# Orange and Rockland Utilities, Inc.
# 2009 Annual Financial Statements and Notes

Financial Statements

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**
PricewaterhouseCoopers Center
300 Madison Avenue
New York NY 10017
Telephone (646) 471 3000
Facsimile (813) 286 6000

**Report of Independent Auditors**

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of capitalization, of income, of comprehensive income, of common shareholder's equity and of cash flows present fairly, in all material respects, the financial position of Orange and Rockland Utilities, Inc. and its subsidiaries (the Company) at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 12, 2010

# Orange and Rockland Utilities, Inc.
## CONSOLIDATED BALANCE SHEET

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| | (Millions of Dollars) | |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and temporary cash investments | $ 52 | $ 17 |
| Accounts receivable - customers, less allowance for uncollectible accounts of $5 and $4 in 2009 and 2008, respectively | 58 | 87 |
| Accrued unbilled revenue | 56 | 47 |
| Other receivables, less allowance for uncollectible accounts of $1 in 2009 and 2008 | 22 | 4 |
| Accounts receivable from affiliated companies | 12 | 24 |
| Gas in storage, at average cost | 31 | 61 |
| Materials and supplies, at average cost | 10 | 10 |
| Prepayments | 15 | 12 |
| Deferred derivative losses | 37 | 42 |
| Recoverable energy costs | 31 | 26 |
| Fair value of derivative assets | 2 | - |
| Other current assets | 14 | 4 |
| TOTAL CURRENT ASSETS | 340 | 334 |
| INVESTMENTS | 10 | 8 |
| UTILITY PLANT, AT ORIGINAL COST | | |
| Electric | 1,076 | 1,023 |
| Gas | 446 | 424 |
| General | 158 | 148 |
| Total | 1,680 | 1,595 |
| Less: Accumulated depreciation | 464 | 443 |
| Net | 1,216 | 1,152 |
| Construction work in progress | 87 | 58 |
| NET UTILITY PLANT | 1,303 | 1,210 |
| DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS | | |
| Regulatory assets | 513 | 573 |
| Other deferred charges and noncurrent assets | 21 | 37 |
| TOTAL DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS | 534 | 610 |
| TOTAL ASSETS | $ 2,187 | $ 2,162 |

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

# Orange and Rockland Utilities, Inc.

## CONSOLIDATED BALANCE SHEET

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| | (Millions of Dollars) | |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| CURRENT LIABILITIES | | |
| Long-term debt due within one year | $ 103 | $ 3 |
| Accounts payable | 88 | 95 |
| Accounts payable to affiliated companies | 24 | 181 |
| Customer deposits | 14 | 15 |
| Accrued interest | 6 | 11 |
| Fair value of derivative liabilities | 36 | 27 |
| Deferred income taxes - recoverable energy costs | 12 | 11 |
| Accrued wages | 2 | 7 |
| Other current liabilities | 25 | 23 |
| TOTAL CURRENT LIABILITIES | 310 | 373 |
| NONCURRENT LIABILITIES | | |
| Provision for injuries and damages | 7 | 7 |
| Pensions and retiree benefits | 386 | 453 |
| Superfund and other environmental costs | 53 | 53 |
| Fair value of derivative liabilities | 30 | 40 |
| Uncertain income taxes | - | 9 |
| TOTAL NONCURRENT LIABILITIES | 476 | 562 |
| DEFERRED CREDITS AND REGULATORY LIABILITIES | | |
| Deferred income taxes and investment tax credits | 268 | 216 |
| Regulatory liabilities | 127 | 137 |
| Other deferred credits | 3 | 3 |
| TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES | 398 | 356 |
| LONG-TERM DEBT (See Statement of Capitalization) | 497 | 416 |
| SHAREHOLDER'S EQUITY | | |
| Common shareholder's equity (See Statement of Common Shareholder's Equity) | 506 | 455 |
| TOTAL SHAREHOLDER'S EQUITY | 506 | 455 |
| TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY | $ 2,187 | $ 2,162 |

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

# Orange and Rockland Utilities, Inc.
## CONSOLIDATED INCOME STATEMENT

| | For the Years Ended December 31, 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Millions of Dollars) | | |
| OPERATING REVENUES | | | |
| Electric | $ 648 | $ 733 | $ 671 |
| Gas | 242 | 259 | 265 |
| TOTAL OPERATING REVENUES | 890 | 992 | 936 |
| OPERATING EXPENSES | | | |
| Purchased power | 328 | 433 | 384 |
| Gas purchased for resale | 136 | 159 | 166 |
| Other operations and maintenance | 247 | 222 | 203 |
| Depreciation and amortization | 42 | 40 | 38 |
| Taxes, other than income taxes | 45 | 44 | 42 |
| TOTAL OPERATING EXPENSES | 798 | 898 | 833 |
| OPERATING INCOME | 92 | 94 | 103 |
| OTHER INCOME (DEDUCTIONS) | | | |
| Investment and other income | 2 | 4 | 1 |
| Allowance for equity funds used during construction | 1 | - | - |
| Other deductions | (1) | (1) | (1) |
| TOTAL OTHER INCOME (DEDUCTIONS) | 2 | 3 | - |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 94 | 97 | 103 |
| INTEREST EXPENSE | | | |
| Interest on long-term debt | 27 | 25 | 25 |
| Other interest | 2 | 3 | 9 |
| Allowance for borrowed funds used during construction | (1) | - | - |
| NET INTEREST EXPENSE | 28 | 28 | 34 |
| INCOME FROM CONTINUING OPERATIONS BEFORE TAXES | 66 | 69 | 69 |
| INCOME TAX EXPENSE FROM CONTINUING OPERATIONS | 23 | 25 | 23 |
| NET INCOME | $ 43 | $ 44 | $ 46 |

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

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

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Millions of Dollars) | | |
| NET INCOME | $ 43 | $ 44 | $ 46 |
| OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | | | |
| Pension plan liability adjustments, net of $7, and $(14) taxes in 2009 and 2008, respectively | 10 | (20) | - |
| Unrealized losses on derivatives qualified as cash flow hedges, net of $(1) taxes in 2008 | - | (1) | - |
| Less: Reclassification adjustment gains/(losses) included in net income | - | 1 | (1) |
| Less: Reclassification adjustment for unrealized losses included in regulatory assets, net of $(5) taxes in 2008 | - | (8) | - |
| TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | 10 | (14) | 1 |
| COMPREHENSIVE INCOME | $ 53 | $ 30 | $ 47 |

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

# Orange and Rockland Utilities, Inc.

## CONSOLIDATED STATEMENT OF COMMON SHAREHOLDER'S EQUITY

| (Millions of Dollars/Except Share Data) | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total |
|---|---|---|---|---|---|---|
| BALANCE AS OF DECEMBER 31, 2006 | 1,000 | $ - | $ 194 | $ 200 | $ (34) | $ 360 |
| Net Income | | | | 46 | | 46 |
| Common stock dividend to parent | | | | (31) | | (31) |
| Capital contribution by parent | | | 40 | | | 40 |
| Other comprehensive income | | | | | 1 | 1 |
| BALANCE AS OF DECEMBER 31, 2007 | 1,000 | $ - | $ 234 | $ 215 | $ (33) | $ 416 |
| Net Income | | | | 44 | | 44 |
| Common stock dividend to parent | | | | (31) | | (31) |
| Capital contribution by parent | | | 40 | | | 40 |
| Other comprehensive loss | | | | | (14) | (14) |
| BALANCE AS OF DECEMBER 31, 2008 | 1,000 | $ - | $ 274 | $ 228 | $ (47) | $ 455 |
| Net Income | | | | 43 | | 43 |
| Common stock dividend to parent | | | | (32) | | (32) |
| Capital contribution by parent | | | 30 | | | 30 |
| Other comprehensive income | | | | | 10 | 10 |
| BALANCE AS OF DECEMBER 31, 2009 | 1,000 | $ - | $ 304 | $ 239 | $ (37) | $ 506 |

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, 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Millions of Dollars) | | |
| OPERATING ACTIVITIES | | | |
| Net income | $ 43 | $ 44 | $ 46 |
| PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME | | | |
| Depreciation and amortization | 42 | 40 | 38 |
| Deferred income taxes | 41 | 16 | 15 |
| Other non-cash items (net) | 1 | (23) | 4 |
| CHANGES IN ASSETS AND LIABILITIES | | | |
| Accounts receivable - customers, less allowance for uncollectibles | 29 | (9) | (6) |
| Accounts receivable from affiliated companies | 15 | (22) | - |
| Materials and supplies, including gas in storage | 30 | (18) | 13 |
| Prepayments, other receivables and other current assets | (40) | (9) | 10 |
| Recoverable energy costs | (20) | 25 | (12) |
| Accounts payable | 58 | (65) | 18 |
| Accounts payable to affiliated companies | (32) | 19 | (7) |
| Pensions and retiree benefits | (13) | 37 | 2 |
| Accrued taxes | - | (1) | (4) |
| Accrued interest | (5) | (1) | 2 |
| Deferred charges, noncurrent assets and other regulatory assets | 29 | (76) | 5 |
| Deferred credits and other regulatory liabilities | (8) | 46 | (22) |
| Superfund and other environmental costs | - | (3) | 7 |
| Other liabilities | (4) | 11 | (9) |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 166 | 11 | 100 |
| INVESTING ACTIVITIES | | | |
| Utility construction expenditures | (127) | (120) | (112) |
| Decrease in restricted cash | - | - | 1 |
| Cost of removal less salvage | (5) | (3) | (3) |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (132) | (123) | (114) |
| FINANCING ACTIVITIES | | | |
| Net proceeds from/(payments of) short-term debt | - | (45) | 11 |
| Issuance of long-term debt | 120 | 50 | - |
| Retirement of long-term debt | (4) | (3) | (22) |
| Capital contribution by parent | 30 | 40 | 40 |
| Dividend to parent | (32) | (31) | (31) |
| Retirement of loan from affiliate | (113) | - | - |
| Loan from affiliate | - | 58 | 55 |
| NET CASH FLOWS FROM FINANCING ACTIVITIES | 1 | 69 | 53 |
| CASH AND TEMPORARY CASH INVESTMENTS: | | | |
| NET CHANGE FOR THE PERIOD | 35 | (43) | 39 |
| BALANCE AT BEGINNING OF PERIOD | 17 | 60 | 21 |
| BALANCE AT END OF PERIOD | $ 52 | $17 | $ 60 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid during the period for: | | | |
| Interest | $33 | $ 29 | $ 24 |
| Income Taxes (Refund) | ($12) | $ 34 | $ 23 |

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

## Orange and Rockland Utilities, Inc.
### Consolidated Statement of Capitalization

| | | | Shares outstanding December 31, 2009 | Shares outstanding December 31, 2008 | At December 31, 2009 (Millions of Dollars) | At December 31, 2008 (Millions of Dollars) |
|---|---|---|---|---|---|---|
| TOTAL COMMON SHAREHOLDER'S EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS | | | 1,000 | 1,000 | $ 543 | $ 502 |
| TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAXES - PENSION PLAN LIABILITY ADJUSTMENTS | | | | | (37) | (47) |
| TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF COMMON SHAREHOLDER'S EQUITY AND NOTE C) | | | | | $ 506 | $ 455 |
| LONG-TERM DEBT (NOTE C) Maturity | Interest Rate | Series | | | | |
| DEBENTURES: | | | | | | |
| 2010 | 7.50% | 2000A | | | $ 55 | $ 55 |
| 2015 | 5.30 | 2005A | | | 40 | 40 |
| 2016 | 5.45 | 2006A | | | 75 | 75 |
| 2018 | 6.15 | 2008A | | | 50 | 50 |
| 2019 | 4.96 | 2009A | | | 60 | - |
| 2027 | 6.50 | 1997F | | | 80 | 80 |
| 2029 | 7.00 | 1999G | | | 45 | 45 |
| 2039 | 6.00 | 2009B | | | 60 | - |
| TOTAL DEBENTURES | | | | | 465 | 345 |
| FIRST MORTGAGE BONDS: | | | | | | |
| 2018 | 7.07 | 1998C | | | 3 | 3 |
| TOTAL FIRST MORTGAGE BONDS | | | | | 3 | 3 |
| TRANSITION BONDS: | | | | | | |
| 2019* | 5.22 | 2004-1 | | | 34 | 37 |
| TOTAL TRANSITION BONDS | | | | | 34 | 37 |
| TAX-EXEMPT DEBT - Notes Issued to New York State Energy Research and Development Authority for Facilities Revenue Bonds: | | | | | | |
| 2014 | 0.27 | 1994A** | | | 55 | 6 |
| 2015 | 0.27 | 1995A** | | | 44 | 28 |
| TOTAL TAX-EXEMPT DEBT | | | | | 99 | 34 |
| Unamortized debt discount | | | | | (1) | - |
| TOTAL | | | | | 600 | 419 |
| Less: long-term debt due within one year | | | | | 103 | 3 |
| TOTAL LONG-TERM DEBT | | | | | 497 | 416 |
| TOTAL CAPITALIZATION | | | | | $ 1,003 | $ 871 |

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

** Issued for pollution control financing.

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

# Notes to the Financial Statements

## General

These notes accompany and form an integral part of the 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, 2009, 2008 and 2007, operating revenues for RECO and Pike were 24.9 percent and 0.8 percent, 24.4 percent and 0.8 percent and 22.7 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.

## 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.

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 M.

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 4.2 percent, 3.5 percent and 5.2 percent for 2009, 2008 and 2007, 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 2.8 percent for 2009, 2008 and 2007.

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

At December 31, 2009 and 2008, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Electric | | |
| Transmission | $137 | $136 |
| Distribution | 618 | 588 |
| Gas* | 334 | 317 |
| General | 115 | 103 |
| Held for future use | 12 | 8 |
| Construction work in progress | 87 | 58 |
| NET UTILITY PLANT | $1,303 | $1,210 |

* Primarily distribution.

Under O&R's current rate plans, the aggregate annual depreciation allowance in effect at December 31, 2009 was $42 million.

## Impairments

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

## 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, 2009 and 2008 were $56 million and $47 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 $6.7 million and $0.3 million, $6.1 million and $0.3 million, and $6.4 million and $0.2 million of gross receipts tax in 2009, 2008 and 2007, respectively. RECO recorded $6.1 million, $6.4 million and $6.5 million in TEFA tax in 2009, 2008 and 2007, respectively.

## 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. Prior to 2008, Pike neither collected nor refunded to customers differences between actual amounts billed for electric supply and electric supply costs it incurred. In January 2008, Pike began deferring 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. See Note B.

## Independent System Operators

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

## Temporary Cash Investments

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

## Investments

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

## Pension and Other Postretirement Benefits

The accounting rules for retirement benefits require an employer to recognize an asset or liability for the overfunded or underfunded status of its pension and other postretirement benefit plans. For a pension plan, the asset or liability is the difference between the fair value of the plan's assets and the projected benefit obligation. For any other postretirement benefit plan, the asset or liability is the difference between the fair value of the plan's assets and the accumulated postretirement benefit obligation. The accounting rules generally require employers to recognize all unrecognized prior service costs and credits and unrecognized actuarial gains and losses in accumulated other comprehensive income (OCI), net of tax. Such amounts will be adjusted as they are subsequently recognized as components of net periodic benefit cost or income pursuant to the current recognition and amortization provisions.

For O&R, 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 Note B – Regulatory Matters.

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.

## 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 between the members of the consolidated group.

## State Income Tax

The Company, along with Con Edison and its other subsidiaries, files a combined New York State Corporation Business Franchise Tax Return. Similar to a federal consolidated income tax return, the income of all entities in the combined group is subject to New York State taxation, after adjustments for differences between federal and New York law. 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. Effective June 2009, the Company is including receivables purchased from energy supply companies within accounts receivable – customers, and to conform to this presentation, have reclassified receivables purchased from energy supply companies that were included in other receivables at December 31, 2008 ($25 million for O&R). This reclassification more appropriately reflects the Company’s customer operations’ practices, policies and procedures. Consistent with current industry practice, the Company is presenting income tax expense as one item on its consolidated income statements (instead of separate items in the operating income and other income sections of the consolidated income statements) and changing the order of presentation on its consolidated balance sheets of current assets, net utility plant, current liabilities, long-term debt and shareholder's equity.

## 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 October 2007, the NYSPSC issued an order that continued O&R's rates for electric service rendered in New York at current levels. The order, which was based on an allowed annual rate of return on common equity of 9.1 percent increased, effective July 1, 2007, by $13.1 million annually the amount recognized for pension and other postretirement benefit costs. Because O&R, in accordance with applicable New York regulatory provisions, defers the difference between the actual amount of such costs and the amounts for such costs reflected in rates, the effect of the increase was to decrease the company's deferrals of such costs and increase other operations and maintenance expense by a like amount. As required by the order, the company also reduced other operating revenues and recorded a regulatory liability of $3 million for earnings attributable to its New York electric business in excess of a 9.1 percent annual rate of return on common equity applicable to the period March through June 2007.

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 2009 or 2008);
- 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 $16 million and $21 million of expenses under this provision in 2009 and 2008, 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 recorded regulatory liability amounts of $8 million and $1 million of expenses under this provision in 2009 and 2008, respectively);

- 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 2009 or 2008);

- potential negative earnings adjustments of up to $3 million annually if certain customer service and system reliability performance targets are not met (the company reduced revenues by $0.4 million under these provisions in 2008; the company met the performance targets in 2009);

- 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 for recovery from customers $6.6 million and $3.3 million of revenues pursuant to this provision in 2009 and 2008, respectively);

- continuation of the rate provisions pursuant to which the company recovers its purchased power costs from customers; and

- withdrawal of litigation O&R commenced relating to the NYSPSC's October 2007 order discussed above.

In July 2004, a special purpose entity formed by RECO (which is included in O&R's consolidated financial statements) issued $46 million of 5.22% Transition Bonds and used the proceeds thereof to purchase from RECO the right to be paid a Transition Bond Charge (TBC) and associated tax charges by its customers relating to previously deferred purchased power costs for which the NJBPU had authorized recovery.

In March 2007, the NJBPU approved a new three-year electric base rate plan for RECO that went into effect on April 1, 2007.  The plan provided for a $6.4 million rate increase during the first year, with no further increase during the final two years. The plan reflected a return on common equity of 9.75 percent and a common equity ratio of 46.5 percent of capitalization.

In August 2009, RECO filed a request with the NJBPU for a net increase in the rates it charges for electric service, effective May 15, 2010, of $9.8 million. The filing reflects a return on common equity of 11.0 percent and a common equity ratio of 53.6 percent. The filing proposes the continuation of the current provisions with respect to recovery from customers of the cost of purchased power and proposes a reconciliation of actual expenses to amounts reflected in electric rates for pension and other postretirement benefit costs. In January 2010, RECO increased its requested rate increase to $13.8 million, due primarily to lower projected revenue associated with lower estimated sales volumes. RECO anticipates that as part of this rate proceeding, the NJBPU will address the company's February 2009 petition that sought authorization to accelerate the timing of certain infrastructure projects (currently estimated at $14 million).

In March 2009, the PAPUC approved a settlement agreement between the company and the other parties to the proceeding which provides for increases in rates, effective April 2009, to produce additional annual electric operating revenues of $0.9 million. The settlement also provides that Pike may not file for new general base rate increases prior to April 2010.

### Gas

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

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

Earnings attributable to its gas business excluding any revenue reductions (O&R Adjusted Earnings) in excess of an 11 percent annual return on common equity (based upon the actual average common equity ratio, subject to a maximum 50 percent of capitalization) were to be allocated as follows: above an 11 percent return were to be used to offset up to one-half of any regulatory asset to be recorded in that year resulting from the cost reconciliations (discussed in the preceding paragraph). One-half of any remaining O&R Adjusted Earnings between 11 and 12 percent return were to be retained by the company, with the balance deferred for the benefit of customers. Thirty-five percent of any remaining O&R Adjusted Earnings between a 12 and 14 percent return were to be retained by the company, with the balance deferred for the benefit of customers. Any remaining O&R Adjusted Earnings above a 14 percent return were to be deferred for the benefit of customers. For purposes of these earnings sharing provisions, if in any rate year O&R Adjusted Earnings was less than 11 percent, the shortfall was deducted from O&R Adjusted Earnings for the other rate years. The earnings sharing thresholds were to each be reduced by 20 basis points if certain objectives relating to the company's retail choice program are not met. O&R recorded regulatory liabilities of $0, $0 and $1.3 million for earnings in excess of the 11 percent target return on equity for the rate years ended October 31, 2009, 2008 and 2007, respectively.

The rate plan also included up to $1 million of potential earnings adjustments in the first year of the agreement, increasing up to $1.2 million, if the company did not comply with certain requirements regarding gas main protection and customer service. O&R recorded regulatory liabilities of $0.4 million and $0.2 million for not complying with certain requirements regarding safety and customer service for the rate years ended October 31, 2008 and 2007, respectively. The company met these requirements for the rate year ended October 31, 2009.

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;

- 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;

- 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;

- 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;

- implementation of a revenue decoupling mechanism;

- 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

- potential negative earnings adjustments of up to $1.4 million annually if certain operations and customer service requirements are not met.

In February 2009, the PAPUC approved a settlement agreement between the company and the other parties to the proceeding which provides for increases in rates, effective April 2009, to produce additional annual gas operating revenues of $0.3 million. Under the terms of the settlement, Pike may not file for new general base rate increases prior to April 2010.

## Other Regulatory Matters

In the fourth quarter of 2009, Con Edison's other regulated utility subsidiary, Consolidated Edison Company of New York, Inc. (CECONY), was selected by the United States Department of Energy for negotiations to receive grants under the American Recovery and Reinvestment Act of 2009 to fund 50 percent of the costs of certain smart electric grid projects, including several Smart Grid pilot projects that RECO would implement. The total cost of these RECO projects amounts to approximately $21 million. In January 2010, RECO filed a petition with the NJBPU seeking authorization to recover from customers the costs of the RECO projects to the extent such costs are not covered by the awards.

## Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2009 and 2008 were comprised of the following items:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Regulatory assets | | |
| Unrecognized pension and other postretirement costs | $213 | $267 |
| Future federal income tax | 68 | 58 |
| Environmental remediation costs | 59 | 63 |
| Transition bond charges | 55 | 59 |
| Pension and other postretirement benefits deferrals | 52 | 55 |
| Deferred derivative losses | 20 | 26 |
| Deferred losses on interest rate swap | 11 | 15 |
| Surcharge for New York State Assessment | 12 | - |
| Other | 23 | 30 |
| Regulatory assets | 513 | 573 |
| Deferred derivative losses - current | 37 | 42 |
| Recoverable energy costs - current | 31 | 26 |
| Total regulatory assets | $581 | $641 |
| Regulatory liabilities | | |
| Allowance for cost of removal less salvage | $68 | $65 |
| Refundable energy costs | 42 | 57 |
| Carrying Charges on T&D Net Plant | 9 | 1 |
| NYS tax law changes | 1 | 1 |
| Other | 7 | 13 |
| Regulatory liabilities | 127 | 137 |
| Deferred derivative gains – current | - | - |
| Total regulatory liabilities | $127 | $137 |

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

## Note C – Capitalization

### Common Stock

At December 31, 2009 and 2008, 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 2010-2014 is as follows:

| (Millions of Dollars) | |
|---|---|
| 2010 | $103 |
| 2011 | 3 |
| 2012 | 3 |
| 2013 | 3 |
| 2014 | 58 |

O&R has issued $99 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. Of this amount, $49 million of the $55 million of O&R's weekly-rate, tax-exempt debt insured by Financial Guaranty Insurance Company (Series 1994A Debt), and $16 million of the $44 million of O&R's weekly-rate, tax exempt debt insured by Ambac Assurance Corporation (Series 1995A Debt), had been tendered by bondholders at December 31, 2008. The tendered bonds were purchased with funds drawn under letters of credit maintained as liquidity facilities for the tax-exempt debt. O&R reimbursed the bank in 2008 for the funds used to purchase its tendered bonds, together with interest thereon. The tendered Series 1995A Debt and tendered Series 1994A Debt were remarketed in April 2009 and June 2009, respectively. The proceeds from each remarketing were used to pay short-term borrowings that funded the purchased tendered bonds. O&R is evaluating alternatives with respect to its tax-exempt debt, including remarketing or refinancing the debt.

Long-term debt is stated at cost, which in total, as of December 31, 2009, approximates fair value (estimated based on year-end market valuations for the debt).

At December 31, 2009 and 2008, 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 $34 million and $37 million at December 31, 2009 and 2008, respectively, of Transition Bonds issued by Transition Funding, in July 2004. The proceeds of which 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, 2009.

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

The liquidity and credit facilities currently in effect for the tax-exempt financing include covenants that the ratio of debt to total capital of the 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. Certain of the facilities also include as events of default, defaults in payments of other debt obligations in excess of $12.5 million.

## Note D – Short-Term Borrowing

In June 2006, O&R along with Con Edison and CECONY, entered into an Amended and Restated Credit Agreement (Credit Agreement) under which banks committed to provide loans and letters of credit, on a revolving credit basis. In June 2007, the Credit Agreement, which was to expire in June 2011, was extended for an additional year. Under the Credit Agreement, there is a maximum of $2.25 billion ($2.2 billion in the additional year) of credit available, with $200 million available to O&R. O&R is solely responsible for its obligations under the Credit Agreement and no company is responsible for the obligations of any company other than itself. O&R uses the Credit Agreement to support its commercial paper program and obtain letters of credit.

The banks' commitments under the Credit Agreement are subject to certain conditions, including that there be no event of default. The commitments are not subject to maintenance of credit rating levels or the absence of a material adverse change. Upon a change of control of, or upon an event of default by Con Edison, CECONY or O&R, the banks may terminate their commitments with respect to that company and declare any amounts owed by that company under the Credit Agreement immediately due and payable. Events of default include the exceeding at any time of a ratio of consolidated debt to consolidated total capital of 0.65 to 1 (at December 31, 2009, this ratio was 0.53 to 1 for O&R); having liens on its assets in an aggregate amount exceeding 5 percent of its consolidated total capital, subject to certain exceptions; and the failure by O&R, following any applicable notice period, to meet certain other customary covenants. The fees charged to O&R for the revolving credit facilities and any loans made or letters of credit issued under the Credit Agreement reflect O&R's credit ratings.

At December 31, 2009 and December 31, 2008, O&R had no commercial paper outstanding. At December 31, 2009 and 2008, $20 million and $10 million of letters of credit, and no borrowings, were outstanding under the Credit Agreement, respectively. There are no outstanding loans to O&R from CECONY at December 31, 2009. Outstanding loans to O&R from CECONY amounted to $113 million at December 31, 2008. See Note N 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 pension plans covering certain current and retired O&R officers.

### Net Periodic Benefit Cost

The components of the Company's net periodic benefit costs for 2009, 2008 and 2007 were as follows:

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Service cost – including administrative expenses | $10 | $10 | $9 |
| Interest cost on projected benefit obligation | 34 | 33 | 31 |
| Expected return on plan assets | (32) | (31) | (27) |
| Amortization of net actuarial loss | 27 | 22 | 21 |
| Amortization of prior service costs | 1 | 1 | 1 |
| NET PERIODIC BENEFIT COST | $40 | $35 | $35 |
| Cost capitalized | (11) | (9) | (9) |
| Cost charged/(deferred) | (6) | - | 1 |
| Cost charged to operating expenses | $23 | $26 | $27 |

### Funded Status

The funded status of the Company's pension obligations at December 31, 2009, 2008 and 2007 were as follows:

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | | |
| Projected benefit obligation at beginning of year | $586 | $553 | $527 |
| Service cost – excluding administrative expenses | 10 | 10 | 9 |
| Interest cost on projected benefit obligation | 34 | 33 | 31 |
| Plan amendments | 5 | - | - |
| Net actuarial loss | 1 | 19 | 15 |
| Benefits paid | (34) | (29) | (29) |
| PROJECTED BENEFIT OBLIGATION AT END OF YEAR | $602 | $586 | $553 |
| CHANGE IN PLAN ASSETS | | | |
| Fair value of plan assets at beginning of year | $271 | $370 | $339 |
| Actual return on plan assets | 54 | (103) | 25 |
| Employer contributions | 40 | 34 | 36 |
| Benefits paid | (34) | (29) | (29) |
| Administrative expenses | (1) | (1) | (1) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | $330 | $271 | $370 |
| FUNDED STATUS | $(272) | $(315) | $(183) |
| Unrecognized net loss | 201 | 247 | 115 |
| Unrecognized prior service costs | 12 | 8 | 10 |
| Accumulated benefit obligation | 580 | 563 | 529 |

The increase in the value of pension plan assets was a primary driver in the decreased pension liability at O&R of $43 million compared with December 31, 2008. This also resulted in a decrease to regulatory assets of $32 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility business 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.

The estimated net loss and prior service cost for the pension plan that will be amortized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R are $25 million and $2 million, respectively.

At December 31, 2009 and 2008, the Company's investments include $10 million and $8 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 $34 million as of December 31, 2009 and 2008.

### Assumptions

The actuarial assumptions were as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount rate | 6.05% | 5.75% | 6.00% |
| Rate of compensation increase | 4.00% | 4.00% | 4.00% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount rate | 5.75% | 6.00% | 6.00% |
| Expected return on plan assets | 8.50% | 8.50% | 8.50% |
| Rate of compensation increase | 4.00% | 4.00% | 4.00% |

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

### Discount Rate Assumption

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

### Expected Benefit Payments

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

| (Millions of Dollars) | 2010 | 2011 | 2012 | 2013 | 2014 | 2015-2019 |
|---|---|---|---|---|---|---|
| O&R | $34 | $36 | $37 | $39 | $40 | $220 |

### Expected Contributions

Based on current estimates, the Company is not required under funding regulations and laws to make any contributions to the pension plan during 2010. The Company's policy is to fund its accounting cost to the extent tax deductible; therefore, O&R expects to make a discretionary contribution of $36 million to the pension plan during 2010. The Company is continuing to monitor changes to funding and tax laws that may impact future pension plan funding requirements.

**Plan Assets**

The asset allocations for the pension plan at the end of 2009, 2008 and 2007, and the target allocation for 2010 are as follows:

| | Target Allocation Range | Plan Assets at December 31, | | |
|---|---|---|---|---|
| ASSET CATEGORY | 2010 | 2009 | 2008 | 2007 |
| Equity Securities | 57% - 73% | 67% | 59% | 65% |
| Debt Securities | 21% - 33% | 28% | 33% | 28% |
| Real Estate | 5% - 11% | 5% | 8% | 7% |
| Total | 100% | 100% | 100% | 100% |

Con Edison has established a pension trust for the investment of assets to be used for the exclusive purpose of providing retirement benefits to pension plan participants and beneficiaries 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 named fiduciaries consist of Con Edison's chief executive, financial and accounting officers.

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, maximize the 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. 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 2010 reflects the results of such a study conducted in 2007.

Individual fund managers operate under written guidelines provided by Con Edison, which cover such areas as investment objectives, performance measurement, permissible investments, investment restrictions, trading and execution, and communication and reporting requirements. Con Edison management regularly monitors, and the named fiduciaries review and report to the Committee regarding, manager 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.

In accordance with the accounting rules for pensions that became effective December 2009, the Company is providing the following disclosures regarding the fair value of the pension trust's investments.

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

Assets measured at fair value on a recurring basis are summarized below under a three-level hierarchy 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, 2009 by asset category are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| U.S. Equity (a) | $3,470 | $- | $- | $3,470 |
| International Equity (b) | 1,140 | 196 | 1 | 1,337 |
| U.S. Government Issues (c) | - | 1,255 | - | 1,255 |
| Corporate Bonds (d) | - | 435 | 143 | 578 |
| Structured Assets (e) | - | - | 91 | 91 |
| Other Fixed Income (f) | - | 10 | 46 | 56 |
| Swaps (g) | - | - | (3) | (3) |
| Real Estate (h) | - | - | 344 | 344 |
| Cash and Cash Equivalents (i) | 197 | 141 | - | 338 |
| Total investments | $4,807 | $2,037 | $622 | $7,466 |
| Funds for retiree health benefits (j) | (215) | (91) | (28) | (334) |
| Investments (excluding funds for retiree health benefits) | $4,592 | $1,946 | $594 | $7,132 |
| Pending activities (k) | | | | (255) |
| Total fair value of plan net assets | | | | $6,877 |

(a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds, actively-managed small-capitalization equities, rights and warrants.
(b) International Equity includes international equity index funds, actively-managed international equities, rights and warrants.
(c) U.S. Government Issues include agency and treasury securities.
(d) Corporate Bonds held in institutional mutual funds which are measured at Net Asset Value (NAV) are classified as Level 3.
(e) Structured Assets are measured using broker quotes and investment manager proprietary models and include commercial-mortgage-backed securities, collateralized mortgage obligations and asset-backed securities.
(f) Other Fixed Income includes emerging market debt valued using broker quotes, municipal bonds, sovereign debt, regional governments and government agencies.
(g) Swaps include total return swaps, interest rate swaps, credit default swaps and swap collateral. Level 3 Swaps are valued using proprietary investment manager models.
(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 and foreign currency.
(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 and their beneficiaries. 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 other postretirement benefit obligation. See Note F.

(k) Pending activities include security purchases and sales that have not settled and interest and dividends that have not been received.

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2009 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2009 | 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, 2009 |
|---|---|---|---|---|---|
| U.S. Equity | $1 | $2 | $(2) | $(1) | $- |
| International Equity | - | - | - | 1 | 1 |
| Corporate Bonds | 172 | 35 | (7) | (57) | 143 |
| Structured Assets | 194 | 93 | (70) | (126) | 91 |
| Other Fixed Income | 52 | 2 | 1 | (9) | 46 |
| Swaps | (32) | 13 | (51) | 67 | (3) |
| Options | 5 | (4) | 4 | (5) | - |
| Real Estate | 515 | (177) | - | 6 | 344 |
| Total investments | $907 | $(36) | $(125) | $(124) | $622 |
| Funds for retiree health benefits | (41) | 2 | 6 | 5 | (28) |
| Investments (excluding funds for retiree health benefits) | $866 | $(34) | $(119) | $(119) | $594 |

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 2009 | 2008 | 2007 |
|---|---|---|---|
| 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 2009, 2008 and 2007 were as follows:

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Service cost | $4 | $4 | $4 |
| Interest cost on accumulated other postretirement benefit obligation | 11 | 11 | 11 |
| Expected return on plan assets | (8) | (7) | (7) |
| Amortization of net actuarial loss | 9 | 8 | 9 |
| Amortization of prior service costs | 2 | 2 | - |
| NET PERIODIC POSTRETIREMENT BENEFIT COST | $18 | $18 | $17 |
| Cost capitalized | (6) | (5) | (5) |
| Cost charged/(deferred) | 2 | (2) | (3) |
| Cost charged to operating expenses | $14 | $11 | $9 |

### Funded Status

The funded status of the programs at December 31, 2009, 2008 and 2007 were as follows:

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| CHANGE IN BENEFIT OBLIGATION | | | |
| Benefit obligation at beginning of year | $206 | $196 | $189 |
| Service cost | 4 | 4 | 4 |
| Interest cost on accumulated postretirement benefit obligation | 11 | 11 | 11 |
| Net actuarial loss/(gain) | (11) | 3 | (11) |
| Benefits paid and administrative expenses | (11) | (10) | (11) |
| Participant contributions | 1 | 1 | - |
| Medicare prescription subsidy | 1 | 1 | - |
| Plan amendments | - | - | 14 |
| BENEFIT OBLIGATION AT END OF YEAR | $201 | $206 | $196 |
| CHANGE IN PLAN ASSETS | | | |
| Fair value of plan assets at beginning of year | $68 | $80 | $77 |
| Actual return on plan assets | 15 | (17) | (1) |
| Employer contributions | 14 | 13 | 12 |
| Benefits paid | (9) | (8) | (8) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | $88 | $68 | $80 |
| FUNDED STATUS | $(113) | $(138) | $(116) |
| Unrecognized net loss | 45 | 71 | 50 |
| Unrecognized prior service costs | 17 | 19 | 21 |

The increase in the value of other postretirement benefit plan assets was a primary driver in the decreased liability for other postretirement benefits at O&R of $25 million compared with December 31, 2008. This also resulted in a decrease to regulatory assets of $21 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 $4 million (net of taxes) for the unrecognized net losses and unrecognized prior service costs associated with RECO and Pike.

The estimated net loss and prior service costs for the other postretirement benefits that will be amortized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R are $8 million and $2 million, respectively.

### Assumptions

The actuarial assumptions were as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount Rate | 5.95% | 5.75% | 6.00% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount Rate | 5.75% | 6.00% | 6.00% |
| Expected Return on Plan Assets | | | |
| Tax-Exempt | 8.50% | 8.50% | 8.50% |
| Taxable | 8.00% | 8.00% | 8.00% |

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

The health care cost trend rate used to determine net periodic benefit cost for the year ended December 31, 2009 was 7.0 percent, which is assumed to decrease gradually to 4.5 percent by 2012 and remain at that level thereafter. The health care cost trend rate used to determine benefit obligations as of December 31, 2009 was 6.5 percent, which is assumed to decrease gradually to 4.5 percent by 2014 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, 2009:

| | 1-Percentage-Point | |
|---|---|---|
| (Millions of Dollars) | Increase | Decrease |
| Effect on accumulated other postretirement benefit obligation | $22 | $(19) |
| Effect on service cost and interest cost components for 2007 | 2 | (2) |

### Expected Benefit Payments

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

| (Millions of Dollars) | 2010 | 2011 | 2012 | 2013 | 2014 | 2015-2019 |
|---|---|---|---|---|---|---|
| Gross Benefit Payments | $12 | $13 | $14 | $14 | $15 | $80 |
| Medicare Prescription Benefit Receipts | 1 | 1 | 1 | 1 | 1 | 9 |

### Expected Contributions

Based on current estimates, O&R expects to make contributions of $13 million to the other postretirement benefit plans in 2010.

### Plan Assets

The asset allocations for O&R's other postretirement benefit plans at the end of 2009, 2008 and 2007, and the target allocation for 2010 are as follows:

| | Target Allocation Range | Plan Assets at December 31 | | |
|---|---|---|---|---|
| ASSET CATEGORY | 2010 | 2009 | 2008 | 2007 |
| Equity Securities | 57% - 73% | 66% | 56% | 65% |
| Debt Securities | 26% - 44% | 34% | 44% | 35% |
| 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, 2009 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) | $101 | $143 | $- | $244 |
| International Equity (b) | - | 92 | - | 92 |
| Other Fixed Income (c) | - | - | 173 | 173 |
| Insurance Contracts (d) | - | - | 8 | 8 |
| Cash and Cash Equivalents (e) | - | 9 | - | 9 |
| Total investments | $101 | $244 | $181 | $526 |
| Funds for retiree health benefits (f) | 215 | 91 | 28 | 334 |
| Investments (including funds for retiree health benefits) | $316 | $335 | $209 | $860 |
| Pending activities (g) | | | | 6 |
| Total fair value of plan net assets | | | | $866 |

(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 (NAV).
(d) Insurance Contracts represent the cash surrender value of life insurance policies. The contracts are measured at NAV, adjusted for fees charged by the insurance company.
(e) Cash and Cash Equivalents include short term investments and money markets.
(f) 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 and their beneficiaries. 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 other postretirement benefit obligation. See Note E.
(g) Pending activities include security purchases and sales that have not settled and interest and dividends that have not been received.

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2009 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2009 | 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, 2009 |
|---|---|---|---|---|---|
| Other Fixed Income | $197 | $11 | $3 | $(38) | $173 |
| Insurance Contracts | 8 | - | - | - | 8 |
| Total investments | $205 | $11 | $3 | $(38) | $181 |
| Funds for retiree health benefits | 41 | (2) | (6) | (5) | 28 |
| Investments (including funds for retiree health benefits) | $246 | $9 | $(3) | $(43) | $209 |

**Effect of Medicare Prescription Benefit**

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 created a benefit for certain employers who provide postretirement drug programs. The accounting rules for retirement benefits provide accounting and disclosure requirements relating to the Act. The Company’s actuaries have determined that the Company’s prescription drug plan provides a benefit that is at least actuarially equivalent to the Medicare prescription drug plan and projections indicate that this will be the case for 20 years; therefore, the Company has determined that it is eligible to receive the benefit that the Act makes available. When the plans’ benefits are no longer actuarially equivalent to the Medicare plan, 25 percent of the retirees in each plan are assumed to begin to decline participation in the Company’s prescription programs.

## 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 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 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 the sites and, for sites that have been investigated in whole or in part, the cost to remediate the sites. Remediation costs are estimated in light of the information available, applicable remediation standards, and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at December 31, 2009 and December 31, 2008 were as follows:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Accrued Liabilities: | | |
| Manufactured gas plant sites | $52 | $52 |
| Other Superfund Sites | 1 | 1 |
| Total | $53 | $53 |
| Regulatory assets | $59 | $63 |

Most of the accrued Superfund Site liability relates to sites that have been investigated, in whole or in part. As investigations progress on these and other sites, O&R expects that additional liability will be accrued, the amount of which is not presently determinable but may be material. In February 2010, for one of its manufactured gas plant sites, O&R submitted to the New York State Department of Environmental Conservation a feasibility study that included a recommended remedy for the site and neighboring areas, the estimated cost of which was approximately $19 million more than O&R's accrued liability for the site at December 31, 2009. 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.

There were no insurance recoveries received related to Superfund Sites for the years ended December 31, 2009 and 2008. Environmental remediation and investigation costs incurred related to Superfund Sites during the years ended December 31, 2009 and 2008 were as follows:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Remediation costs incurred | $2.4 | $3.6 |

In 2007, 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 such contaminants could range up to $115 million. These estimates were based on assumptions regarding the extent of contamination and the type and extent of remediation that may be required. Actual experience may be materially different.

### Asbestos Proceedings

Suits have been brought 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, 2009 and 2008 were as follows:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Accrued liability – asbestos suits | $0.4 | $0.4 |
| Regulatory assets – asbestos suits | 0.4 | 0.4 |
| Accrued liability – workers' compensation | $5.9 | $5.5 |

## 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.

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

| (Millions of Dollars) | |
|---|---|
| 2010 | $ 1 |
| 2011 | 1 |
| All years thereafter | - |
| Total | $2 |

## Note I – Income Tax

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

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Charge/(benefit) to operations: | | | |
| State | | | |
| Current | $(3) | $2 | $1 |
| Deferred – net | 9 | 4 | 5 |
| Federal | | | |
| Current | (16) | 5 | 8 |
| Deferred – net | 32 | 13 | 10 |
| TOTAL CHARGE TO OPERATIONS | 22 | 24 | 24 |
| TOTAL CHARGE/(BENEFIT) TO OTHER INCOME | 1 | 1 | (1) |
| TOTAL | $23 | $25 | $23 |

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

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Deferred tax liabilities: | | |
| Depreciation | $143 | $133 |
| Regulatory liability – future income tax | 85 | 79 |
| Unrecognized pension and other postretirement costs | 87 | 112 |
| State income tax | 27 | 22 |
| Capitalized overheads | 58 | 41 |
| Other | 11 | 18 |
| Total deferred tax liabilities | 411 | 405 |
| Deferred tax assets: | | |
| Unrecognized pension and other postretirement costs | 87 | 112 |
| Regulatory asset – future income tax | 17 | 17 |
| Other | 54 | 63 |
| Total deferred tax assets | 158 | 192 |
| NET LIABILITIES | 253 | 213 |
| INVESTMENT TAX CREDITS | 3 | 3 |
| DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS | 256 | 216 |
| DEFERRED INCOME TAXES – RECOVERABLE ENERGY COSTS | 24 | 11 |
| TOTAL DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS | $280 | $227 |

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

| (% of Pre-tax income) | 2009 | 2008 | 2007 |
|---|---|---|---|
| STATUTORY TAX RATE | | | |
| Federal | 35% | 35% | 35% |
| Changes in computed taxes resulting from: | | | |
| State income tax | 6 | 6 | 6 |
| Depreciation related differences | (1) | (1) | - |
| Cost of removal | (3) | (2) | (3) |
| Other | (3) | (2) | (4) |
| Effective Tax Rate | 34% | 36% | 34% |

For federal income tax purposes in 2009, O&R has a net operating loss, primarily as a result of deductions for accelerated depreciation. O&R understands that Con Edison intends to file a request for a refund using this net operating loss to offset prior years' federal taxable income. At December 31, 2009, the refund receivable was classified as accounts receivable from affiliated companies of $2.6 million on O&R's consolidated balance sheet.

### Uncertain Tax Positions

Under the accounting rules for income taxes, an enterprise is not allowed to recognize, in its financial statements, the benefit of a tax position unless that position is more likely than not to be sustained upon examination by taxing authorities, including resolution of any related appeals and litigation processes, based solely on the technical merits of the position.

O&R files a consolidated tax return with Con Edison and its other subsidiaries. See "Federal Income Tax" and "State Income Tax" in Note A. The IRS has essentially completed its field audits of Con Edison's consolidated federal income tax returns through 2008. Con Edison's federal income tax returns for 1998 through 2008, which remain open to examination by the IRS, reflect certain tax positions with which the IRS does not or may not agree. Any adjustments to federal income tax returns will result in Con Edison filing the federal audit changes with New York State to incorporate in the applicable state income tax returns. In addition, Con Edison's New York State tax returns for years beginning with 2006 remain open to examination by New York State.

O&R has no uncertain tax positions for years prior to 2002. O&R's uncertain tax positions include the methods used to determine the extent to which construction-related costs could be deducted in 2002 through 2008. Settlement of this uncertain tax position would not affect O&R's results of operations because deferred taxes have been previously provided for the related temporary differences between the deductions taken for federal income tax purposes and the corresponding amounts charged to expense for financial reporting purposes.

In July 2008, the IRS entered into a closing agreement with Con Edison covering, among other things O&R's use of the "simplified service cost method" (SSCM) to determine the extent to which construction-related costs could be deducted in 2002 through 2004. In December 2008, Con Edison notified New York State of the closing agreement and made a payment to the State that included $3 million (including interest of $1 million) attributable to O&R in settlement of the issue for those years.

In June 2009, Con Edison entered into partial agreements with the IRS, which incorporate the July 2008 closing agreement and in relation to O&R, resulted in tax deficiencies allocable to O&R of $6 million for 2002 and a total of approximately $554 thousand for 2003 and 2004.

In August 2009, the IRS billed Con Edison for tax liabilities and related interest, including $9 million allocable to O&R for 2002 ($6 million for the tax liabilities and $3 million for related interest), which Con Edison paid in September 2009 by applying $9 million allocable to O&R of a deposit Con Edison made with the IRS in June 2007.

At December 31, 2009, the remainder of the deposit allocable to O&R, $4 million, was reclassified as current assets on O&R's consolidated balance sheet. At December 31, 2008, the deposit allocable to O&R, $13 million, was included in other deferred charges and noncurrent assets on O&R's consolidated balance sheet.

At December 31, 2009, O&R's estimated net asset for uncertain tax positions of $11 million was classified as a current asset on its consolidated balance sheet. O&R reasonably expects to resolve these uncertain tax positions with the IRS in the next 12 months.

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

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Balance at the beginning of the year | $9 | $12 | $12 |
| Additions based on tax positions related to the current year | - | - | - |
| Additions based on tax positions of prior years | - | - | 1 |
| Reductions for tax positions of prior years | (14) | (1) | (1) |
| Settlements | (6) | (2) | - |
| Balance at the end of the year | $(11) | $9 | $12 |

## 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 shares used during the period ended December 31, 2009 and 2008 have been new shares.

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, 2009, 2008 and 2007:

| (Thousands of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Stock options | $8 | $43 | $44 |
| Restricted stock units | 56 | 102 | (49) |
| Performance-based restricted stock | 1,082 | 804 | 421 |
| Total | $1,146 | $949 | $416 |

## 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, 2009 is as follows:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at 12/31/08 | 522,000 | $42.644 |
| Exercised | 26,000 | 37.487 |
| Outstanding at 12/31/09 | 496,000 | $42.914 |

The change in the fair value of all outstanding options from their grant dates to December 31, 2009 and 2008 (aggregate intrinsic value) for O&R were $1 million and $(2) million, respectively. The aggregate intrinsic value of options exercised in 2009 and 2008 were $150,090 and $33,254, respectively, and the cash received by Con Edison for payment of the exercise price was $974,655 and $187,620, respectively. The weighted average remaining contractual life of options outstanding is four years as of December 31, 2009.

The following table summarizes O&R employees' stock options outstanding at December 31, 2009 for each plan year:

| Plan Year | Remaining Contractual Life | Options Outstanding | Weighted Average Exercise Price | Options Exercisable |
|---|---|---|---|---|
| 2006 | 7 | 124,000 | $45.599 | 124,000 |
| 2005 | 6 | 104,000 | 43.039 | 104,000 |
| 2004 | 5 | 82,500 | 43.749 | 82,500 |
| 2003 | 4 | 77,500 | 39.980 | 77,500 |
| 2002 | 3 | 85,500 | 42.510 | 85,500 |
| 2001 | 2 | 15,500 | 37.750 | 15,500 |
| 2000 | 1 | 7,000 | 32.500 | 7,000 |
| Total | | 496,000 | $42.914 | 496,000 |

## 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 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 are recognizing compensation expense over the vesting period. The weighted average vesting period for outstanding awards is one year 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. At December 31, 2009 and 2008, there were 38,450 and 37,100 units outstanding for O&R. The weighted average fair value as of the grant date of the outstanding units for December 31, 2009 and 2008 was $35.577 and $35.399 per unit, respectively, for O&R. The total expense to be recognized by the Company in future periods for unvested awards outstanding as of December 31, 2009 was $60,763.

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 132 percent based on determinations made in connection with the O&R Annual Team Incentive Plan (the EIP portion). Units generally vest when the performance period ends.

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

| | 2009 |
|---|---|
| Risk-free interest rate | 0.45% - 5.95% |
| Expected term | 3 years |
| Expected volatility | 22.30% |

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, 2009 is as follows:

| | Units | Weighted Average Fair Value* |
|---|---|---|
| Non-vested at 12/31/08 | 32,300 | $48.782 |
| Granted | 9,035 | 36.949 |
| Vested | (4,007) | 68.150 |
| Forfeited | (1,403) | - |
| Transferred to Affiliate | (16,600) | - |
| Non-vested at 12/31/09 | 19,325 | $55.364 |

* Fair value is determined using the Monte Carlo simulation described above. Weighted average fair value at December 31, 2008 reflects assumption that dividends are accrued or paid on Performance RSUs prior to vesting. Weighted average fair value at December 31, 2009 and weighted average fair value of Performance RSUs granted do 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, 2009 is as follows:

| | Units | Weighted Average Price* |
|---|---|---|
| Non-vested at 12/31/08 | 32,300 | $38.930 |
| Granted | 9,035 | 40.696 |
| Vested | (4,007) | 45.430 |
| Forfeited | (1,403) | - |
| Transferred to Affiliate | (16,600) | - |
| Non-vested at 12/31/09 | 19,325 | $45.430 |

*Fair value is determined using the market price of one share of Con Edison common stock on the respective dates indicated or the grant or vesting dates. 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, 2009 is $0.9 million.

### Stock Purchase Plan

Under the Con Edison Stock Purchase Plan, O&R 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.

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 2009, 2008 and 2007, 868,622, 745,869 and 633,647 shares were purchased under the Stock Purchase Plan at a weighted average price of $38.15, $42.47 and $47.70 per share, respectively.

## Note K – Financial Information by Business Segment

The business segments of the Company were determined based on management's reporting and decision-making requirements in accordance with 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, 2009 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
|---|---|---|---|---|---|---|---|---|
| Electric | $648 | $- | $30 | $64 | $18 | $15 | $1,525 | $85 |
| Gas | 242 | - | 12 | 28 | 9 | 7 | 627 | 42 |
| Other* | - | - | - | - | 2 | - | 35 | - |
| Total | $890 | $- | $42 | $92 | $29 | $22 | $2,187 | $127 |

| As of and for the Year Ended December 31, 2008 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
|---|---|---|---|---|---|---|---|---|
| Electric | $733 | $- | $29 | $68 | $18 | $18 | $1,514 | $88 |
| Gas | 258 | - | 11 | 25 | 9 | 6 | 590 | 32 |
| Other* | - | - | - | - | 1 | - | 58 | - |
| Total | $991 | $- | $40 | $93 | $28 | $24 | $2,162 | $120 |

| As of and for the Year Ended December 31, 2007 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
|---|---|---|---|---|---|---|---|---|
| Electric | $671 | $- | $27 | $76 | $21 | $19 | $1,271 | $80 |
| Gas | 265 | - | 11 | 27 | 11 | 5 | 530 | 32 |
| Other* | - | - | - | - | 2 | (1) | 61 | - |
| Total | $936 | $- | $38 | $103 | $34 | $23 | $1,862 | $112 |

* Includes amounts related to Transition Funding.

## 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.

The accounting rules for derivatives and hedging were expanded in 2009 to require the Company to provide users of financial statements with enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under the accounting rules, and

(c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The accounting rules require qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements.

## 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, basic swaps, options, transmission congestion contracts and financial transmission rights contracts. The fair values of these hedges at December 31, 2009 and 2008 were as follows:

| (Millions of Dollars) | 2009 | 2008 |
|---|---|---|
| Fair value of net derivative assets/ (liabilities) – gross | $ (52) | $(63) |
| Impact of netting of cash collateral | - | - |
| Fair value of net derivative assets/ (liabilities) – net | $ (52) | $(63) |

O&R and CECONY 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 N.

### 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 $1 million of credit exposure in connection with electricity supply and hedging activities, net of collateral, at December 31, 2009. The Company's net credit exposure was with investment-grade counterparties and 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 electric prices.

The fair values of the Company's commodity derivatives at December 31, 2009 were:

| (Millions of Dollars) | Balance Sheet Location | Fair Value of Commodity Derivatives [(a)] |
|---|---|---|
| | Asset Derivatives | |
| Current | Fair value of derivative assets | $2 |
| Long term | Other deferred charges and non-current assets | 2 |
| Total asset derivatives | | $4 |
| Impact of netting | | (1) |
| Net asset derivatives | | $3 |
| | Liability Derivatives | |
| Current | Fair value of derivative liabilities | $36 |
| Long term | Fair value of derivative liabilities | 20 |
| Total liability derivatives | | $56 |
| Impact of netting | | (1) |
| Net liability derivatives | | $55[(b)] |

(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) Includes derivative liabilities of $9 million with Con Edison's competitive energy businesses. See Note N.

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 on the Company's commodity derivatives 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, 2009:

Realized and Unrealized (Losses) on Commodity Derivatives[(a)]

| (Millions of Dollars) | Balance Sheet Location | Deferred for the Year Ended December 31, 2009 |
|---|---|---|
| Pre-tax gains/(losses) deferred in accordance with the accounting rules for regulated operations: | | |
| Current | Deferred derivative losses | $4 |
| Current | Recoverable energy costs[(b)] | (124) |
| Long term | Regulatory assets | 6 |
| Total deferred losses | | $(114) |
| Net deferred (losses) | | $(114) |

(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 $37 million to Con Edison's competitive energy businesses for the year ended December 31, 2009. See Note N.

As of December 31, 2009, the Company had 54 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 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 | | |
|---|---|---|---|---|---|---|
| Number of Energy Contracts[(a) (c)] | MWhs[(b) (c)] | Number of Capacity Contracts[(a)] | MWs[(b)] | Number of Contracts[(a)] | Dths[(b)] | Total Number Of Contracts[(a)] |
| 8 | 3,582,524 | 1 | 228 | 45 | 5,960,000 | 54 |

(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.
(c) Includes one contract of 401,846 MWhs with Con Edison's competitive energy businesses. See Note N.

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 of the Company's 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 N). 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 of the Company's derivative instruments with credit-risk-related contingent features that are in a net liability position, and the amount of collateral posted at December 31, 2009 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)] | $44 |
| Collateral posted[(b)] | 37 |
| Additional collateral[(c)] (downgrade one level from current rating[(d)]) | - |
| Additional collateral[(c)] (downgrade to below investment grade from current rating[(d)]) | 12[(e)] |

(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) Across the Utilities' energy derivative positions, credit limits for the same counterparties are generally integrated. At December 31, 2009, all collateral for these positions was posted by CECONY, including the collateral posted that is estimated to be attributable to O&R shown above.
(c) 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.
(d) The current long-term ratings of O&R are Baa1/A-/A by Moody's Investors Service, Standard & Poor's Rating Services and Fitch Ratings, 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.
(e) Derivative instruments that are net assets have been excluded from the table. At December 31, 2009, if O&R had been downgraded to below investment grade, the requirement for additional collateral posting would not have resulted in a material change.

**Interest Rate Swaps**

O&R has an interest rate swap related to its Series 1994A Debt. See Note C. O&R 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, 2009 was an unrealized loss of $11 million, which has been included in the consolidated balance sheet as a regulatory asset and a fair value of derivative liabilities – noncurrent liabilities. The increase in the fair value of the swap for the year ended December 31, 2009 was $4 million. In the event O&R's credit rating was downgraded to BBB-/Baa3 or lower, the swap counterparty could elect to terminate the agreement and O&R would be required to settle the transaction.

## Note M – Asset Retirement Obligations

In accordance with accounting rules for asset retirement obligations, companies are 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 $68 million and $65 million at December 31, 2009 and 2008, respectively.

## Note N – 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, 2009, 2008 and 2007 were as follows:

| (Millions of Dollars) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Cost of services provided | $18 | $19 | $17 |
| Cost of services received | $41 | $31 | $30 |

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY $124 million, $183 million and $161 million of natural gas for the years ended December 31, 2009, 2008 and 2007, respectively. These amounts are net of the effect of related hedging transactions. At December 31, 2009 and 2008, O&R's net payable to CECONY associated with these gas purchases was $16 million and $41 million, respectively.

RECO purchased from Consolidated Edison Energy, Inc. $37 million and $24 million of electricity for the periods ended December 31, 2009 and 2008, respectively, pursuant to energy auctions. There were no purchases for the period ended December 31, 2007.

At December 31, 2009 and 2008, the Company's receivable from Con Edison for income taxes was $12 million and $24 million, respectively. See Note A.

FERC has authorized CECONY through 2011 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, 2009, there were no loans outstanding for O&R. CECONY's outstanding loans to O&R amounted to $113 million at December 31, 2008.

## Note O – 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 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, 2009, the Company determined that nonperformance risk would have no material impact on their 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.

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.

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

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 are summarized below.

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Derivative assets: | | | | |
| Energy (1) | $ - | $ 4 | $ - | $ 4 |
| Other assets (3) | - | - | 9 | 9 |
| Total | $ - | $ 4 | $ 9 | $ 13 |
| Derivative liabilities: | | | | |
| Energy (1) | $ - | $ 1 | $ 55(4) | $ 56(4) |
| Financial & other (2) | - | - | 11 | 11 |
| Total | $ - | $ 1 | $ 66 | $ 67 |

(1) A significant portion of the energy derivative contracts categorized in Level 3 is valued using either an industry acceptable model or an internally developed model with observable inputs. The models also include some less readily observable inputs resulting in the classification of the respective contract as Level 3. See Note L.
(2) Includes only an interest rate swap. See Note L.
(3) Other assets are comprised of assets such as life insurance contracts within the Supplemental Employee Retirement Plan, held in a rabbi trust.
(4) Includes derivative liabilities of $9 million with Con Edison's competitive energy businesses. See Note N.

## Notes to the Financial Statements - Continued

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2008 are summarized below.

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Derivative assets: | | | | |
| Energy [1] | - | - | - | - |
| Other assets [3] | - | - | $8 | $8 |
| Total | - | - | $8 | $8 |
| Derivative liabilities: | | | | |
| Energy [1] | - | $10 | $53[4] | $63[4] |
| Financial & other [2] | - | - | 15 | 15 |
| Total | - | $10 | $68 | $78 |

(1) A significant portion of the energy derivative contracts categorized in Level 3 is valued using either an industry acceptable model or an internally developed model with observable inputs. The models also include some less readily observable inputs resulting in the classification of the respective contract as Level 3. See Note L.
(2) Includes only an interest rate swap. See Note L.
(3) Other assets are comprised of assets such as life insurance contracts within the Supplemental Employee Retirement Plan, held in a rabbi trust.
(4) Includes derivative liabilities of $13 million with Con Edison's competitive energy businesses. See Note N.

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, 2009 and 2008 and classified as Level 3 in the fair value hierarchy:

| | For the Year Ended December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Balance as of January 1, 2009 | Total Gains/(Losses) – Realized and Unrealized | | Purchases, Issuances, Sales and Settlements | Transfer In/Out of Level 3 | Ending Balance as of December 31, 2009 |
| (Millions of Dollars) | | Included in Earnings | Included in Regulatory Assets and Liabilities | | | |
| Derivatives: | | | | | | |
| Energy | $ (53) | $ (93) | $ (2) | $ 93 | $ - | $ (55) |
| Financial & other | (15) | (3) | 4 | 3 | - | (11) |
| Other | 8 | - | 1 | - | - | 9 |
| Total | $(60) | $ (96) | $ 3 | $ 96 | $ - | $ (57) |

| | For the Year Ended December 31, 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Balance as of January 1, 2008 | Total Gains/(Losses) – Realized and Unrealized | | Purchases, Issuances, Sales and Settlements | Transfer In/Out of Level 3 | Ending Balance as of December 31, 2008 |
| (Millions of Dollars) | | Included in Earnings | Included in Regulatory Assets and Liabilities | | | |
| Derivatives: | | | | | | |
| Energy | $16 | $9 | $(69) | $(9) | - | $(53) |
| Financial & other | (11) | (2) | (4) | 2 | - | (15) |
| Other | 12 | - | (4) | - | - | 8 |
| Total | $17 | $9 | $(77) | $(9) | - | $(60) |

Realized gains and losses on Level 3 energy 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. See Note A. Unrealized gains and losses for energy derivatives are generally deferred on the consolidated balance sheet in accordance with the accounting rules for regulated operations.

## Note P – New Financial Accounting Standards

In December 2009, the Financial Accounting Standards Board (FASB) issued new guidance for consolidations through Accounting Standards Update (ASU) No. 2009-17, "*Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*." The amendments in this update to the Accounting Standards Codification (ASC) are the result of Statement of Financial Accounting Standards (SFAS) No. 167, "*Amendments to FASB Interpretation No. 46(R)*." The update amends FASB Interpretation No. 46(R), "*Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51,*" to improve financial reporting by entities involved with VIEs and to address the impact of pending amendments to derecognition guidance. Under this new guidance, an entity must perform qualitative assessments of power and economics when determining the primary beneficiary of VIEs. This update is effective as of the beginning of the first fiscal year that begins after November 15, 2009. The application of this guidance does not have a material impact on the Company's financial position, results of operations and liquidity.

In December 2009, the FASB issued new guidance for transfers of financial assets through ASU No. 2009-16, "*Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*." The amendments in this update to the ASC are the result of SFAS No. 166, "*Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140.*" This update amends FASB Statement No. 140, "*Accounting for Transfers of Financial Assets,*" by eliminating the concept of a Qualified Special Purpose Entity, modifying the transferability constraints, requiring consideration of all arrangements made in connection with a transfer, clarifying the legal isolation analysis, providing guidance on when a portion of a financial asset can be derecognized, and modifying the initial measurement of a beneficial interest retained by a transferor. This update is effective as of the beginning of the first fiscal year that begins after November 15, 2009. The application of this guidance does not have a material impact on the Company's financial position, results of operations and liquidity.

In August 2009, the FASB issued ASU No. 2009-05, "*Fair Value Measurements and Disclosures (Topic 820)—Measuring Liabilities at Fair Value*." The amendments in this update attempt to reduce ambiguity in financial reporting when measuring the fair value of liabilities through providing clarification on valuation techniques for circumstances in which a quoted price in an active market for the identical liability is not available. The guidance requires companies to measure fair value using valuation techniques provided within the update or those consistent with Topic 820.  The update was effective for the first interim or annual reporting period beginning after the update's issuance. The Company currently records certain derivative liabilities at fair value using valuation techniques consistent with Topic 820. As such, the adoption of this guidance did not have a material impact on the Company's financial position, results of operations or liquidity

In June 2009, the FASB issued ASU No. 2009-01, "*Generally Accepted Accounting Principles (Topic 105).*" The amendments in this update to the ASC are the result of Statement No. 168, "*The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*." This update replaces FASB Statement No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*" and establishes the FASB Accounting Standards Codification™ as the source of authoritative U.S. generally accepted accounting principles recognized by the FASB to be applied to by nongovernmental entities. This update is effective for interim and annual periods ending after September 15, 2009. The adoption of this Statement did not have a material impact on the Company's financial position, results of operations or liquidity.

In May 2009, the FASB issued FAS No. 165, "*Subsequent Events*." This Standard has been codified in ASC Topic 855 – "*Subsequent Events*." This new guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The guidance specifies the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance is effective for interim and annual periods ending after June 15, 2009. The application of this guidance did not have a material impact on the Company's financial position, results of operations and liquidity.

In April 2009, the FASB issued FASB Staff Position (FSP) FAS 157-4 "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That are Not Orderly*." This FSP has been incorporated within the Codification in ASC Topic 820, "*Fair Value Measurements and Disclosures."* This FSP provides additional guidance on factors that should be considered in estimating fair value when there has been a significant decrease in market activity for a financial asset or liability. Additionally, this FSP requires an entity to disclose the inputs and valuation techniques used to measure fair value and discussion of changes in valuation techniques and related inputs, if any, during the period. This FSP applies to all fair value measurements when appropriate and is effective for interim and annual periods ending after June 15, 2009. The application of this FSP did not have a material impact on the Company's financial position, results of operations and liquidity.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." This FSP has been incorporated within the Codification in ASC Topic 320, "*Investments—Debt and Equity Securities*." This FSP amends the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of an impairment charge to be recorded in earnings. Under the FSP, an entity must assess the likelihood of selling the security prior to recovering its cost basis to determine whether any other-than-temporary impairment exists. This FSP is effective for interim and annual periods ending after June 15, 2009. The application of this FSP did not have a material impact on the Company's financial position, results of operations and liquidity.

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board (APB) 28-1 "*Interim Disclosures about Fair Value of Financial Instruments*." This FSP has been incorporated within the Codification in ASC Topic 825, "*Financial Instruments,*" and applies to all financial instruments within the scope of FASB Statement No. 107, "*Disclosures about Fair Value of Financial Instruments.*" This FSP requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments, in both interim financial statements as well as annual financial statements. This FSP is effective for interim and annual periods ending after June 15, 2009. The application of this FSP did not have a material impact on the Company's financial position, results of operations and liquidity.