Orange and Rockland Utilities, Inc.
2008 Annual Financial Statements and Notes

Financial Statements

PRICEWATERHOUSECOOPERS

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Report of Independent Registered Public Accounting Firm

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

In our opinion, the accompanying consolidated balance sheet and statement of capitalization and the related consolidated statements 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 at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 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 the standards of the Public Company Accounting Oversight Board (United States). 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

PricewaterhouseCoopers LLP
New York, New York
February 19, 2009

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2008	December 31, 2007
	(Millions of Dollars)	
ASSETS		
UTILITY PLANT, AT ORIGINAL COST (Note A)		
Electric	$ 1,023	$ 952
Gas	424	403
General	148	133
Total	1,595	1,488
Less: Accumulated depreciation	443	423
Net	1,152	1,065
Construction work in progress	58	55
NET UTILITY PLANT	1,210	1,120
CURRENT ASSETS		
Cash and temporary cash investments (Note A)	17	60
Restricted cash	1	1
Accounts receivable - customers, less allowance for uncollectible accounts of $3 and $2 in 2008 and 2007, respectively	63	54
Accrued unbilled revenue (Note A)	47	42
Other receivables, less allowance for uncollectible accounts of $2 in 2008 and 2007	29	26
Accounts receivable from affiliated companies	25	5
Gas in storage, at average cost	60	43
Materials and supplies, at average cost	9	8
Prepayments	12	11
Fair value of derivative assets	-	4
Deferred derivative losses	27	1
Recoverable energy costs (Notes A and B)	26	23
TOTAL CURRENT ASSETS	316	278
INVESTMENTS (Note A)	8	12
DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS		
Regulatory assets (Note B)	591	408
Other deferred charges and noncurrent assets	37	44
TOTAL DEFERRED CHARGES, REGULATORY ASSETS AND NONCURRENT ASSETS	628	452
TOTAL ASSETS	$ 2,162	$ 1,862

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

Orange and Rockland Utilities, Inc.
CONSOLIDATED BALANCE SHEET

	December 31, 2008	December 31, 2007
	(Millions of Dollars)	
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION		
Common shareholder's equity (See Statement of Common Shareholder's Equity)	$ 455	$ 416
Long-term debt (See Statement of Capitalization)	416	433
TOTAL CAPITALIZATION	871	849
NONCURRENT LIABILITIES		
Provision for injuries and damages (Note G)	7	6
Pensions and retiree benefits	453	299
Superfund and other environmental costs (Note G)	53	56
Fair value of derivative liabilities (Note L)	40	10
Uncertain income taxes	9	12
TOTAL NONCURRENT LIABILITIES	562	383
CURRENT LIABILITIES		
Long-term debt due within one year	3	3
Notes payable	-	45
Accounts payable	95	95
Accounts payable to affiliated companies	181	94
Customer deposits	15	15
Accrued taxes	-	1
Accrued interest	11	12
Fair value of derivative liabilities	27	1
Deferred derivative gains (Note B)	-	5
Deferred income taxes - recoverable energy costs (Note I)	11	9
Other current liabilities	30	19
TOTAL CURRENT LIABILITIES	373	299
DEFERRED CREDITS AND REGULATORY LIABILITIES		
Deferred income taxes and investment tax credits (Notes A and I)	216	207
Regulatory liabilities (Note B)	137	121
Other deferred credits	3	3
TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES	356	331
TOTAL CAPITALIZATION AND LIABILITIES	$ 2,162	$ 1,862

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,		
	2008	2007	2006
	(Millions of Dollars)		
OPERATING REVENUES (Note A)			
Electric	$ 733	$ 671	$ 582
Gas	259	265	236
TOTAL OPERATING REVENUES	992	936	818
OPERATING EXPENSES			
Purchased power	433	384	307
Gas purchased for resale	159	166	150
Other operations and maintenance	222	203	185
Depreciation and amortization (Note A)	40	38	35
Taxes, other than income taxes	44	42	47
Income taxes (Notes A and I)	24	24	25
TOTAL OPERATING EXPENSES	922	857	749
OPERATING INCOME	70	79	69
OTHER INCOME (DEDUCTIONS)			
Investment and other income (Note A)	4	1	5
Income taxes (Notes A and I)	(1)	1	(1)
Other deductions	(1)	(1)	-
TOTAL OTHER INCOME (DEDUCTIONS)	2	1	4
INTEREST EXPENSE			
Interest on long-term debt	25	25	23
Other interest	3	9	5
NET INTEREST EXPENSE	28	34	28
NET INCOME	$ 44	$ 46	$ 45

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, 2008	2007	2006
	(Millions of Dollars)		
NET INCOME	$ 44	$ 46	$ 45
OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES			
Pension plan liability adjustments, net of $(14) and $(1) taxes in 2008 and 2006, respectively	(20)	-	(1)
Unrealized losses on derivatives qualified as cash flow hedges, net of $(1) and $(2) taxes in 2008 and 2006, respectively	(1)	-	(2)
Less: Reclassification adjustment gains/(losses) included in net income, net of $(1) taxes in 2006	1	(1)	(2)
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	(14)	1	(1)
COMPREHENSIVE INCOME	$ 30	$ 47	$ 44

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, 2005	1,000	$ -	$ 194	$ 183	$ (8)	$ 369
Net Income				45		45
Common stock dividend to parent				(28)		(28)
Other comprehensive loss					(1)	(1)
Adjustment to initially apply FASB Statement No. 158, net of tax (Notes E and F)					(25)	(25)
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

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, 2008	2007	2006
	(Millions of Dollars)		
OPERATING ACTIVITIES			
Net income	$ 44	$ 46	$ 45
PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME			
Depreciation and amortization	40	38	35
Deferred income taxes	16	15	16
Other non-cash items (net)	(23)	4	(9)
CHANGES IN ASSETS AND LIABILITIES			
Accounts receivable - customers, less allowance for uncollectibles	(9)	(6)	13
Accounts receivable from affiliated companies	(22)	-	22
Materials and supplies, including gas in storage	(18)	13	4
Prepayments, other receivables and other current assets	(9)	10	(10)
Recoverable energy costs	25	(12)	(6)
Accounts payable	(65)	18	(4)
Accounts payable to affiliated companies	19	(7)	15
Pensions and retiree benefits	37	2	4
Accrued taxes	(1)	(4)	1
Accrued interest	(1)	2	4
Deferred charges, noncurrent assets and other regulatory assets	(76)	5	(17)
Deferred credits and other regulatory liabilities	46	(22)	17
Superfund and other environmental costs	(3)	7	(4)
Other liabilities	11	(9)	18
NET CASH FLOWS FROM OPERATING ACTIVITIES	11	100	144
INVESTING ACTIVITIES			
Utility construction expenditures	(120)	(112)	(110)
Decrease in restricted cash	-	1	-
Cost of removal less salvage	(3)	(3)	-
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(123)	(114)	(110)
FINANCING ACTIVITIES			
Net proceeds from/(payments of) short-term debt	(45)	11	(67)
Issuance of long-term debt	50	-	75
Retirement of long-term debt	(3)	(22)	(2)
Capital contribution by parent	40	40	-
Dividend to parent	(31)	(31)	(28)
Loan from affiliate	58	55	-
NET CASH FLOWS FROM/(USED IN) FINANCING ACTIVITIES	69	53	(22)
CASH AND TEMPORARY CASH INVESTMENTS:			
NET CHANGE FOR THE PERIOD	(43)	39	12
BALANCE AT BEGINNING OF PERIOD	60	21	9
BALANCE AT END OF PERIOD	$ 17	$ 60	$ 21
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the period for:			
Interest	$ 29	$ 24	$ 23
Income Taxes	$ 34	$ 23	$ 36

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

Orange and Rockland Utilities, Inc.
Consolidated Statement of Capitalization

	Interest Rate	Series	Shares outstanding December 31, 2008	Shares outstanding December 31, 2007	At December 31, 2008	At December 31, 2007
					(Millions of Dollars)	
TOTAL COMMON SHAREHOLDER'S EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS			1,000	1,000	$ 502	$ 449
ACCUMULATED OTHER COMPREHENSIVE LOSS						
Pension plan minimum liability adjustments, net of $(17) and $(3) taxes in 2008 and 2007, respectively					(22)	(2)
Adjustment to initially apply FASB Statement No. 158, net of $(15) taxes in 2008 and 2007 (Notes E and F)					(25)	(25)
Unrealized losses on derivatives qualified as cash flow hedges net of $(6) and $(5) taxes in 2008 and 2007, respectively					(8)	(7)
Less: Reclassification adjustment for unrealized losses included in regulatory assets, net of $(5) taxes in 2008					(8)	-
Less: Reclassification adjustment for losses included in net income					-	(1)
TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAXES					(47)	(33)
TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF COMMON SHAREHOLDER'S EQUITY AND NOTE C)					$ 455	$ 416
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	-
2027	6.50	1997F			80	80
2029	7.00	1999G			45	45
TOTAL DEBENTURES					345	295
FIRST MORTGAGE BONDS:						
2018	7.07	1998C			3	3
TOTAL FIRST MORTGAGE BONDS					3	3
TRANSITION BONDS:						
2019*	5.22	2004-1			37	40
TOTAL TRANSITION BONDS					37	40
TAX-EXEMPT DEBT - Notes Issued to New York State Energy Research and Development Authority for Facilities Revenue Bonds:						
2014 (Note L)	10.0	1994A**			6	55
2015	9.00	1995A**			28	44
TOTAL TAX-EXEMPT DEBT					34	99
Unamortized debt discount					-	(1)
TOTAL					419	436
Less: long-term debt due within one year					3	3
TOTAL LONG-TERM DEBT					416	433
TOTAL CAPITALIZATION					$ 871	$ 849

* 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, 2008 and 2007, operating revenues for RECO and Pike were 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.

The Company is subject to regulation by the Federal Energy Regulatory Commission (FERC), the New York Public Service Commission (PSC), the New Jersey Board of Public Utilities (NJBPU) and the Pennsylvania Public Utility Commission (PPUC) 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 Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 71 (SFAS No. 71), "Accounting for the Effects of Certain Types of Regulation," and, in accordance with SFAS No. 71, the accounting requirements of the FERC and the state public utility regulatory commissions having jurisdiction.

SFAS No. 71 specifies 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 SFAS No. 71. 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 SFAS No. 71.

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 3.5 percent, 5.2 percent and 5.0 percent for 2008, 2007 and 2006, 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 2008, 2007 and 2006.

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, 2008 and 2007, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

(Millions of Dollars)	2008	2007
Electric		
Transmission	$136	$124
Distribution	588	544
Gas*	317	305
General	103	87
Held for future use	8	5
Construction work in progress	58	55
NET UTILITY PLANT	$1,210	$1,120

* Primarily distribution.

Impairments

In accordance with SFAS No. 144, "Accounting 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 electric and gas 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 PSC 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, 2008 and 2007 were $47 million and $42 million, respectively.

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 $4.1 million and $0.3 million and $3.7 million and $0.3 million of gross receipts tax in 2008 and 2007, respectively. RECO recorded $7.0 million and $8.2 million in TEFA tax in 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. 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 PPUC. 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.

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.

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

Federal Income Tax

In accordance with SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109), 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 SFAS No. 71, 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 PSC issued a Policy Statement approving accounting procedures consistent with SFAS No. 109 and providing assurances that these future increases in taxes will be recoverable in rates. In January 2007, the Company adopted FASB Interpretation No. 48, "Accounting for

Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" (FIN 48). This interpretation clarifies the accounting for uncertain tax positions in accordance with FASB Statement No. 109. See Note I.

Accumulated deferred investment tax credits are amortized ratably over the lives of the related properties and applied as a reduction to future federal income tax expense.

The Company, along with Con Edison and its other subsidiaries, files a consolidated federal income tax return. The consolidated federal income tax liability is allocated to each member of the consolidated group using the separate return method. Each member pays or receives an amount based on its own taxable income or loss in accordance with tax sharing agreements 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.

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

Electric

In October 2003, the PSC approved an agreement among O&R, the staff of the PSC and other parties with respect to the rates O&R can charge to its New York customers for electric service. The electric agreement, which covered the period from July 2003 through October 2006, provided for no changes to electric base rates and provided for the amortization and offset of regulatory assets and liabilities, the net effect of which was to reduce electric operating income by a total of $11 million (pre-tax) over the period covered by the agreement. The agreement provided for recovery of energy costs from customers on a current basis. It also provided for O&R to share equally with customers earnings above a 12.75 percent return on common equity during the three-year period from July 2003 through June 2006. Beginning July 2006 and until the July 2008 Joint Proposal (discussed below) was adopted, O&R was not subject to earnings sharing. Pursuant to these provisions, $3.6 million and $6.7 million was deferred for future customer benefit in 2006 and 2005, respectively.

In October 2007, the PSC 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 post-retirement 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 June 2007, O&R commenced an action in New York State Supreme Court seeking to annul the March 2007 PSC order that initiated the proceeding in which the October 2007 order was issued.

In July 2008, the PSC approved a Joint Proposal among O&R, the PSC 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 PSC 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 post-retirement benefit expenses (the Company did not reduce regulatory assets under this provision in 2008);
- deferral as a regulatory asset or regulatory liability, as the case may be, of the difference between actual pension and other post-retirement 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 $21 million of expenses under this provision in 2008);
- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which actual transmission and distribution related capital expenditures are less than amounts reflected in rates (the Company deferred $1 million under this

provision in 2008);

- 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 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);

- implementation of a revenue decoupling mechanism under which actual energy delivery revenues would be compared, on a periodic basis, with the authorized delivery revenues with the difference accrued, with interest, for refund to, or recovery from, customers, as applicable (the Company accrued $3.3 million of revenues pursuant to this provision in 2008);

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

- withdrawal of the litigation O&R commenced seeking to annul the PSC's March and October 2007 orders relating to O&R's electric rates.

In July 2004, NJBPU approved RECO's petition to increase base rates annually by $2.7 million, effective August 1, 2004. The decision provided for the recovery of carrying costs for two substation projects and specified additional reliability programs. Also 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 provides for a $6.4 million rate increase during the first year, with no further increase during the final two years. The plan reflects a return on common equity of 9.75 percent and a common equity ratio of 46.5 percent of capitalization.

In August 2008, the NJBPU directed RECO to enter into 15-year contracts to purchase solar renewable energy certificates from solar electric generation projects beginning in June 2009. RECO expects that the costs it incurs under the contracts will be recovered from customers.

In October 2008, Governor Corzine announced his intention to significantly increase New Jersey's energy efficiency efforts in calendar year 2009, which builds upon his commitment to reduce energy consumption in New Jersey by 20 percent by 2020. Specifically, the state's gas and electric utilities will implement individual utility energy efficiency programs, the total cost for which will be approximately $500 million. This amount may be divided among the utilities based on each utility's market share and is expected to be recovered from customers.

In February 2009, RECO filed two economic stimulus related petitions with the NJBPU. The first seeks authorization to implement various energy efficiency programs. RECO has proposed that the cost of these programs, $3 million over three years, be recovered by means of a surcharge mechanism. The second seeks authorization to accelerate $30 million of infrastructure projects over three years. RECO has proposed that the carrying costs and incremental operation and maintenance costs of these projects be recovered by means of a surcharge until these projects are included in rate base. It is unclear when the NJBPU will rule on these petitions.

Pike is obligated under Pennsylvania law to serve those customers who do not purchase electricity from other suppliers. Pike bills its customers for the electricity it supplies to them based on a default service rate approved by the PPUC. See “Recoverable Energy Costs” in Note A. In February 2009, the PPUC approved a settlement in the Pike default service case. No party opposed the settlement. Under the settlement, Direct Energy, LLC will provide aggregation service from June 1, 2009 through May 31, 2011. Under this aggregation service, Direct Energy will provide electric commodity service to customers at a fixed price. Pike will continue to provide default service to its other customers (that do not purchase electricity from Direct Energy) at rates based on spot market prices. Any over- or under-collections will be fully reconciled on a quarterly basis through Pike's Electric Supply Adjustment Charge.

In July 2008, Pike filed an electric base rate case with the PPUC seeking an electric base rate increase of approximately $1.2 million. In March 2009, the PPUC 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 2003, the PSC approved a gas rate agreement among O&R, the PSC staff and other parties. This agreement, which covered the period November 2003 through October 2006, provided for annual increases in gas base rates of $9 million effective November 2003, $9 million effective November 2004 and $5 million effective November 2005. The agreement provided for O&R to share equally with customers earnings in excess of an 11 percent return on common equity. Earnings for the rate years ended October 2004, 2005 and 2006 were below this level. The rate agreement also included the amortization of certain regulatory assets and liabilities. The net effect of this amortization was a non-cash increase in gas revenues of $2 million over the period of the three-year rate plan.

In October 2006, the PSC approved the June 2006 settlement agreement among O&R, the staff of the PSC and other parties. The settlement agreement establishes a rate plan that covers the three-year period November 1, 2006 through October 31, 2009. The rate plan provides 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 provides 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, will be 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 will increase $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 will be used to offset the cost of gas to be recovered from customers. The rate plan continues 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 provides that if the actual amount of pension or other post-retirement 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 will 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) are allocated as follows: above an 11 percent return are 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 are retained by the Company, with the balance being deferred for the benefit of customers. Thirty-five percent of any remaining O&R Adjusted Earnings between a 12 and 14 percent return are retained by the Company, with the balance deferred for the benefit of customers. Any remaining O&R Adjusted Earnings above a 14 percent return are to be deferred for the benefit of customers. For purposes of these earnings sharing provisions, if in any rate year O&R Adjusted Earnings is less than 11 percent, the shortfall will be deducted from O&R Adjusted Earnings for the other rate years. The earnings sharing thresholds will each be reduced by 20 basis points if certain objectives relating to the Company's retail choice program are not met. Earnings for the rate year end October 31, 2008 did not exceed the 11 percent target return on equity.

The rate plan also includes up to $1 million of potential revenue reductions in the first year of the agreement, increasing up to $1.2 million, if the Company does 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.

In November 2008, O&R filed with the PSC for an increase in gas base rates of $17.8 million, effective October 2009. The filing reflects a return on common equity of 11.6 percent and a common equity ratio of 48 percent. The filing also included an alternative proposal for a three-year plan with rate increases of $6.6 million, $11.9 million and $11.9 million, effective November 2009, 2010 and 2011, respectively. The filing reflects lower sales volumes, increased operating and capital costs and proposals for operational improvements. In February 2009, O&R submitted to the PSC an update to the filing, primarily reflecting the inclusion of additional pension and other post-retirement benefit costs, as a result of which the Company's proposed October 2009 rate increase is $24 million.

In July 2008, Pike filed a gas base rate case with the PPUC seeking a gas rate increase of approximately $0.4 million. In February 2009, the PPUC 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.

Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2008 and 2007 were comprised of the following items:

(Millions of Dollars)	2008	2007
Regulatory assets		
Unrecognized pension and other post-retirement costs	$267	$150
Environmental remediation costs	63	65
Transition bond charges	59	63
Future federal income tax	58	55
Pension and other post-retirement benefits deferrals	55	56
Deferred derivative losses	26	1
Interest rate swap	15	-
Other	48	18
Regulatory assets	591	408
Deferred derivative losses - current	27	1
Recoverable energy costs - current	26	23
Total regulatory assets	$644	$432
Regulatory liabilities		
Allowance for cost of removal less salvage	$65	$61
Refundable energy costs	57	29
NYS tax law changes	1	2
Unrealized gains on hedging	-	13
Other	14	16
Regulatory liabilities	137	121
Deferred derivative gains – current	-	5
Total regulatory liabilities	$137	$126

"Unrecognized pension and other post-retirement costs" represents the net regulatory asset associated with the Company's adoption of FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans - an amendment of FASB Statements No. 87, 88,106, and 132(R)" (SFAS No. 158) in December 2006. See Notes E and F.

Note C – Capitalization

Common Stock

At December 31, 2008 and 2007, all of the outstanding common stock of the Company was owned by Con Edison. In accordance with PSC 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 2009-2013 is as follows:

(Millions of Dollars)	
2009	$3
2010	58
2011	3
2012	3
2013	3

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, 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. 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, 2008, approximates fair value (estimated based on year-end market valuations for the debt).

At December 31, 2008 and 2007, 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 $37 million and $40 million at December 31, 2008 and 2007, respectively, of Transition Bonds issued by Transition Funding. See Note B.

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, 2008.

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 obligated utility 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 its other regulated utility subsidiary, Consolidated Edison of New York, Inc. (Con Edison of New York), 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, Con Edison of New York 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, 2008, this ratio was 0.54 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, 2008, O&R had no commercial paper outstanding. At December 31, 2007, O&R had $45 million of commercial paper outstanding at a weighted average interest rate of 5.6 percent. At December 31, 2008 and 2007, $10 million and $25 million of letters of credit, and no borrowings, were outstanding under the Credit Agreement, respectively. Outstanding loans to O&R from Con Edison of New York amounted to $113 million and $55 million at December 31, 2008 and 2007, respectively. 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 Con Edison of New York 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.

Investment gains and losses are fully recognized in expense over a 15-year period and other actuarial gains and losses are fully recognized in expense over a 10-year period, subject to the deferral provisions in the next paragraph. This amortization is in accordance with the Statement of Policy issued by the PSC and is permitted under SFAS No. 87, "Employers' Accounting for Pensions," which provides a "corridor method" for moderating the effect of investment gains and losses on pension expense, or alternatively, allows for any systematic method of amortization of unrecognized gains and losses that is faster than the corridor method and is applied consistently to both gains and losses.

In accordance with O&R's current electric and gas rate plans, the Company defers any difference between expenses recognized under SFAS No. 87 for the Company's New York business and the amount reflected in O&R's rates for such expenses. The rate plans for RECO and Pike do not have comparable deferral provisions.

Net Periodic Benefit Cost

The components of the Company's net periodic benefit costs for 2008, 2007 and 2006 were as follows:

(Millions of Dollars)	2008	2007	2006
Service cost – including administrative expenses	$10	$9	$10
Interest cost on projected benefit obligation	33	31	29
Expected return on plan assets	(31)	(27)	(25)
Amortization of net actuarial loss	22	21	22
Amortization of prior service costs	1	1	1
NET PERIODIC BENEFIT COST	$35	$35	$37
Cost capitalized	(9)	(9)	(8)
Cost expensed/(deferred)	-	1	(13)
Cost charged to operating expenses	$26	$27	$16

Funded Status

The funded status of the Company's pension obligations at December 31, 2008, 2007 and 2006 were as follows:

(Millions of Dollars)	2008	2007	2006
CHANGE IN PROJECTED BENEFIT OBLIGATION			
Projected benefit obligation at beginning of year	$553	$527	$521
Service cost – excluding administrative expenses	10	9	9
Interest cost on projected benefit obligation	33	31	29
Plan amendments	-	-	-
Net actuarial loss	19	15	(5)
Benefits paid	(29)	(29)	(27)
PROJECTED BENEFIT OBLIGATION AT END OF YEAR	$586	$553	$527
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	$370	$339	$294
Actual return on plan assets	(103)	25	37
Employer contributions	34	36	37
Benefits paid	(29)	(29)	(27)
Administrative expenses	(1)	(1)	(2)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	$271	$370	$339
FUNDED STATUS	$(315)	$(183)	$(188)
Unrecognized net loss	247	115	118
Unrecognized prior service costs	8	10	11
ACCUMULATED BENEFIT OBLIGATION	$563	$529	$505

In December 2006, O&R adopted SFAS No. 158. This Statement required an employer to recognize an asset or liability for the overfunded or underfunded status of its pension and other post-retirement 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 post-retirement benefit plan, the asset or liability is the difference between the fair value of the plan's assets and the accumulated post-retirement benefit obligation. The Statement required 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 SFAS No. 71. Unrecognized prior service costs or credits and unrecognized gains and losses are recorded to regulatory assets or liabilities, rather than OCI.

The decline in the value of pension plan assets due to the recent global financial turmoil was a primary driver in the increased pension liability at O&R of $132 million compared with December 31, 2007. This also resulted in an increase to regulatory assets of $102 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility business consistent with SFAS No. 71 net of amortizations of prior gains and losses and the Statement of Policy, and an OCI charge of $20 million (net of taxes) for the unrecognized net losses and unrecognized prior service costs associated with O&R's New Jersey and Pennsylvania utility subsidiaries.

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 $26 million and $1 million, respectively.

At December 31, 2008 and 2007, the Company's investments include $8 million and $12 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 and $33 million as of December 31, 2008 and 2007, respectively.

Assumptions

The actuarial assumptions were as follows:

	2008	2007	2006
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount rate	5.75%	6.00%	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	6.00%	6.00%	5.70%
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)	2009	2010	2011	2012	2013	2014-2018
O&R	$32	$33	$35	$36	$38	$205

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 2009. 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 $37 million to the pension plan during 2009. 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 2008, 2007 and 2006, and the target allocation for 2009 are as follows:

	Target Allocation Range	Plan Assets at December 31,		
ASSET CATEGORY	2009	2008	2007	2006
Equity Securities	57% - 73%	59%	65%	66%
Debt Securities	21% - 33%	33%	28%	28%
Real Estate	5% - 11%	8%	7%	6%
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.

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, chief financial and chief accounting officers and others the Board of Trustees may appoint in addition to or in place of the designated Named Fiduciaries.

The investment objective for the pension trust is to maximize the long-term total return on the trust assets within a prudent level of risk. The investment strategy is to diversify its funds across asset classes, investment styles and fund managers. The target asset allocation is reviewed periodically based on asset/liability studies and may be modified as appropriate. The target asset allocation for 2009 reflects the results of such a study conducted in 2007.

Individual 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. Manager performance, total fund performance, and compliance with asset allocation guidelines are monitored on an ongoing basis, and reviewed by the Named Fiduciaries and reported to the Committee on a regular basis. Changes in fund managers and rebalancing of the portfolio are undertaken as appropriate. The Named Fiduciaries approve such changes, which are also reported to the Committee.

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

	For the Years Ended December 31,		
(Millions of Dollars)	2008	2007	2006
O&R	$2	$2	$2

Note F – Other Post-Retirement 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.

Investment plan gains and losses are fully recognized in expense over a 15-year period and other actuarial gains and losses are fully recognized in expense over a 10-year period, provided, however, that O&R defers any difference between expenses recognized under SFAS No. 106, “Employers’ Accounting for Post-Retirement Benefits Other Than Pension,” and the current rate allowance for its electric and gas operations. The electric rate plan for Pike has a comparable deferral provision. The rate plan for RECO and the gas rate plan for Pike do not have comparable deferral provisions.

Net Periodic Benefit Cost

The components of the Company’s net periodic post-retirement benefit costs for 2008, 2007 and 2006 were as follows:

(Millions of Dollars)	2008	2007	2006
Service cost	$4	$4	$4
Interest cost on accumulated other post-retirement benefit obligation	11	11	10
Expected return on plan assets	(7)	(7)	(6)
Amortization of net actuarial loss	8	9	9
Amortization of prior service costs	2	-	-
NET PERIODIC POST-RETIREMENT BENEFIT COST	$18	$17	$17
Cost capitalized	(5)	(5)	(4)
Cost deferred	(2)	(3)	(5)
Cost charged to operating expenses	$11	$9	$8

Funded Status

The funded status of the programs at December 31, 2008, 2007 and 2006 were as follows:

(Millions of Dollars)	2008	2007	2006
CHANGE IN BENEFIT OBLIGATION			
Benefit obligation at beginning of year	$196	$189	$184
Service cost	4	4	4
Interest cost on accumulated post-retirement benefit obligation	11	11	10
Net actuarial loss	3	(11)	(8)
Benefits paid and administrative expenses	(10)	(11)	(10)
Participant contributions	1	-	-
Medicare prescription subsidy	1	-	1
Plan amendments	-	14	8
BENEFIT OBLIGATION AT END OF YEAR	$206	$196	$189
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	$80	$77	$64
Actual return on plan assets	(17)	(1)	8
Employer contributions	13	12	13
Benefits paid	(8)	(8)	(8)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	$68	$80	$77
FUNDED STATUS	$(138)	$(116)	$(112)
Unrecognized net loss	71	50	61
Unrecognized prior service costs	19	21	7

For discussion of SFAS No. 158 and the application of SFAS No. 71 in recording unrecognized prior service costs or credits and unrecognized gains and losses, see Note E.

The decline in the value of other post-retirement benefit plan assets due to the recent global financial turmoil was a primary driver in the increased liability at O&R of $22 million compared with December 31, 2007. This also resulted in an increase to regulatory assets of $15 million for unrecognized net losses and unrecognized prior service costs associated with O&R consistent with SFAS No. 71 net of amortizations of prior gains and losses and the Statement of Policy.

The estimated net loss and prior service costs for the other post-retirement 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 $10 million and $2 million, respectively.

Assumptions

The actuarial assumptions were as follows:

	2008	2007	2006
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount Rate	5.75%	6.00%	6.00%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount Rate	6.00%	6.00%	5.70%
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, 2008 was 8.0 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, 2008 was 7.0 percent, which is assumed to decrease gradually to 4.5 percent by 2012 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, 2008:

	1-Percentage-Point	
(Millions of Dollars)	Increase	Decrease
Effect on accumulated other post-retirement benefit obligation	$22	$(18)
Effect on service cost and interest cost components for 2007	3	(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)	2009	2010	2011	2012	2013	2014-2018
Gross Benefit Payments	$12	$13	$14	$14	$15	$80
Medicare Prescription Benefit Receipts	1	1	1	1	1	8

Expected Contributions

Based on current estimates, O&R expects to make contributions of $15 million to the other post-retirement benefit plans in 2009.

Plan Assets

The asset allocations for O&R's other post-retirement benefit plans at the end of 2008, 2007 and 2006, and the target allocation for 2009 are as follows:

	Target Allocation Range	Plan Assets at December 31		
ASSET CATEGORY	2009	2008	2007	2006
Equity Securities	54% - 74%	56%	63%	63%
Debt Securities	15% - 49%	44%	37%	37%
Total	100%	100%	100%	100%

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

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

Effect of Medicare Prescription Benefit

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 created a benefit for certain employers who provide post-retirement drug programs. FASB Staff Position (FSP) No. FAS 106-2, issued by the FASB in May 2004, provides 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

Hazardous substances, such as coal tar and asbestos, 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 (the MGP Sites).

MGP Sites

The New York State Department of Environmental Conservation (DEC) requires O&R to develop and implement remediation programs for its MGP Sites. O&R has investigated and detected soil and/or groundwater contamination to varying degrees at its MGP Sites. Remediation has been completed at one MGP site and is currently underway at another MGP site. Additional investigation will be required for three of the remaining five MGP sites and remediation required at all of them. At December 31, 2008 and 2007, O&R had an accrued liability of $53 million and $56 million, respectively, for its MGP Sites.

In 2007, O&R estimated that for its MGP 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.

O&R is permitted under its New York rate agreements to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs. At December 31, 2008 and 2007, O&R's regulatory asset for recovery of these costs was $63 million and $65 million, respectively. The environmental remediation costs for the years ended December 31, 2008 and 2007 were approximately $4 million and $8 million, respectively. There were no insurance recoveries during these periods.

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) was $6 million and $5 million at December 31, 2008 and 2007, respectively.

Note H – Leases

O&R's leases include rights of way for electric and gas distribution facilities, office buildings and automobiles. In accordance with SFAS No. 13, "Accounting 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 SFAS No. 71, 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)	
2009	$1
2010	1
2011	1
2012	-
All years thereafter	-
Total	$3

Note I – Income Tax

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

(Millions of Dollars)	2008	2007	2006
Charge/(benefit) to operations:			
State			
Current	$2	$1	$1
Deferred – net	4	5	5
Federal			
Current	5	8	8
Deferred – net	13	10	11
TOTAL CHARGE TO OPERATIONS	24	24	25
TOTAL CHARGE/(BENEFIT) TO OTHER INCOME	1	(1)	1
TOTAL	$25	$23	$26

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

(Millions of Dollars)	2008	2007
Deferred tax liabilities:		
Depreciation	$133	$121
Regulatory liability – future income tax	79	75
Unrecognized pension and other post-retirement costs – SFAS No. 158	112	61
State income tax	22	19
Capitalized overheads	41	33
Other	18	27

Total deferred tax liabilities	405	336
Deferred tax assets:		
Unrecognized pension and other post-retirement costs – SFAS No. 158	112	61
Regulatory asset – future income tax	17	17
Other	63	55
Total deferred tax assets	192	133
NET LIABILITIES	213	203
INVESTMENT TAX CREDITS	3	4
DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS	216	207
DEFERRED INCOME TAXES – RECOVERABLE ENERGY COSTS	11	9
TOTAL DEFERRED INCOME TAXES AND INVESTMENT TAX CREDITS	$227	$216

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)	2008	2007	2006
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	(2)	(3)	(2)
Other	(2)	(4)	(2)
Effective Tax Rate	36%	34%	36%

Uncertain Tax Positions

In January 2007, Con Edison and its subsidiaries adopted FIN 48. This interpretation clarifies the accounting for uncertain tax positions in accordance with FASB Statement No. 109. Under the interpretation, an enterprise would not be 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.

The IRS has essentially completed its field audits of Con Edison's federal income tax returns, which include O&R, through 2007. Con Edison's federal income tax returns for 2002 through 2007 reflect certain tax positions with which the IRS does not or may not agree, including tax positions with respect to the deduction of certain construction-related costs for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The field audits of Con Edison's New York State income tax returns have been completed through 2005. 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 state income tax returns.

The Company's uncertain tax positions include use of the "simplified service cost method" (SSCM) to determine the extent to which construction-related costs could be deducted in 2002 through 2005. In July 2008, the IRS entered into a closing agreement with Con Edison covering the use by O&R and Con Edison of New York of the SSCM to determine the extent to which construction-related costs could be deducted in 2002 through 2004. The closing agreement does not cover 2005, the last year for which SSCM is an uncertain tax position. The Company does not expect the required repayment, with interest, to the IRS of its SSCM tax benefits for 2002 through 2005 to exceed the $13 million attributable to O&R that was paid to the IRS in June 2007 as a deposit for the repayment. Repayment of the SSCM tax benefits would not affect the Company's results of operations because deferred taxes have been previously provided for the related temporary differences between the SSCM deductions taken for federal income tax purposes and the corresponding amounts charged to expense for financial reporting purposes. Con Edison notified New York State of the closing agreement with the IRS applicable to the years 2002 through 2004 and, in December 2008, made a payment that included $3 million (including interest of $1 million) attributable to O&R in settlement of the issue for those years.

Upon adoption of FIN 48, the Company reclassified previously recorded tax liabilities of $12 million, which primarily related to SSCM, to a liability for uncertain tax positions. At December 31, 2008 and 2007, the liabilities for uncertain tax positions were $9 million and $12 million, respectively, and accrued interest on the liabilities amounted to $3 million and $4 million, respectively. The closing agreement with the IRS and payment to New York State in settlement of SSCM for years 2002 through 2004 resulted in the decrease in accrued interest balances and for uncertain tax positions. The Company recognizes interest accrued related to the liability for uncertain tax positions in interest expense and penalties, if any, in operating expenses in the Company's consolidated income statements. In 2008, the Company recognized an immaterial amount of interest expense for uncertain tax positions. In 2007, interest expense for uncertain tax positions was $2 million.

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

(Millions of Dollars)	2008	2007
Balance at the beginning of the year	$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	(1)	(1)
Settlements	(2)	-
Balance at the end of the year	$9	$12

The Company does not expect the total amounts of uncertain tax positions or unrecognized tax benefits to significantly increase or decrease within the next 12 months.

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, 2008 and 2007 have been new shares.

In January 2006, Con Edison adopted SFAS No. 123(R), "Share-Based Payment" (SFAS No. 123(R)), applying the modified prospective approach. Pursuant to SFAS No. 123(R), 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 periods ended December 31, 2008, 2007 and 2006:

(Thousands of Dollars)	2008	2007	2006
Stock options	$43	$44	$527
Restricted stock units	102	(49)	2
Performance-based restricted stock	804	421	767
Total	$949	$416	$1,296

Stock Options

Stock options generally vest over a three-year period and have a term of ten years. Options are granted at an exercise price equal to the fair market value of a 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. There were no options granted in 2008 and 2007. The weighted average fair value of options granted in 2006 was $3.81 per share. This value was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2006
Risk-free interest rate	4.62%
Expected life	4.6 years
Expected stock volatility	13.41%
Expected dividend yield	5.06%

The weighted average risk-free rate is calculated using the five-year U.S. Treasury securities rate on the grant date of each stock option and then weighted for the number of shares awarded. The expected life of the options is based on historical employee exercise behavior and post-vesting cancellations. The expected stock volatility is calculated using the quarterly closing prices of Con Edison stock over a period of five years, which approximates the expected term of the options. The expected dividend yield is calculated using the annualized dividend divided by the stock price on the date of grant.

A summary of changes in the status of stock options awarded to O&R employees as of December 31, 2008, 2007 and 2006 is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at 12/31/05	538,000	$40.788
Granted	124,000	45.599
Exercised	(47,150)	38.337
Forfeited	-	-
Outstanding at 12/31/06	614,850	$41.946
Granted	-	-
Exercised	(66,650)	39.313
Forfeited	-	-
Outstanding at 12/31/07	548,200	$42.266
Granted	-	-
Exercised	(24,700)	34.223
Forfeited	(1,500)	43.460
Outstanding at 12/31/08	522,000	$42.644

The change in the fair value of all outstanding options from their grant dates to December 31, 2008 and 2007 (aggregate intrinsic value) for O&R were $(2) million and $4 million, respectively. The aggregate intrinsic value of options exercised in 2008 and 2007 were $1.4 million and $0.7 million, respectively, and the cash received by Con Edison for payment of the exercise price was $10.7 million and $3 million, respectively. The weighted average remaining contractual life of options outstanding is five years as of December 31, 2008.

The following table summarizes O&R employees' stock options outstanding at December 31, 2008 for each plan year:

Plan Year	Remaining Contractual Life	Options Outstanding	Weighted Average Exercise Price	Options Exercisable
2006	8	124,000	$45.599	-
2005	7	104,500	43.035	104,500
2004	6	82,500	43.749	82,500
2003	5	79,500	39.942	79,500
2002	4	85,500	42.510	85,500
2001	3	37,000	37.750	37,000
2000	2	9,000	32.500	9,000
Total		522,000	$42.644	398,000

The exercise prices of options awarded in 2006 range from $43.50 to $46.88. The total expense to be recognized in future periods for the unvested stock options outstanding as of December 31, 2008 is $9 thousand for O&R.

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 SFAS No. 123(R), 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 two years and is based on the employees' continuous service to O&R. Prior to vesting, the awards are subject to forfeiture in whole or in part under certain circumstances. The awards are "liability awards" because each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, prior to vesting, changes in the fair value of the units are reflected in net income. At December 31, 2008 and 2007, there were 37,100 and 36,200 units outstanding for O&R. The weighted average fair value as of the grant date of the outstanding units for December 31, 2008 and 2007 was $35.399 and $35.322 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, 2008 was $47 thousand.

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 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 on the date of grant. 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:

	2008
Risk-free interest rate	0.34% - 2.04%
Expected term	3 years
Expected volatility	28.91%
Expected quarterly dividends	$0.585 - $0.600

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. Expected annual escalation of dividends is based on historical trends.

A summary of changes in the status of the Performance RSUs TSR portion during the period ended December 31, 2008 and 2007 is as follows:

	Units	Weighted Average Fair Value*
Non-vested at 12/31/06	8,575	$18.58
Granted	12,725	46.18
Vested and Exercised	(1,470)	22.51
Forfeited	(2,205)	-
Non-vested at 12/31/07	17,625	$33.10
Granted	22,010	34.93
Vested and Exercised	(1,205)	11.69
Forfeited	(6,130)	-
Non-vested at 12/31/08	32,300	$48.78

* Fair value is determined using the Monte Carlo simulation described above.

A summary of changes in the status of the Performance RSUs' EIP portion during the period ended December 31, 2008 and 2007 is as follows:

	Units	Weighted Average Price
Non-vested at 12/31/06	8,575	$48.07
Granted	12,725	48.22
Vested and Exercised	(3,675)	48.85
Forfeited	-	-
Non-vested at 12/31/07	17,625	$48.85
Granted	22,010	45.56
Vested and Exercised	(4,820)	38.95
Forfeited	(2,515)	-
Non-vested at 12/31/08	32,300	$38.93

The total expense to be recognized by O&R in future periods for unvested Performance RSUs outstanding as of December 31, 2008 is $1.6 million.

Stock Purchase Plan

Under the Con Edison Stock Purchase Plan, O&R contributes $1 for each $9 invested by its officers and 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 officers and 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 2008, 2007 and 2006, 745,869 and 633,647and 624,751 shares were purchased under the Stock Purchase Plan at a weighted average price of $42.47, $47.70 and $45.33 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 SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information."

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, 2008 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$733	$29	$18	$51	$18	$1,514	$88
Gas	259	11	6	19	9	590	32
Other*	-	-	-	-	1	58	-
Total	$992	$40	$24	$70	$28	$2,162	$120

As of and for the Year Ended December 31, 2007 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$671	$27	$19	$57	$21	$1,271	$80
Gas	265	11	5	22	11	530	32
Other*	-	-	-	-	2	61	-
Total	$936	$38	$24	$79	$34	$1,862	$112

As of and for the Year Ended December 31, 2006 (Millions of Dollars)	Operating revenues	Depreciation and amortization	Income tax expense	Operating income	Interest charges	Total assets	Construction expenditures
Electric	$582	$25	$20	$ 53	$18	$1,230	$84
Gas	236	10	5	16	7	495	26
Other*	-	-	-	-	3	43	-
Total	$818	$35	$25	$69	$28	$1,768	$110

* Includes amounts related to Transition Funding.

Note L – Derivative Instruments and Hedging Activities

Derivative instruments and hedging activities are accounted for in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133). Under SFAS No. 133, derivatives are recognized on the balance sheet at fair value, unless an exception is available under the standard.

Energy Price Hedging

The Company hedges market price fluctuations associated with physical purchases and sales of electricity and natural gas by using derivative instruments including futures, forwards, basic swaps, or options. The fair values of these hedges at December 31, 2008 and 2007 were as follows:

(Millions of Dollars)	2008	2007
Fair value of net derivative assets/ (liabilities) – gross	$(63)	$14
Impact of netting of cash collateral	-	-
Fair value of net derivative assets/ (liabilities) - net	$(63)	$14

The Company is permitted by its regulators to reflect in rates all reasonably incurred gains and losses on hedge instruments. See “Recoverable Energy Costs” in Note A.

Generally, 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.

Credit Exposure

The Company is exposed to credit risk related to transactions entered into primarily for the various electricity 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 did not have any credit exposure in connection with energy supply and hedging activities at December 31, 2008.

Interest Rate Swaps

O&R has an interest rate swap related to its Series 1994A Debt. See Note C. At December 31, 2007, the swap was designated as a cash flow hedge, the fair value of which was an unrealized loss of $11 million that was recorded in OCI. In February 2008, the swap counterparty changed the method of calculating its payments under the swap and, as a result, the swap no longer qualified as a hedge under SFAS No. 133. In accordance with O&R’s July 2008 electric rate plan (see Note B), O&R is to defer as a regulatory asset or liability the difference between its actual interest and swap costs relating to its tax-exempt debt and the amount for such costs reflected in rates. Similar treatment is expected in O&R’s other services. The fair value of this interest rate swap at December 31, 2008 was an unrealized loss of $15 million, which has been deferred as a regulatory asset.

Note M – Asset Retirement Obligations

In accordance with SFAS No. 143, “Accounting for Asset Retirement Obligations” (SFAS No. 143), companies are required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The Company has not identified any such obligations and, accordingly, has not recognized any asset retirement obligation under SFAS No. 143.

The Company includes in depreciation the estimated removal costs, less salvage, for utility plant assets. In accordance with SFAS No. 143, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities pursuant to SFAS No. 71. The related regulatory liabilities recorded for the Company were $65 million and $61 million in 2008 and 2007, 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 PSC 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, 2008, 2007 and 2006 were as follows:

(Millions of Dollars)	2008	2007	2006
Cost of services provided	$19	$17	$16
Cost of services received	$31	$30	$28

In addition, Con Edison of New York and O&R have joint gas supply arrangements, in connection with which O&R purchased from Con Edison of New York $183 million, $161 million and $149 million of natural gas for the years ended December 31, 2008, 2007 and 2006, respectively. These amounts are net of the effect of related hedging transactions.

Con Edison of New York also hedges electricity purchases for O&R. Electric hedging transactions executed by Con Edison of New York on behalf of O&R resulted in a credit to purchased power of $189 thousand for the year ended December 31, 2008. Electric hedging transactions executed by Con Edison of New York on behalf of O&R resulted in a charge to purchased power of $5 million and $9 million for the years ended December 31, 2007 and 2006, respectively.

At December 31, 2008 and 2007, O&R's net payable to Con Edison of New York associated with derivatives for energy price hedging was $15 million and $4 million, respectively. See Note L.

At December 31, 2008 and 2007, the Company's receivable from Con Edison for income taxes was $24 million and $2 million, respectively. See Note A.

FERC has authorized Con Edison of New York through 2010 to lend funds to O&R from time to time, for periods of not more than 12 months, in amounts not to exceed $200 million outstanding at any time, at prevailing market rates. Con Edison of New York's outstanding loans to O&R amounted to $113 million and $55 million, at December 31, 2008 and 2007, respectively.

Note O – Fair Value Measurements

Effective January 1, 2008, the Company adopted FASB Statement No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands the disclosures about fair value measurements.

SFAS No. 157 defines 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.

SFAS No. 157 requires 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, 2008, 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.

SFAS No. 157 established a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value in three broad levels. The standard requires 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 SFAS No. 157 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, 2008 are summarized below under the three-level hierarchy established by SFAS No. 157.

(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	$63
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.

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

	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)	-	(4)	-	-	(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 and gas costs. The Company generally recovers these costs in accordance with rate provisions approved by the applicable state public utilities commissions, and therefore have no impact on earnings. See Note A. Unrealized gains and losses for energy derivatives are generally deferred on the consolidated balance sheet in accordance with SFAS No. 71.

Realized and unrealized losses on Level 3 financial and other derivatives and other assets are generally deferred on the consolidated balance sheet in accordance with SFAS No. 71. The change in realized and unrealized losses on Level 3 financial and other derivatives and other assets for the year ended December 31, 2008 was primarily due to the ongoing global financial turmoil.

Note P – New Financial Accounting Standards

In December 2008, the FASB issued FSP FAS 132(R)-1, "Employers' Disclosures about Post-Retirement Benefit Plan Assets." This FSP amends FASB Statement No. 132, "Employers' Disclosures about Pensions and Other Post-Retirement Benefits," and requires an employer to separately disclose the fair value of each major category of plan assets of a defined benefit pension or post-retirement plan. In addition, employers are required to disclose information enabling users to understand investment policies and strategies, assess the inputs and valuation techniques used to develop fair value measurements, and to disclose any significant concentrations of risks within plan assets. This FSP is effective for fiscal years ending after December 15, 2009, earlier application is permitted. The Company is currently evaluating the impact of this FSP on the disclosures for defined benefit pension and post-retirement plan assets.

In November 2008, the FASB issued EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations," which provides clarification on the measurement of the initial carrying value of an equity investment, impairment assessment of underlying indefinite-lived intangible assets of an equity method investment, accounting for an equity method investee's issuance of shares, and how to account for a change in investment from the equity method to the cost method. The guidance in this EITF is effective for fiscal years beginning on or after December 15, 2008, and is to be applied prospectively. The Company is currently evaluating the impact of this FSP on its financial position, results of operations and liquidity.

In October 2008, the FASB issued FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." This FSP would amend FASB Statement No. 157, "Fair Value Measurements," to clarify its application in an inactive market by providing an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. The FSP was effective upon issuance, including prior periods for which financial statements have not been issued. The application of this FSP did not have a material impact on the Company's financial position, results of operations or liquidity.

In May 2008, the FASB issued Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This Statement is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Board does not expect that this Statement will result in a change in current practice.

The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

In May 2008, the FASB issued FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." This FSP applies to convertible debt instruments that may be settled in cash, or other assets, upon conversion and are not addressed by APB Opinion No. 14 "Accounting for Convertible Debt Instruments and Debt Issued with Stock Purchase Warrants." If the embedded conversion option is required to be separately accounted for as a derivative, then such convertible debt instruments should be accounted for under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" and this FSP does not apply. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. This FSP is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

In April 2008, the FASB issued FSP No. 142-3, "Determination of the Useful Life of Intangible Assets." This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets." The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), "Business Combinations," and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the impact of this FSP on its financial position, results of operations and liquidity.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities." This Statement amends and expands the disclosure requirements of Statement 133 with the intent 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 Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The Statement requires 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. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of this Statement on its disclosures of financial position, results of operations and liquidity.

In February 2008, the FASB issued FSP No. 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13," and FSP No. FAS 157-2, "Effective Date of FASB Statement

No. 157." FSP No. 157-1 amends FASB Statement No. 157 to exclude FASB Statement No. 13, "Accounting for Leases," and other accounting pronouncements that address fair value measurements for purposes of lease classification and measurement under Statement No. 13. This FSP is effective upon the initial adoption of SFAS 157. FSP No. FAS 157-2 delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for items within the scope of this FSP. The adoption of both FSP No. 157-1 and FSP No. FAS 157-2 did not have a material impact on the Company's financial position, results of operations or liquidity.

In January 2008, the FASB issued Statement 133 Implementation Issue No. E23, "Hedging—General: Issues Involving the Application of the Shortcut Method under Paragraph 68." Issue E23 amends paragraph 68 of SFAS 133 with respect to the conditions that must be met in order to apply the shortcut method for assessing hedge effectiveness. The implementation guidance in this Issue is effective for hedging relationships designated on or after January 1, 2008. The adoption of Issue E23 did not have a material impact on the Company's financial position, results of operations or liquidity.