Derivative liabilities:					
Commodity	\$-	\$ 2	\$21	\$(4)	\$19 ⁽⁴⁾
Transfer in ⁽⁵⁾⁽⁶⁾	-	2	-	-	2
Transfer out ⁽⁵⁾⁽⁶⁾	-	-	(2)	-	(2)
Commodity Total⁽¹⁾	\$-	\$ 4	\$19	\$(4)	\$19
Interest rate contract	-	(2)	8	-	6
Transfer in ⁽⁵⁾⁽⁶⁾	-	8	-	-	8
Transfer out ⁽⁵⁾⁽⁶⁾	-	-	(8)	-	(8)
Interest rate contract Total ⁽²⁾	\$-	\$ 6	\$ -	\$ -	\$ 6
Total	\$-	\$10	\$19	\$(4)	\$25

(1) A portion of the commodity derivative contracts categorized in Level 3 is valued using an internally developed model with observable inputs. The model also includes some less readily observable inputs resulting in the classification of the respective contract as Level 3. See Note L.

(2) See Note L.

(3) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.

(4) 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.

(5) The Company's policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.

(6) Transferred from Level 3 to Level 2 because of reassessment of the levels in the fair value hierarchy within which certain inputs fall. Other assets and interest rate contract were transferred as of March 31, 2012.

Notes to the Financial Statements - Continued

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are summarized below.

(Millions of Dollars)	Level 1	Level 2	Level 3	Netting Adjustments ⁽⁴⁾	Total
Derivative assets:					
Commodity ⁽¹⁾	\$-	\$1	\$-	\$-	\$1
Other assets ⁽³⁾	-	-	9	-	9
Total	\$-	\$1	\$9	\$-	\$10
Derivative liabilities:					
Commodity	\$-	\$-	\$29	\$(2)	\$27 ⁽⁴⁾
Transfer in ⁽⁵⁾⁽⁶⁾	-	1	-	-	1
Transfer out ⁽⁵⁾⁽⁶⁾	-	-	(1)	-	(1)
Commodity Total ⁽¹⁾	\$-	\$1	\$28	\$(2)	\$27
Interest rate contract ⁽²⁾	-	-	8	-	8
Total	\$-	\$1	\$36	\$(2)	\$35

- (1) A portion of the commodity derivative contracts categorized in Level 3 is valued using an internally developed model with observable inputs. The model also includes some less readily observable inputs resulting in the classification of the respective contract as Level 3. See Note L.
- (2) See Note L.
- (3) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.
- (4) 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.
- (5) The Company's policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.
- (6) Transferred from Level 3 to Level 2 because of availability of observable market data due to decrease in the terms of certain contracts from beyond one year as of December 31, 2010 to less than one year as of December 31, 2011.

The employees in the risk management group of the Utilities develop and maintain the Utilities' valuation policies and procedures for, and verify pricing and fair value valuation of, commodity derivatives. Under the Utilities' 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 committee, comprised of officers and employees of the Utilities' that oversee energy hedging. The managers of the risk management group report to the Utilities' Vice President and Treasurer.

(Millions of Dollars)	Fair Value of Level 3 at			
	December 31, 2012	Valuation Techniques	Unobservable Inputs	Range
Electricity	\$ (7)	Discounted cash flow	Forward prices	\$28-\$82 per MWH
Standard Offer Capacity Agreements	(12)	Discounted cash flow	Forward capacity prices ⁽¹⁾ Forward price escalator ⁽¹⁾ Present value factor ⁽¹⁾	\$166 MW-day 0% - 3% 1.66%
Total	\$(19)			

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

Notes to the Financial Statements - Continued

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, 2012 and 2011 and classified as Level 3 in the fair value hierarchy:

For the Year Ended December 31, 2012									
(Millions of Dollars)	Beginning Balance as of January 1, 2012	Total Gains/(Losses) – Realized and Unrealized		Purchases	Issuances	Sales	Settlements	Transfer In/Out of Level 3	Ending Balance as of December 31, 2012
		Included in Earnings	Included in Regulatory Assets and Liabilities						
Derivatives:									
Commodity	\$(29)	\$(25)	\$8	\$-	\$-	\$-	\$25	\$ 2	\$(19)
Interest rate contract	(8)	(1)	-	-	-	-	1	8 ⁽¹⁾	-
Other assets (1)	9	-	1	-	-	-	-	(10) ⁽¹⁾	-
Total	\$(28)	\$(26)	\$9	\$-	\$-	\$-	\$26	\$ -	\$(19)

(1) Other assets and interest rate contract were transferred as of March 31, 2012.

For the Year Ended December 31, 2011									
(Millions of Dollars)	Beginning Balance as of January 1, 2011	Total Gains/(Losses) – Realized and Unrealized		Purchases	Issuances	Sales	Settlements	Transfer In/Out of Level 3	Ending Balance as of December 31, 2011
		Included in Earnings	Included in Regulatory Assets and Liabilities						
Derivatives:									
Commodity	\$(49)	\$(40)	\$19	\$-	\$-	\$-	\$40	\$1	\$(29)
Interest rate contract	(10)	(3)	2	-	-	-	3	-	(8)
Other assets (1)	9	-	-	-	-	-	-	-	9
Total	\$(50)	\$(43)	\$21	\$-	\$-	\$-	\$43	\$1	\$(28)

(1) Amounts included in earnings are reported in investments and other income on the consolidated income statement.

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

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, 2012, the Company determined that nonperformance risk would have no material impact on its financial position or results of operations. To assess nonperformance risk, the Company considered information such as collateral requirements, master netting arrangements, letters of credit and parent company guarantees, and applied a market-based method by using the counterparty (for an asset) or the Company's (for a liability) credit default swaps rates.

Notes to the Financial Statements - Continued

Note N – Asset Retirement Obligations

In accordance with accounting rules for asset retirement obligations, the Company is required to recognize a liability for legal obligations associated with the retirement of long-lived assets. Any such obligations identified by the Company were immaterial.

The Company includes in depreciation the estimated removal costs, less salvage, for utility plant assets. In accordance with accounting rules for asset retirement obligations, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities pursuant to accounting rules for regulated operations. The related regulatory liabilities recorded for the Company were \$82 million and \$76 million at December 31, 2012 and 2011, 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 NYSPSC and/or other regulatory authorities, as applicable. The services received include substantial administrative support operations, such as corporate secretarial and associated ministerial duties, accounting, treasury, investor relations, information resources, legal, human resources, fuel supply, and energy management services. The costs of administrative and other services provided by the Company, and received from Con Edison and its other subsidiaries for the years ended December 31, 2012, 2011 and 2010 were as follows:

(Millions of Dollars)	2012	2011	2010
Cost of services provided	\$19	\$19	\$17
Cost of services received	\$42	\$41	\$40

At December 31, 2012, 2011 and 2010, O&R's payable to CECONY associated with these services was \$10 million, \$3 million and \$3 million, respectively.

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY \$54 million, \$81 million and \$99 million of natural gas for the years ended December 31, 2012, 2011 and 2010, respectively. These amounts are net of the effect of related hedging transactions. At December 31, 2012, 2011 and 2010, O&R's net payable to CECONY associated with these gas purchases was \$9 million, \$4 million and \$11 million, respectively. At December 31, 2012, 2011 and 2010, O&R's payable to Con Edison's competitive energy businesses associated with electricity purchases and retail services was \$1 million, \$2 million and \$4 million, respectively.

RECO made no purchases of electricity from Consolidated Edison Energy, Inc. in 2012. RECO purchased from Consolidated Edison Energy, Inc. \$11 million and \$32 million of electricity for the periods ended December 31, 2011 and 2010, respectively, pursuant to energy auctions.

Notes to the Financial Statements - Continued

At December 31, 2012 and 2011, the Company's receivable from Con Edison for income taxes was \$63 million and \$4 million, respectively.

At December 31, 2012 and 2011, the Company's receivable from CECONY for an Economic Stimulus Grant was \$1 million.

FERC has authorized CECONY through 2013 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, 2012 and 2011, there were no loans outstanding for O&R.