# Orange and Rockland Utilities, Inc.
# Third Quarter 2012 Financial Statements and Notes

Financial Statements (Unaudited)

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

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (Millions of Dollars) | | | |
| OPERATING REVENUES | | | | |
| Electric | $ 199 | $ 217 | $ 457 | $ 507 |
| Gas | 27 | 24 | 144 | 153 |
| TOTAL OPERATING REVENUES | 226 | 241 | 601 | 660 |
| OPERATING EXPENSES | | | | |
| Purchased power | 70 | 95 | 150 | 218 |
| Gas purchased for resale | 11 | 9 | 48 | 62 |
| Operations and maintenance | 72 | 71 | 219 | 212 |
| Depreciation and amortization | 13 | 12 | 39 | 36 |
| Taxes, other than income taxes | 16 | 16 | 45 | 41 |
| TOTAL OPERATING EXPENSES | 182 | 203 | 501 | 569 |
| OPERATING INCOME | 44 | 38 | 100 | 91 |
| OTHER INCOME (DEDUCTIONS) | | | | |
| Investment and other income | - | - | - | 1 |
| Allowance for equity funds used during construction | - | 1 | - | 2 |
| TOTAL OTHER INCOME (DEDUCTIONS) | - | 1 | - | 3 |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 44 | 39 | 100 | 94 |
| INTEREST EXPENSE | | | | |
| Interest on long-term debt | 9 | 8 | 25 | 24 |
| Other interest | (2) | (2) | (2) | 3 |
| Allowance for borrowed funds used during construction | - | - | (1) | (1) |
| NET INTEREST EXPENSE | 7 | 6 | 22 | 26 |
| INCOME BEFORE INCOME TAX EXPENSE | 37 | 33 | 78 | 68 |
| INCOME TAX EXPENSE | 14 | 13 | 24 | 24 |
| NET INCOME | $ 23 | $ 20 | $ 54 | $ 44 |

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

# Orange and Rockland Utilities, Inc.

## CONSOLIDATED STATEMENT OF CASH FLOWS

**(Unaudited)**

| | For the Nine Months Ended September 30, 2012 | 2011 |
|---|---|---|
| | (Millions of Dollars) | |
| OPERATING ACTIVITIES | | |
| Net income | $ 54 | $ 44 |
| PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME | | |
| Depreciation and amortization | 39 | 36 |
| Deferred income taxes | 49 | 22 |
| Other non-cash items (net) | 6 | 2 |
| CHANGES IN ASSETS AND LIABILITIES | | |
| Accounts receivable - customers, less allowance for uncollectibles | (6) | 9 |
| Accounts receivable from affiliated companies | (47) | 16 |
| Materials and supplies, including gas in storage | 5 | (4) |
| Prepayments, other receivables and other current assets | (4) | 8 |
| Recoverable energy costs | (2) | 12 |
| Accounts payable | (7) | (8) |
| Accounts payable to affiliated companies | 4 | (21) |
| Pensions and retiree obligations | 64 | 44 |
| Pensions and retiree contributions | (60) | (47) |
| Accrued taxes | - | 4 |
| Accrued interest | (1) | 4 |
| Accrued wages | (6) | (6) |
| Deferred charges, noncurrent assets and other regulatory assets | - | 27 |
| Deferred credits and other regulatory liabilities | (8) | (6) |
| Superfund and other environmental costs (net) | - | (1) |
| Other liabilities | (1) | - |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 79 | 135 |
| INVESTING ACTIVITIES | | |
| Utility construction expenditures | (83) | (74) |
| Cost of removal less salvage | (3) | (4) |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (86) | (78) |
| FINANCING ACTIVITIES | | |
| Retirement of long-term debt | (2) | (2) |
| Dividend to parent | (26) | (24) |
| NET CASH FLOWS USED IN FINANCING ACTIVITIES | (28) | (26) |
| CASH AND TEMPORARY CASH INVESTMENTS: | | |
| NET CHANGE FOR THE PERIOD | (35) | 31 |
| BALANCE AT BEGINNING OF PERIOD | 69 | 38 |
| BALANCE AT END OF PERIOD | $ 34 | $ 69 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid/(refunded) during the period for: | | |
| Interest | $21 | $21 |
| Income taxes | $19 | ($12) |

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

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

| | September 30, 2012 | December 31, 2011 |
|---|---|---|
| | (Millions of Dollars) | |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and temporary cash investments | $ 34 | $ 69 |
| Accounts receivable - customers, less allowance for uncollectible accounts of $4 and $6 in 2012 and 2011, respectively | 64 | 58 |
| Accrued unbilled revenue | 25 | 32 |
| Other receivables, less allowance for uncollectible accounts of $1 in 2012 and 2011 | 5 | 9 |
| Accounts receivable from affiliated companies | 59 | 12 |
| Gas in storage, at average cost | 21 | 29 |
| Materials and supplies, at average cost | 14 | 11 |
| Prepayments | 35 | 21 |
| Deferred tax assets - current | 25 | 29 |
| Regulatory assets | 15 | 24 |
| Other current assets | 13 | 12 |
| TOTAL CURRENT ASSETS | 310 | 306 |
| INVESTMENTS | 16 | 10 |
| UTILITY PLANT, AT ORIGINAL COST | | |
| Electric | 1,291 | 1,228 |
| Gas | 560 | 534 |
| General | 172 | 159 |
| Total | 2,023 | 1,921 |
| Less: Accumulated depreciation | 554 | 528 |
| Net | 1,469 | 1,393 |
| Construction work in progress | 49 | 76 |
| NET UTILITY PLANT | 1,518 | 1,469 |
| DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS | | |
| Regulatory assets | 611 | 676 |
| Other deferred charges and noncurrent assets | 18 | 25 |
| TOTAL DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS | 629 | 701 |
| TOTAL ASSETS | $ 2,473 | $ 2,486 |

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

# Orange and Rockland Utilities, Inc.

## CONSOLIDATED BALANCE SHEET

**(Unaudited)**

| | September 30, 2012 | December 31, 2011 |
|---|---|---|
| | (Millions of Dollars) | |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| CURRENT LIABILITIES | | |
| Long-term debt due within one year | $ 3 | $ 3 |
| Accounts payable | 78 | 85 |
| Accounts payable to affiliated companies | 18 | 13 |
| Customer deposits | 12 | 13 |
| Accrued taxes | 1 | 1 |
| Accrued taxes to affiliated companies | 3 | 4 |
| Accrued interest | 10 | 11 |
| Accrued wages | 4 | 10 |
| Fair value of derivative liabilities | 10 | 22 |
| Regulatory liabilities | 33 | 39 |
| Other current liabilities | 29 | 38 |
| TOTAL CURRENT LIABILITIES | 201 | 239 |
| NONCURRENT LIABILITIES | | |
| Provision for injuries and damages | 7 | 7 |
| Pensions and retiree benefits | 412 | 498 |
| Superfund and other environmental costs | 114 | 116 |
| Fair value of derivative liabilities | 20 | 14 |
| Other noncurrent liabilities | 3 | 4 |
| TOTAL NONCURRENT LIABILITIES | 556 | 639 |
| DEFERRED CREDITS AND REGULATORY LIABILITIES | | |
| Deferred income taxes and investment tax credits | 414 | 350 |
| Regulatory liabilities | 124 | 116 |
| Other deferred credits | 3 | 3 |
| TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES | 541 | 469 |
| LONG-TERM DEBT | 605 | 607 |
| SHAREHOLDER'S EQUITY | | |
| Common shareholder's equity (See Statement of Common Shareholder's Equity) | 570 | 532 |
| TOTAL SHAREHOLDER'S EQUITY | 570 | 532 |
| TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY | $2,473 | $2,486 |

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

# Orange and Rockland Utilities, Inc.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

**(Unaudited)**

| | For the Three Months Ended September 30, 2012 | For the Three Months Ended September 30, 2011 | For the Nine Months Ended September 30, 2012 | For the Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| | (Millions of Dollars) | | | |
| NET INCOME | $ 23 | $ 20 | $ 54 | $ 44 |
| OTHER COMPREHENSIVE INCOME, NET OF TAXES | | | | |
| Pension plan liability adjustments, net of $1 and $6 taxes in 2012 and $1 and $4 taxes 2011, respectively | 2 | 2 | 10 | 6 |
| TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAXES | 2 | 2 | 10 | 6 |
| COMPREHENSIVE INCOME | $ 25 | $ 22 | $ 64 | $ 50 |

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

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

| (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, 2010 | 1,000 | $ - | $ 304 | $ 256 | $ (33) | $ 527 |
| Net income | | | | 19 | | 19 |
| Common stock dividend to parent | | | | (8) | | (8) |
| Other comprehensive income | | | | | 3 | 3 |
| BALANCE AS OF MARCH 31, 2011 | 1,000 | $ - | $ 304 | $ 267 | $ (30) | $ 541 |
| Net income | | | | 4 | | 4 |
| Common stock dividend to parent | | | | (8) | | (8) |
| Other comprehensive income | | | | | 1 | 1 |
| BALANCE AS OF JUNE 30, 2011 | 1,000 | $ - | $ 304 | $ 263 | $ (29) | $ 538 |
| Net income | | | | 20 | | 20 |
| Common stock dividend to parent | | | | (8) | | (8) |
| Other comprehensive income | | | | | 2 | 2 |
| BALANCE AS OF SEPTEMBER 30, 2011 | 1,000 | $ - | $ 304 | $ 275 | $ (27) | $ 552 |
| BALANCE AS OF DECEMBER 31, 2011 | 1,000 | $ - | $ 304 | $ 277 | $ (49) | $ 532 |
| Net income | | | | 20 | | 20 |
| Common stock dividend to parent | | | | (9) | | (9) |
| Other comprehensive income | | | | | 7 | 7 |
| BALANCE AS OF MARCH 31, 2012 | 1,000 | $ - | $ 304 | $ 288 | $ (42) | $ 550 |
| Net income | | | | 11 | | 11 |
| Common stock dividend to parent | | | | (9) | | (9) |
| Other comprehensive income | | | | | 1 | 1 |
| BALANCE AS OF JUNE 30, 2012 | 1,000 | $ - | $ 304 | $ 290 | $ (41) | $ 553 |
| Net income | | | | 23 | | 23 |
| Common stock dividend to parent | | | | (8) | | (8) |
| Other comprehensive income | | | | | 2 | 2 |
| BALANCE AS OF SEPTEMBER 30, 2012 | 1,000 | $ - | $ 304 | $ 305 | $ (39) | $ 570 |

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

# Notes to the Financial Statements (Unaudited)

## General

These notes accompany and form an integral part of the consolidated 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 nine months ended September 30, 2012 and 2011, operating revenues for RECO and Pike were 24.7 percent and 0.8 percent, 25.1 percent and 0.9 percent, respectively, of O&R's consolidated operating revenues. O&R, along with its regulated utility subsidiaries, provides electric service in southeastern New York and adjacent areas of northern New Jersey and eastern Pennsylvania and gas service in southeastern New York and adjacent areas of eastern Pennsylvania. RECO owns Rockland Electric Company Transition Funding LLC (Transition Funding), which was formed in 2004 in connection with the securitization of certain purchased power costs.

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

The interim consolidated financial statements as of September 30, 2012 and 2011 and for the three and nine month periods ended September 30, 2012 and 2011 (the Third Quarter Financial Statements) are unaudited but, in the opinion of the Company's management, reflect all adjustments (which include only normally recurring adjustments) necessary for a fair presentation of the results for the interim periods presented. The Third Quarter Financial Statements should be read together with the audited consolidated financial statements of the Company, as of December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011, including the notes thereto. Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company has, pursuant to the accounting rules for subsequent events, evaluated events or transactions that occurred after September 30, 2012 through the posting on its website (November 14, 2012) of the Third Quarter Financial Statements for potential recognition or disclosure in the Third Quarter Financial Statements.

## Note A – Regulatory Matters

### Rate Agreements

### Electric

On February 24, 2012, O&R, the staff of the NYSPSC and the Utility Intervention Unit of New York State's Division of Consumer Protection entered into a Joint Proposal with respect to the Company's rates for electric delivery service rendered in New York. The Joint Proposal, which the NYSPSC approved in June 2012, covers the three-year period from July 2012 through June 2015. The Joint Proposal provides for electric base rate increases of $19.4 million, $8.8 million and $15.2 million, effective July 2012, 2013 and 2014, respectively, which is being implemented, at the NYSPSC's option, with increases of $15.2 million effective July 2012 and 2013 and an increase of $13.1 million, together with a surcharge of $2.1 million, effective July 2014. The Joint Proposal reflects the following major items:

- a weighted average cost of capital of 7.61 percent, 7.65 percent and 7.48 percent for the rate years ending June 30, 2013, 2014 and 2015, respectively, reflecting:
    - a return on common equity of 9.4 percent, 9.5 percent and 9.6 percent for the rate years ending June 30, 2013, 2014 and 2015, respectively;
    - cost of long-term debt of 6.07 percent for each of the rate years ending June 30, 2013 and 2014 and 5.64 percent for the rate year ending June 30 2015;
    - common equity ratio of 48 percent for each of the rate years ending June 30, 2013, 2014 and 2015; and
    - average rate base of $671 million, $708 million and $759 million for the rate years ending June 30, 2013, 2014 and 2015, respectively;
- sharing with electric customers of any actual earnings, excluding the effects of any penalties and certain other items, above specified percentage returns on common equity (based on the actual average common equity ratio, subject to a 50 percent maximum):
    - the company will allocate to customers the revenue requirement equivalent of 50 percent, 75 percent and 90 percent of any such earnings for each rate year in excess of 80 basis points, 180 basis points and 280 basis points, respectively, above the return on common equity for that rate year indicated above; and
    - the earnings sharing allocation between the company and customers will be done on a cumulative basis at the end of rate year three;
- continuation of a revenue decoupling mechanism;
- continuation of a provision which defers as a regulatory liability for the benefit of customers or, subject to certain limitations, a regulatory asset for recovery from customers, as the case may be, the revenue requirement impact of the amount by which actual average net utility plant for each rate year is different than the average net utility plant reflected in rates ($678 million, $704 million and $753 million for the rate years ending June 30, 2013, 2014 and 2015, respectively);
- continuation of the rate provisions pursuant to which the company recovers its purchased power costs from customers;
- continuation of rate provisions under which pension and other postretirement benefit expenses, environmental remediation expenses, tax-exempt debt costs and certain other expenses are reconciled to amounts for those expenses reflected in rates;
- provisions under which property taxes are reconciled to amounts reflected in rates; and
- continuation of provisions for potential operations penalties of up to $3 million annually if certain customer service and system reliability performance targets are not met.

Regulatory Assets and Liabilities

Regulatory assets and liabilities at September 30, 2012 and December 31, 2011 were comprised of the following items:

| (Millions of Dollars) | 2012 | 2011 |
|---|---|---|
| Regulatory assets | | |
| Unrecognized pension and other postretirement costs | $239 | $298 |
| Environmental remediation costs | 115 | 117 |
| Future federal income tax | 79 | 74 |
| Deferred storm costs | 42 | 48 |
| Transition bond charges | 40 | 44 |
| Pension and other postretirement benefits deferrals | 31 | 41 |
| Deferred derivative losses – long-term | 22 | 16 |
| Surcharge for New York State assessment | 10 | 8 |
| Other | 33 | 30 |
| Regulatory assets – long-term | 611 | 676 |
| Deferred derivative losses – current | 13 | 24 |
| Recoverable energy costs – current | 2 | - |
| Regulatory assets - current | 15 | 24 |
| Total regulatory assets | $626 | $700 |
| Regulatory liabilities | | |
| Allowance for cost of removal less salvage | $ 81 | $ 76 |
| Carrying charges on transmission and distribution net plant | 20 | 24 |
| Other | 23 | 16 |
| Regulatory liabilities | 124 | 116 |
| Refundable energy costs – current | 28 | 39 |
| Revenue decoupling mechanism | 5 | - |
| Regulatory liabilities - current | 33 | 39 |
| Total regulatory liabilities | $157 | $155 |

## Note B – Capitalization

### Long-Term Debt

The carrying amounts and fair values of long-term debt are:

| | September 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| (Millions of Dollars) | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Long-Term Debt (including current portion) | $608 | $721 | $610 | $715 |

Fair values of long-term debt have been estimated primarily using available market information and are classified as Level 2 liabilities (see Note I).

## Note C – Short-Term Borrowing

At September 30, 2012 and December 31, 2011, O&R had no commercial paper outstanding. O&R has not borrowed under its October 2011 credit agreement. At September 30, 2012 and December 31, 2011, $15 million and $23 million of letters of credit were outstanding under the credit agreement.

## Note D – Pension Benefits

### Net Periodic Benefit Cost

The components of the Company's net periodic benefit costs for the three and nine months ended September 30, 2012 and 2011 were as follows:

| | For the Three Months Ended September 30 | |
|---|---|---|
| (Millions of Dollars) | 2012 | 2011 |
| Service cost – including administrative expenses | $ 4 | $ 3 |
| Interest cost on projected benefit obligation | 9 | 9 |
| Expected return on plan assets | (9) | (9) |
| Amortization of net actuarial loss | 10 | 7 |
| Amortization of prior service costs | - | 1 |
| NET PERIODIC BENEFIT COST | $14 | $11 |
| Cost capitalized | (4) | (3) |
| Reconciliation to rate level | 1 | 1 |
| Cost charged to operating expenses | $11 | $ 9 |

| | For the Nine Months Ended September 30 | |
|---|---|---|
| (Millions of Dollars) | 2012 | 2011 |
| Service cost – including administrative expenses | $12 | $ 9 |
| Interest cost on projected benefit obligation | 26 | 27 |
| Expected return on plan assets | (26) | (27) |
| Amortization of net actuarial loss | 29 | 21 |
| Amortization of prior service costs | 1 | 2 |
| NET PERIODIC BENEFIT COST | $42 | $ 32 |
| Cost capitalized | (13) | (10) |
| Reconciliation to rate level | (1) | 3 |
| Cost charged to operating expenses | $28 | $ 25 |

### Expected Contributions

O&R made contributions to the pension plan during 2012 of $54 million. O&R's policy is to fund its accounting cost to the extent tax deductible.

## Note E – Other Postretirement Benefits

### Net Periodic Benefit Cost

The components of the Company's net periodic postretirement benefit costs for the three and nine months ended September 30, 2012 and 2011 were as follows:

| | For the Three Months Ended September 30, | |
|---|---|---|
| (Millions of Dollars) | 2012 | 2011 |
| Service cost | $1 | $ 1 |
| Interest cost on accumulated other postretirement benefit obligation | 2 | 3 |
| Expected return on plan assets | (2) | (2) |
| Amortization of net actuarial loss | 3 | 2 |
| Amortization of prior service costs | (1) | - |
| NET PERIODIC POSTRETIREMENT BENEFIT COST | $3 | $ 4 |
| Cost capitalized | (1) | (1) |
| Cost charged to operating expenses | $2 | $ 3 |

| (Millions of Dollars) | For the Nine Months Ended September 30, 2012 | 2011 |
|---|---|---|
| Service cost | $4 | $ 3 |
| Interest cost on accumulated other postretirement benefit obligation | 7 | 9 |
| Expected return on plan assets | (7) | (6) |
| Amortization of net actuarial loss | 8 | 6 |
| Amortization of prior service costs | (3) | 1 |
| NET PERIODIC POSTRETIREMENT BENEFIT COST | $9 | $13 |
| Cost capitalized | (4) | (4) |
| Reconciliation to rate level | 3 | 2 |
| Cost charged to operating expenses | $8 | $11 |

During the first quarter of 2012, the Company amended its postretirement life and health benefit plans for management employees. The Company's other postretirement benefit liabilities were reduced by $39 million due to the plan amendments.

**Expected Contributions**

O&R expects to make a contribution of $12 million to the other postretirement benefit plans in 2012. During the first nine months of 2012, the Company contributed $6 million to the other postretirement benefit plans.

## Note F – 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 investigate and, where determinable, discharge its related obligations. For Superfund Sites (including the manufactured gas plant sites) for which O&R is managing the investigation and remediation, the accrued liability represents an estimate of the Company's share of undiscounted cost to investigate and remediate the sites. Remediation costs are estimated based on the information available, applicable remediation standards, and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at September 30, 2012 and December 31, 2011 were as follows:

| (Millions of Dollars) | 2012 | 2011 |
|---|---|---|
| Accrued Liabilities: | | |
| Manufactured gas plant sites | $113 | $115 |
| Other superfund sites | 1 | 1 |
| Total | $114 | $116 |
| Regulatory assets | $115 | $117 |

The Superfund Sites have been investigated. However, for some of the sites, the extent and associated cost of the required remediation has not yet been determined. As information pertaining to the required remediation becomes available, the Company expects that additional liability may be accrued, the amount of which is not presently determinable but may be material. Under its current rate plans for provision of electric and gas service in New York, O&R is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs. In February 2011, the NYSPSC initiated a proceeding to examine the existing mechanisms pursuant to which the Company recovers such costs and possible alternatives.

Insurance recoveries related to Superfund Sites for the three and nine months ended September 30, 2012 and 2011 were immaterial.

Environmental remediation costs incurred related to Superfund Sites for the three and nine months ended September 30, 2012 and 2011 were as follows:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Millions of Dollars) | 2012 | 2011 | 2012 | 2011 |
| Remediation costs incurred | $2.0 | $0.1 | $2.7 | $2.0 |

In 2010, O&R estimated that for its manufactured gas plant sites, each of which has been investigated, the aggregate undiscounted potential liability for the remediation of coal tar and/or other manufactured gas plant related environmental contaminants could range up to $200 million. These estimates were based on assumptions regarding the extent of contamination and the type and extent of remediation that may be required. Actual experience may be materially different.

### Asbestos Proceedings

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

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

The Company's accrued liability for asbestos suits and workers' compensation proceedings (including those related to asbestos exposure) and the amounts deferred as regulatory assets at September 30, 2012 and December 31, 2011 were as follows:

| (Millions of Dollars) | 2012 | 2011 |
|---|---|---|
| Accrued liability – asbestos suits | $0.3 | $0.3 |
| Regulatory assets – asbestos suits | 0.3 | 0.3 |
| Accrued liability – workers' compensation | $4.6 | $4.7 |
| Regulatory assets – workers' compensation | 0.1 | 0.3 |

## Note G – Financial Information by Business Segment

The financial data for the business segments are as follows:

| | For the Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Operating revenues | | Inter-segment revenues | | Depreciation and amortization | | Operating income | |
| (Millions of Dollars) | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Electric | $199 | $217 | $- | $- | $ 9 | $ 9 | $50 | $44 |
| Gas | 27 | 24 | - | - | 4 | 3 | (6) | (6) |
| Total | $226 | $241 | $- | $- | $13 | $12 | $44 | $38 |

| | For the Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Operating Revenues | | Inter-segment revenues | | Depreciation and amortization | | Operating Income | |
| (Millions of Dollars) | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Electric | $457 | $507 | $- | $- | $28 | $26 | $ 74 | $69 |
| Gas | 144 | 153 | - | - | 11 | 10 | 26 | 22 |
| Total | $601 | $660 | $- | $- | $39 | $36 | $100 | $91 |

## Note H – Derivative Instruments and Hedging Activities

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

### Energy Price Hedging

The Company hedges market price fluctuations associated with physical purchases of electricity by using electric and gas derivative instruments including futures, forwards, and options. The fair values of the Company's commodity derivatives at September 30, 2012 and December 31, 2011 were as follows:

| (Millions of Dollars) | 2012 | 2011 |
|---|---|---|
| Fair value of net derivative assets/(liabilities) – gross | $(25) | $(28) |
| Impact of netting of cash collateral | 3 | 2 |
| Fair value of net derivative assets/(liabilities) – net | $(22) | $(26) |

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

**Credit Exposure**

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

The Company had $2 million of credit exposure in connection with electricity supply and hedging activities, net of collateral, at September 30, 2012. The Company's net credit exposure consisted of $1 million with investment-grade counterparties and $1 million with commodity exchange brokers.

**Economic Hedges**

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

The fair values of the Company's commodity derivatives at September 30, 2012 and December 31, 2011 were:

Fair Value of Commodity Derivatives [(a)]

| (Millions of Dollars) | Balance Sheet Location | 2012 | 2011 |
|---|---|---|---|
| **Derivative Assets** | | | |
| Current | Other current assets | $ 1 | $ - |
| Long-term | Other deferred charges and non-current assets | 2 | 1 |
| Total derivative assets | | $ 3 | $ 1 |
| Impact of netting | | (1) | - |
| Net derivative assets | | $ 2 | $ 1 |
| **Derivative Liabilities** | | | |
| Current | Fair value of derivative liabilities | $12 | $22 |
| Long-term | Fair value of derivative liabilities | 16 | 7 |
| Total derivative liabilities | | $28 | $29 |
| Impact of netting | | (4) | (2) |
| Net derivative liabilities | | $24 | $27 |

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

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

The following table presents the changes in the fair values of commodity derivatives that have been deferred for the three and nine months ended September 30, 2012 and 2011:

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

| (Millions of Dollars) | Balance Sheet Location | Deferred for the Three Months Ended September 30, 2012 | 2011 |
|---|---|---|---|
| Pre-tax gains/(losses) deferred in accordance with the accounting rules for regulated operations: | | | |
| Current | Deferred derivative gains | $ - | $ (1) |
| Long-term | Deferred derivative gains | 1 | - |
| Total deferred gains/(losses) | | $ 1 | $ (1) |
| Current | Deferred derivative losses | $ 9 | $ 4 |
| Current | Recoverable energy costs | (8) | (22) |
| Long-term | Deferred derivative losses | 3 | 4 |
| Total deferred gains/(losses) | | $ 4 | $(14) |
| Net deferred gains/(losses) | | $ 5 | $(15) |

(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.

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

| (Millions of Dollars) | Balance Sheet Location | Deferred for the Nine Months Ended September 30, 2012 | 2011 |
|---|---|---|---|
| Pre-tax gains/(losses) deferred in accordance with the accounting rules for regulated operations: | | | |
| Long-term | Deferred derivative gains | $ 1 | $ - |
| Total deferred gains/(losses) | | $ 1 | $ - |
| Current | Deferred derivative losses | $ 12 | $ 19 |
| Current | Recoverable energy costs[(b)] | (22) | (54) |
| Long-term | Deferred derivative losses | (7) | 11 |
| Total deferred gains/(losses) | | $(17) | $(24) |
| Net deferred gains/(losses) | | $(16) | $(24) |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.
(b) Includes payments of $11 million to Con Edison's competitive energy businesses for the nine months ended September 30, 2011. See Note J.

As of September 30, 2012, the Company had 93 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)] | MWhs[(b)] | Number of Capacity Contracts[(a)] | MWs[(b)] | Number of Contracts[(a)] | Dths[(b)] | Total Number of Contracts[(a)] |
| 23 | 1,548,603 | 3 | 5,181 | 67 | 4,850,000 | 93 |

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

The collateral requirements associated with, and settlement of, derivative transactions are included in net cash flows from operating activities in the Company's consolidated statement of cash flows. Most derivative instrument contracts contain provisions that may require the Company to provide collateral on derivative instruments in net liability positions. The Utilities enter into separate derivative instruments for electric energy or capacity, and CECONY enters into derivative instruments in connection with the Utilities' joint gas supply arrangements (See Note J). The amount of collateral to be provided will depend on the fair value of the derivative instruments and the Utilities' credit ratings.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position, and collateral posted at September 30, 2012, and the additional collateral that would have been required to be posted had the lowest applicable credit rating been reduced one level and to below investment grade were:

| (Millions of Dollars) | |
|---|---|
| Aggregate fair value – net liabilities[(a)] | $11 |
| Collateral posted | $ 5 |
| Additional collateral[(b)] (downgrade one level from current rating[(c)]) | $ - |
| Additional collateral[(b)] (downgrade to below investment grade from current rating[(c)]) | $ 10 |

(a) Non-derivative transactions for the purchase and sale of electricity and qualifying derivative instruments, which have been designated as normal purchases or normal sales, are excluded from the table. These transactions primarily include purchases of electricity from independent system operators. For certain other such non-derivative transactions, the Company could be required to post collateral under certain circumstances, including in the event counterparties had reasonable grounds for insecurity.
(b) The additional collateral amounts shown above are based upon the estimated O&R allocation of the Utilities' collateral requirements. The Utilities measure the collateral requirements by taking into consideration the fair value amounts of derivative instruments that contain credit-risk-related contingent features that are in a net liability position plus amounts owed to counterparties for settled transactions and amounts required by counterparties for minimum financial security. The fair value amounts represent unrealized losses, net of any unrealized gains where the Utilities have a legally enforceable right of setoff.
(c) The current long-term ratings of O&R are Baa1/A-/A- by Moody's, S&P, and Fitch, respectively. Credit ratings assigned by rating agencies are expressions of opinions that are subject to revision or withdrawal at any time by the assigning rating agency.
(d) Derivative instruments that are net assets have been excluded from the table. At September 30, 2012, if O&R had been downgraded to below investment grade, it would have been required to post additional collateral for such derivative instruments of $1 million.

**Interest Rate Swap**

O&R has an interest rate swap pursuant to which it pays a fixed-rate of 6.09 percent and receives a LIBOR-based variable rate. The fair value of this interest rate swap at September 30, 2012 was an unrealized loss of $6 million, which has been included in the Company's consolidated balance sheet as a noncurrent liability/fair value of derivative liabilities and a regulatory asset. The increase in the fair value of the swap for the three and nine months ended September 30, 2012 was $1 million and $2 million, respectively. The increase in the fair value of the swap for the three and nine months ended September 30, 2011 was not material. In the event O&R's credit rating was downgraded to BBB- or lower by S&P or Baa3 or lower by Moody's, the swap counterparty could elect to terminate the agreement and, if it did so, the parties would then be required to settle the transaction.

## Note I – Fair Value Measurements

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

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

- Level 1 – Consists of assets or liabilities whose value is based on unadjusted quoted prices in active markets at the measurement date. An active market is one in which transactions for assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis. This category includes contracts traded on active exchange markets valued using unadjusted prices quoted directly from the exchange.

- Level 2 – Consists of assets or liabilities valued using industry standard models and based on prices, other than quoted prices within Level 1, that are either directly or indirectly observable as of the measurement date. The industry standard models consider observable assumptions including time value, volatility factors, and current market and contractual prices for the underlying commodities, in addition to other economic measures. This category includes contracts traded on active exchanges or in over-the-counter markets priced with industry standard models.

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

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

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2012 are summarized below.

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Netting Adjustments [4] | Total |
|---|---|---|---|---|---|
| Derivative assets: | | | | | |
| Commodity | $- | $ 2 | $ - | $- | $ 2 |
| Other assets | 7 | (1) | 10 | - | 16 |
| Transfer in [5][6] | - | 10 | - | - | 10 |
| Transfer out [5][6] | - | - | (10) | - | (10) |
| Other assets [3] | $7 | $ 9 | $ - | $- | $ 16 |
| Total | $7 | $11 | $ - | $- | $ 18 |
| Derivative liabilities: | | | | | |
| Commodity | $- | $ 1 | $ 26 | $(3) | $24[4] |
| Transfer in [5][6] | - | 14 | - | - | 14 |
| Transfer out [5][6] | - | - | (14) | - | (14) |
| Commodity[1] | $- | $15 | $ 12 | $(3) | $24 |
| Interest rate contract | - | (2) | 8 | - | 6 |
| Transfer in [5][6] | - | 8 | - | - | 8 |
| Transfer out [5][6] | - | - | (8) | - | (8) |
| Interest rate contract [2] | $- | $ 6 | $ - | $ - | $ 6 |
| Total | $- | $21 | $12 | $(3) | $30 |

(1) A portion of the commodity derivative contracts categorized in Level 3 is valued using 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 H.
(2) See Note H.
(3) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.
(4) Amounts represent the impact of legally-enforceable master netting agreements that allow the Company to net gain and loss positions and cash collateral held or placed with the same counterparties.
(5) The Company's policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.
(6) Transferred from Level 3 to Level 2 because of reassessment of the levels in the fair value hierarchy within which certain inputs fall. Other assets and interest rate contract were transferred as of March 31, 2012.

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

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

(1) A portion of the commodity derivative contracts categorized in Level 3 is valued using an internally developed model with observable inputs. The models also include some less readily observable inputs resulting in the classification of the respective contract as Level 3. See Note H.
(2) See Note H.
(3) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.
(4) Amounts represent the impact of legally-enforceable master netting agreements that allow the Company to net gain and loss positions and cash collateral held or placed with the same counterparties.
(5) The Company's policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.
(6) Transferred from Level 3 to Level 2 because of availability of observable market data due to decrease in the terms of certain contracts from beyond one year as of December 31, 2010 to less than one year as of December 31, 2011.

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

| (Millions of Dollars) | Fair Value of Level 3 at September 30, 2012 | Valuation Techniques | Unobservable Inputs | Range |
|---|---|---|---|---|
| Standard Offer Capacity Agreements | $(12) | Discounted cash flows | Forward capacity prices(1) | $166 MW-day |
| | | | Forward price escalator(1) | 0% - 3% |
| | | | Present value factor(1) | 1.66% |

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

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the three and nine months ended September 30, 2012 and classified as Level 3 in the fair value hierarchy:

| | For the Three Months Ended September 30, 2012 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Total Gains/(Losses) – Realized and Unrealized | | | | | | | |
| (Millions of Dollars) | Beginning Balance as of July 1, 2012 | Included in Earnings | Included in Regulatory Assets and Liabilities | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of September 30, 2012 |
| Derivatives: | | | | | | | | | |
| Commodity | $(36) | $(8) | $11 | $- | $- | $- | $8 | $13 | $(12) |

| (Millions of Dollars) | Beginning Balance as of January 1, 2012 | Total Gains/(Losses) – Realized and Unrealized: Included in Earnings | Total Gains/(Losses) – Realized and Unrealized: Included in Regulatory Assets and Liabilities | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of September 30, 2012 |
|---|---|---|---|---|---|---|---|---|---|
| | For the Nine Months Ended September 30, 2012 | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | $(29) | $(21) | $3 | $- | $- | $- | $21 | $14 | $(12) |
| Interest rate contract | (8) | (1) | - | - | - | - | 1 | 8 (1) | - |
| Other assets | 9 | - | 1 | - | - | - | - | (10) (1) | - |
| Total | $(28) | $(22) | $4 | $- | $- | $- | $22 | $12 | $(12) |

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

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the three and nine months ended September 30, 2011 and classified as Level 3 in the fair value hierarchy:

| (Millions of Dollars) | Beginning Balance as of July 1, 2011 | Total Gains/(Losses) – Realized and Unrealized: Included in Earnings | Total Gains/(Losses) – Realized and Unrealized: Included in Regulatory Assets and Liabilities | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of September 30, 2011 |
|---|---|---|---|---|---|---|---|---|---|
| | For the Three Months Ended September 30, 2011 | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | $(25) | $(6) | $8 | $- | $- | $- | $6 | $15 | $(2) |
| Interest rate contract | (10) | (1) | 1 | - | - | - | 1 | - | (9) |
| Other assets | 10 | - | (1) | - | - | - | - | - | 9 |
| Total | $(25) | $(7) | $8 | $- | $- | $- | $7 | $15 | $(2) |

| (Millions of Dollars) | Beginning Balance as of January 1, 2011 | Total Gains/(Losses) – Realized and Unrealized: Included in Earnings | Total Gains/(Losses) – Realized and Unrealized: Included in Regulatory Assets and Liabilities | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of September 30, 2011 |
|---|---|---|---|---|---|---|---|---|---|
| | For the Nine Months Ended September 30, 2011 | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | $(49) | $(30) | $32 | $- | $- | $- | $30 | $15 | $(2) |
| Interest rate contract | (10) | (3) | 1 | - | - | - | 3 | - | (9) |
| Other assets | 9 | - | - | - | - | - | - | - | 9 |
| Total | $(50) | $(33) | $33 | $- | $- | $- | $33 | $15 | $(2) |

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

The accounting rules for fair value measurements and disclosures require consideration of the impact of nonperformance risk (including credit risk) from a market participant perspective in the measurement of the fair value of assets and liabilities. At September 30, 2012, the Company determined that nonperformance risk would have no material impact on its financial position or results of operations. To assess nonperformance risk, the Company considered information such as collateral requirements, master netting arrangements, letters of credit and parent company guarantees, and applied a market-based method by using the counterparty (for an asset) or the Company's (for a liability) credit default swaps rates.

## Note J – 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 three and nine months ended September 30, 2012 and 2011 were as follows:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Millions of Dollars) | 2012 | 2011 | 2012 | 2011 |
| Cost of services provided | $ 4 | $ 5 | $14 | $15 |
| Cost of services received | $11 | $11 | $32 | $30 |

At September 30, 2012 and December 31, 2011, O&R's payable to CECONY associated with these services was $9 million and $3 million, respectively.

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY $12 million and $21 million of natural gas for the three months ended September 30, 2012 and 2011, respectively, and $35 million and $65 million of natural gas for nine months ended September 30 2012 and 2011, respectively. These amounts are net of the effect of related hedging transactions.

At September 30, 2012 and December 31, 2011, O&R's net payable to CECONY associated with gas purchases and to Con Edison's competitive energy businesses associated with electricity purchases and retail services was $7 million and $6 million, respectively.

RECO made no purchases of electricity from Consolidated Edison Energy, Inc. in both the three and nine months ended September 30, 2012 and the three months ended September 30, 2011 and purchased $11 million of electricity for the nine months ended September 30, 2011 pursuant to NJBPU-approved energy auctions.

At September 30, 2012 and December 31, 2011, the Company's receivable from Con Edison for income taxes was $51 million and $4 million, respectively.

At September 30, 2012 and December 31, 2011, the Company's receivable from CECONY for an Economic Stimulus Grant was $1 million for both periods.

FERC has authorized CECONY through 2013 to lend funds to O&R from time to time, for periods of not more than 12 months, in amounts not to exceed $250 million outstanding at any time, at prevailing market rates. At September 30, 2012 and December 31, 2011, there were no loans outstanding for O&R.

## Note K – Hurricane Sandy

In late October 2012, Hurricane Sandy caused extensive damage to the Company's electric distribution system and interrupted service to approximately 250,000 customers. To restore service to its customers and repair its energy systems, the Company is incurring substantial operating costs and making substantial capital expenditures. The Company estimates its response and restoration costs for Hurricane Sandy and a November 2012 Nor'easter to be $75 million to $100 million. The primary basis for this preliminary estimate is the Company's experience with Hurricane Irene. This preliminary estimate does not include the costs that will continue to be incurred to inspect and assess the condition of the Company's energy systems, and to repair them to their normal operating condition. The Company's rate plans provide for operating costs and capital expenditures under different provisions. The Company expects that most of its operating expenses attributable to these storms will be deferred for recovery as a regulatory asset under its New York electric rate plan. The Company's capital expenditures, up to specified levels, are reflected in rates under its rate plans. Under its New York electric rate plan, subject to certain limitations, the Company defers as a regulatory asset the revenue requirement impact of the amount by which actual average net utility plant is different than the average net utility plant reflected in rates. Under the New York electric rate plan, the Company also may petition the NYSPSC for authorization to defer extraordinary expenditures not otherwise addressed in the rate plan. The Company's New York electric rate plan includes provisions for revenue decoupling, as a result of which delivery revenues generally are not affected by changes in delivery volumes from levels assumed when rates were approved. The provisions of the Company's New York electric plan that impose penalties for operating performance provide for exceptions for major storms and catastrophic events beyond the control of the company, including natural disasters such as hurricanes and floods. The Company expects the NYSPSC to investigate the preparation and performance of New York utilities in connection with Hurricane Sandy.

In November 2012, the Governor of New York established a commission to review actions taken by New York utilities relating to emergency weather events, including Hurricanes Sandy and Irene and Tropical Storm Lee, and to make recommendations regarding, among other things, the oversight, management and legal framework governing power delivery services in New York.