

Orange and Rockland Utilities, Inc.
First Quarter 2015 Financial Statements and Notes

Financial Statements (Unaudited)

Report of Independent Registered Public Accounting Firm

Consolidated Income Statement

Consolidated Statement of Comprehensive Income

Consolidated Statement of Cash Flows

Consolidated Balance Sheet

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Independent Auditor's Report

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

We have reviewed the accompanying consolidated interim financial information of Orange and Rockland Utilities, Inc. and its subsidiaries ("the Company"), which comprise the consolidated balance sheet as of March 31, 2015, and the related consolidated statements of income, comprehensive income, and shareholder's equity for the three-month periods ended March 31, 2015 and 2014 and the consolidated statement of cash flows for the three-month periods ended March 31, 2015 and 2014.

Management's Responsibility for the Consolidated Interim Financial Information

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

Auditor's Responsibility

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

Conclusion

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

Other Matter

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet and related consolidated statement of capitalization of the Company as of December 31, 2014, and the related consolidated statements of income, comprehensive income, cash flows, and shareholder's equity for the year then ended (not presented herein), and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 6, 2015. In our opinion, the information set forth in the accompanying consolidated balance sheet information and consolidated statement of shareholder's equity as of March 31, 2015, is consistent, in all material respects, with the audited consolidated balance sheet from which it has been derived.

PricewaterhouseCoopers LLP

May 14, 2015

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

	For the Three Months Ended March 31,	
	2015	2014
	(Millions of Dollars)	
OPERATING REVENUES		
Electric	\$ 156	\$ 163
Gas	77	93
TOTAL OPERATING REVENUES	233	256
OPERATING EXPENSES		
Purchased power	51	69
Gas purchased for resale	22	40
Operations and maintenance	82	78
Depreciation and amortization	17	14
Taxes, other than income taxes	16	16
TOTAL OPERATING EXPENSES	188	217
OPERATING INCOME	45	39
OTHER INCOME		
Investment and other income	-	-
Allowance for equity funds used during construction	-	1
TOTAL OTHER INCOME	-	1
INCOME BEFORE INTEREST AND INCOME TAX EXPENSE	45	40
INTEREST EXPENSE		
Interest on long-term debt	8	8
Other interest	1	1
Allowance for borrowed funds used during construction	-	-
NET INTEREST EXPENSE	9	9
INCOME BEFORE INCOME TAX EXPENSE	36	31
INCOME TAX EXPENSE	14	10
NET INCOME	\$ 22	\$ 21

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

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

	For the Three Months Ended March 31,	
	2015	2014
	(Millions of Dollars)	
NET INCOME	\$ 22	\$ 21
OTHER COMPREHENSIVE INCOME, NET OF TAXES		
Pension and other postretirement benefit plan liability adjustments, net of taxes	3	2
TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAXES	3	2
COMPREHENSIVE INCOME	\$ 25	\$ 23

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

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

	For the Three Months Ended March 31,	
	2015	2014
	(Millions of Dollars)	
OPERATING ACTIVITIES		
Net income	\$ 22	\$ 21
PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME		
Depreciation and amortization	17	14
Deferred income taxes	6	2
Other non-cash items (net)	4	3
CHANGES IN ASSETS AND LIABILITIES		
Accounts receivable - customers, less allowance for uncollectibles	(16)	(39)
Accounts receivable from affiliated companies	(3)	22
Materials and supplies, including gas in storage	10	13
Prepayments, other receivables and other current assets	8	6
Accounts payable	(2)	-
Accounts payable to affiliated companies	3	10
Pensions and retiree benefits obligations (net)	7	(2)
Pensions and retiree contributions	(1)	-
Accrued taxes	7	1
Accrued interest	2	2
Accrued wages	(3)	(2)
Deferred charges, noncurrent assets and other regulatory assets	5	(13)
Deferred credits and other regulatory liabilities	(8)	20
Other current and noncurrent liabilities	(11)	(2)
NET CASH FLOWS FROM OPERATING ACTIVITIES	47	56
INVESTING ACTIVITIES		
Utility construction expenditures	(31)	(33)
Cost of removal less salvage	(2)	(1)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(33)	(34)
FINANCING ACTIVITIES		
Net Issuance of short-term debt	25	(8)
Retirement of long-term debt	-	(1)
Dividend to parent	(50)	(10)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	(25)	(19)
CASH AND TEMPORARY CASH INVESTMENTS:		
NET CHANGE FOR THE PERIOD	(11)	3
BALANCE AT BEGINNING OF PERIOD	49	29
BALANCE AT END OF PERIOD	\$ 38	\$ 32
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	\$ 5	\$ 5
Income taxes	\$ -	\$ 3
SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION		
Construction expenditures in accounts payable	\$ 11	\$ 16

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

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

	March 31, 2015	December 31, 2014
	(Millions of Dollars)	
ASSETS		
CURRENT ASSETS		
Cash and temporary cash investments	\$ 38	\$ 49
Accounts receivable - customers, less allowance for uncollectible accounts of \$4 in 2015 and 2014	87	71
Other receivables, less allowance for uncollectible accounts of \$2 in 2015 and 2014	10	9
Accrued unbilled revenue	34	43
Accounts receivable from affiliated companies	18	15
Gas in storage, at average cost	6	16
Materials and supplies, at average cost	18	18
Prepayments	29	29
Regulatory assets	15	16
Deferred tax assets	19	24
Other current assets	6	5
TOTAL CURRENT ASSETS	280	295
INVESTMENTS		
UTILITY PLANT, AT ORIGINAL COST		
Electric	1,507	1,491
Gas	641	633
General	204	200
Total	2,352	2,324
Less: Accumulated depreciation	654	644
Net	1,698	1,680
Construction work in progress	54	60
NET UTILITY PLANT	1,752	1,740
OTHER NONCURRENT ASSETS		
Regulatory assets	655	675
Other deferred charges and noncurrent assets	18	21
TOTAL OTHER NONCURRENT ASSETS	673	696
TOTAL ASSETS	\$ 2,723	\$ 2,749

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

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

	March 31, 2015	December 31, 2014
	(Millions of Dollars)	
LIABILITIES AND SHAREHOLDER'S EQUITY		
CURRENT LIABILITIES		
Long-term debt due within one year	\$ 143	\$ 143
Notes payable	101	76
Accounts payable	62	69
Accounts payable to affiliated companies	27	24
Customer deposits	14	13
Accrued taxes	-	4
Accrued taxes to affiliated companies	17	6
Accrued interest	9	7
Accrued wages	8	11
Fair value of derivative liabilities	2	4
Regulatory liabilities	28	45
Other current liabilities	31	40
TOTAL CURRENT LIABILITIES	442	442
NONCURRENT LIABILITIES		
Provision for injuries and damages	6	6
Pensions and retiree benefits	407	421
Superfund and other environmental costs	96	98
Deferred income taxes and investment tax credits	538	533
Regulatory liabilities	164	156
Other deferred credits and noncurrent liabilities	13	11
TOTAL NONCURRENT LIABILITIES	1,224	1,225
LONG-TERM DEBT	457	457
COMMON SHAREHOLDER'S EQUITY (See Statement of Shareholder's Equity)	600	625
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	\$ 2,723	\$ 2,749

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

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

(Millions of Dollars/Except Share Data)	Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Paid-In Capital	Earnings	Income/(Loss)	
BALANCE AS OF DECEMBER 31, 2013	1,000	\$ -	\$ 304	\$ 334	\$ (18)	\$ 620
Net Income				21		21
Common stock dividend to parent				(10)		(10)
Other comprehensive income					2	2
BALANCE AS OF MARCH 31, 2014	1,000	\$ -	\$ 304	\$ 345	\$ (16)	\$ 633
BALANCE AS OF DECEMBER 31, 2014	1,000	\$ -	\$ 304	\$ 354	\$ (33)	\$ 625
Net Income				22		22
Common stock dividend to parent				(50)		(50)
Other comprehensive income					3	3
BALANCE AS OF MARCH 31, 2015	1,000	\$ -	\$ 304	\$ 326	\$ (30)	\$ 600

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

Notes to the Financial Statements (Unaudited)

General

These notes accompany and form an integral part of the financial statements of Orange and Rockland Utilities, Inc., a New York corporation, and its subsidiaries (the Company or O&R). The Company is a regulated utility, the equity of which is owned entirely by Consolidated Edison, Inc. (Con Edison). O&R has two regulated utility subsidiaries: Rockland Electric Company (RECO) and Pike County Light & Power Company (Pike). For the three months ended March 31, 2015 and 2014, operating revenues for RECO and Pike were 18.4 percent and 1.5 percent and 15.5 percent and 1.3 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 has a subsidiary, Rockland Electric Company Transition Funding LLC (Transition Funding), which was formed in 2004 in connection with the securitization of certain purchased power costs. See "Long-Term Debt" in Note C.

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

The interim consolidated financial statements as of March 31, 2015 and for the three month periods ended March 31, 2015 and 2014 (the First Quarter Financial Statements) are unaudited but, in the opinion of the Company's management, reflect all adjustments (which include only normally recurring adjustments) necessary for a fair presentation of the results for the interim periods presented. The First Quarter Financial Statements should be read together with the audited consolidated financial statements of the Company, as of December 31, 2014 and 2013 and for each of the three years ended December 31, 2014, including the notes thereto.

The Company has, pursuant to the accounting rules for subsequent events, evaluated events or transactions that occurred after March 31, 2015 through the posting on its website (May 14, 2015) of the First Quarter Financial Statements for potential recognition or disclosure in the First Quarter Financial Statements.

Note A – Summary of Significant Accounting Policies

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

For the three months ended March 31, 2015 and 2014, changes to accumulated other comprehensive income/(loss) (OCI) are as follows:

(Millions of Dollars)	2015	2014
Beginning balance accumulated OCI, net of taxes	\$(33)	\$(18)
OCI before reclassifications, net of tax of \$(2) and \$(1) in 2015 and 2014, respectively	2	1
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(1) and \$(1) in 2015 and 2014, respectively(a)(b)	1	1
Current period total OCI, net of taxes	3	2
Ending balance, accumulated OCI, net of taxes	\$(30)	\$(16)

(a) Only RECO's portion of unrecognized pension and other postretirement benefit costs and Pike's portion of unrecognized pension costs are recorded into, and amortized out of, OCI. All other such costs are recorded through regulatory assets. The net actuarial losses and prior service costs recognized during the period are included in the computation of total periodic pension and other postretirement benefit cost.

(b) Tax reclassified from accumulated OCI is reported in the income tax expense line item of the income statement.

Notes to the Financial Statements (Unaudited) - Continued

Note B – Regulatory Matters

Rate Plans

O&R New York – Electric and Gas

In March 2015, in O&R's electric and gas rate proceedings, NYSPSC staff recommended a \$0.6 million decrease in O&R's electric rates and a \$14.7 million increase in its gas rates (reflecting an authorized return on common equity of 8.5 percent). In April 2015, O&R submitted updated requests to the NYSPSC for increases in its electric and gas rates of \$34 million and \$44.2 million, respectively (reflecting an authorized return on common equity of 9.75 percent).

Other Regulatory Matters

In late October 2012, Superstorm Sandy caused extensive damage to the Company's electric distribution system and interrupted service to approximately 0.3 million customers. As of March 31, 2015, O&R incurred response and restoration costs for Superstorm Sandy of \$91 million (including capital expenditures of \$15 million). Most of the costs that were not capitalized were deferred for recovery as a regulatory asset under the Company's electric rate plans. See "Regulatory Assets and Liabilities" below. As part of its rate filing, in November 2014 O&R requested recovery of deferred storm costs for its New York electric operations, which are subject to NYSPSC review. RECO's current electric rate plan includes collection from customers of deferred storm costs.

In June 2014, the NYSPSC initiated a proceeding to investigate the practices of qualifying persons to perform plastic fusions on gas facilities. New York State regulations require gas utilities to qualify and, except in certain circumstances, annually requalify workers that perform fusion to join plastic pipe. The NYSPSC directed the New York gas utilities to provide information in this proceeding about their compliance with the qualification and requalification requirements and related matters; their procedures for compliance with all gas safety regulations; and their annual chief executive officer certifications regarding these and other procedures. O&R had not timely requalified certain workers that had been qualified under its procedures to perform fusion to join plastic pipe. O&R has requalified its workers who perform plastic pipe fusions. In April 2015, the NYSPSC issued a notice seeking the sampling plans O&R and other gas utilities intend to use to inspect and test plastic pipe fusions. The notice also included NYSPSC staff proposals to require these utilities to perform remediation plans, additional leakage surveying and reporting and for certain new plastic fusion requirements for gas utilities.

Notes to the Financial Statements (Unaudited) - Continued

Regulatory Assets and Liabilities

Regulatory assets and liabilities at March 31, 2015 and December 31, 2014 were comprised of the following items:

(Millions of Dollars)	2015	2014
Regulatory assets		
Unrecognized pension and other postretirement costs	\$219	\$237
Future income tax	108	108
Environmental remediation costs	103	105
Deferred storm costs	91	95
Property tax reconciliation	40	36
Pension and other postretirement benefits deferrals	26	24
Transition bond charges	25	27
Revenue taxes	12	12
Surcharge for New York State assessment	6	7
Deferred derivative losses – noncurrent	4	2
Other	21	22
Regulatory assets – noncurrent	655	675
Future income tax - current	10	10
Deferred derivative losses - current	4	5
Recoverable energy costs - current	1	1
Regulatory assets - current	15	16
Total Regulatory Assets	\$670	\$691
Regulatory liabilities		
Allowance for cost of removal less salvage	\$100	\$98
Pension and other postretirement benefit deferrals	22	10
Carrying charges on deferred tax liability	18	17
Net utility plant reconciliations	-	1
Other	24	30
Regulatory liabilities – noncurrent	164	156
Refundable energy costs – current	27	45
Deferred derivative gains - current	1	-
Regulatory liabilities – current	28	45
Total Regulatory Liabilities	\$192	\$201

Note C – Capitalization

Long-Term Debt

The carrying amounts and fair values of long-term debt at March 31, 2015 and December 31, 2014 are:

(Millions of Dollars)	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-Term Debt (including current portion)	\$600	\$689	\$600	\$689

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

At March 31, 2015 and December 31, 2014, 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 \$18 million at March 31, 2015 and December 31, 2014 of Transition Bonds issued by Transition Funding in July 2004. The proceeds from the Transition Bonds were used to purchase from RECO the right to be paid a Transition Bond Charge and associated tax charges by its customers relating to previously deferred purchased power costs for which the NJBPU had authorized recovery.

Notes to the Financial Statements (Unaudited) - Continued

Note D – Short-Term Borrowing

At March 31, 2015 and December 31, 2014, O&R had \$101 million and \$76 million of commercial paper outstanding, respectively. At March 31, 2015 and December 31, 2014, an immaterial amount of letters of credit were outstanding for O&R under the Credit Agreement.

Note E – Pension Benefits

Total Periodic Benefit Cost

The components of the Company's total periodic benefit costs for the three months ended March 31, 2015 and 2014 were as follows:

(Millions of Dollars)	2015	2014
Service cost – including administrative expenses	\$4	\$4
Interest cost on projected benefit obligation	9	9
Expected return on plan assets	(11)	(10)
Recognition of net actuarial loss	10	8
Recognition of prior service costs	1	-
TOTAL PERIODIC BENEFIT COST	\$13	\$11
Cost capitalized	(3)	(3)
Reconciliation to rate level	-	3
Cost charged to operating expenses	\$10	\$11

Expected Contributions

Based on estimates as of March 31, 2015, O&R expects to make contributions to the pension plans during 2015 of \$53 million. O&R's policy is to fund the total periodic benefit cost of the qualified plan to the extent tax deductible and to also contribute to the non-qualified plan. During the first quarter of 2015, the Company contributed \$1 million to the pension plans.

Note F – Other Postretirement Benefits

Total Periodic Benefit Cost

The components of the Company's total periodic other postretirement benefit costs for the three months ended March 31, 2015 and 2014 were as follows:

(Millions of Dollars)	2015	2014
Service cost	\$1	\$1
Interest cost on accumulated other postretirement benefit obligation	2	2
Expected return on plan assets	(2)	(2)
Recognition of net actuarial loss	1	1
Recognition of prior service cost	(2)	(1)
TOTAL PERIODIC OTHER POSTRETIREMENT BENEFIT COST	\$-	\$1
Cost capitalized	-	(1)
Reconciliation to rate level	2	3
Cost charged to operating expenses	\$2	\$3

Expected Contributions

Based on estimates as of March 31, 2015, O&R expects to make a contribution of an immaterial amount to the other postretirement benefit plans in 2015.

Notes to the Financial Statements (Unaudited) - Continued

Note G – Environmental Matters

Superfund Sites

Hazardous substances, such as asbestos, polychlorinated biphenyls (PCBs) and coal tar, have been used or generated in the course of operations of O&R and its predecessors and are present at sites and in facilities and equipment they currently or previously owned, including sites at which gas was manufactured or stored.

The Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state statutes (Superfund) impose joint and several liability, regardless of fault, upon generators of hazardous substances for investigation and remediation costs (which include costs of demolition, removal, disposal, storage, replacement, containment, and monitoring) and natural resource damages. Liability under these laws can be material and may be imposed for contamination from past acts, even though such past acts may have been lawful at the time they occurred. The sites at which O&R has been asserted to have liability under these laws, including its manufactured gas plant sites and any neighboring areas to which contamination may have migrated, are referred to herein as “Superfund Sites.”

For Superfund Sites where there are other potentially responsible parties and O&R is not managing the site investigation and remediation, the accrued liability represents an estimate of the amount O&R will need to pay to investigate and, where determinable, discharge its related obligations. For Superfund Sites (including the manufactured gas plant sites) for which O&R is managing the investigation and remediation, the accrued liability represents an estimate of the Company’s share of the undiscounted cost to investigate and remediate the sites. Remediation costs are estimated in light of the information available, applicable remediation standards and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at March 31, 2015 and December 31, 2014 were as follows:

(Millions of Dollars)	2015	2014
Accrued Liabilities:		
Manufactured gas plant sites	\$95	\$97
Other Superfund Sites	1	1
Total	\$96	\$98
Regulatory assets	\$103	\$105

The Superfund Sites have been investigated. However, for some of the sites, the extent and associated cost of the required remediation has not yet been determined. As information pertaining to the required remediation becomes available, the Company expects that additional liability may be accrued, the amount of which is not presently determinable but may be material. The Company is unable to estimate the time period over which the remaining accrued liability will be incurred because, among other things, the required remediation has not been determined for some of the sites. Under its current rate plans, the Company is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs.

Notes to the Financial Statements (Unaudited) - Continued

Insurance recoveries related to Superfund Sites for the three months ended March 31, 2015 and 2014 were immaterial. Environmental remediation costs incurred related to Superfund Sites for the three months ended March 31, 2015 and 2014 were as follows:

(Millions of Dollars)	2015	2014
Remediation costs incurred	\$1	\$1

In 2014, O&R estimated that for its manufactured gas plant sites, each of which has been investigated, the aggregate undiscounted potential liability for the remediation of coal tar and/or other environmental contaminants could range up to \$155 million. These estimates were based on assumptions regarding the extent of contamination and the type and extent of remediation that may be required. Actual experience may be materially different.

Asbestos Proceedings

Suits have been brought in New York State and federal courts against O&R and many other defendants, wherein a large number of plaintiffs sought large amounts of compensatory and punitive damages for deaths and injuries allegedly caused by exposure to asbestos at various O&R premises. The suits that have been resolved, which are many, have been resolved without any payment by O&R, or for amounts that were not, in the aggregate, material to the Company. The amounts specified in all the remaining suits total billions of dollars; however, the Company believes that these amounts are greatly exaggerated, based on the disposition of previous claims. At March 31, 2015, the Company had accrued its estimated aggregate undiscounted potential liability for these suits and additional suits that may be brought over the next 15 years of \$0.3 million. The estimate was based upon a combination of modeling, historical data analysis and risk factor assessment. Trial courts have begun, and unless otherwise determined by an appellate court may continue, to apply a different standard for determining liability in asbestos suits than the standard that applied historically. As a result, the Company currently believes that there is a reasonable possibility of an exposure to loss in excess of the liability accrued for the suits. The Company is unable to estimate the amount or range of such loss. In addition, certain current and former employees have claimed or are claiming workers' compensation benefits based on alleged disability from exposure to asbestos. The Company defers as regulatory assets (for subsequent recovery through rates) liabilities incurred for asbestos claims by employees and third-party contractors relating to its divested generating plants.

The Company's accrued liability for asbestos suits and workers' compensation proceedings (including those related to asbestos exposure) and the amounts deferred as regulatory assets for the Company at March 31, 2015 and December 31, 2014 were as follows:

(Millions of Dollars)	2015	2014
Accrued liability – asbestos suits	\$0.3	\$0.3
Regulatory assets – asbestos suits	\$0.3	\$0.3
Accrued liability – workers' compensation	\$5.1	\$5.0
Regulatory assets – workers' compensation	\$-	\$-

Notes to the Financial Statements (Unaudited) - Continued

Note H – Income Tax

O&R's income tax expense increased to \$14 million for the three months ended March 31, 2015, from \$10 million for the three months ended March 31, 2014. The effective tax rate for the three months ended March 31, 2015 and 2014 was 39 percent and 32 percent, respectively. The increase in the effective tax rate was primarily attributable to higher amortization of New York State's Metropolitan Transportation Authority business tax (\$1 million).

Uncertain Tax Positions

At March 31, 2015, the estimated liability for uncertain tax positions for O&R was \$3 million. O&R does not expect to resolve any of its uncertain tax positions within the next twelve months. The total amount of unrecognized tax benefits, if recognized, would reduce O&R's effective tax rate is \$3 million (\$2 million net of federal taxes).

O&R recognizes interest on liabilities for uncertain tax positions in interest expense and would recognize penalties, if any, in operating expenses in O&R's consolidated income statement. In the three months ended March 31, 2015, O&R recognized an immaterial amount of interest expense and no penalties for uncertain tax positions in its consolidated income statement. At March 31, 2015, O&R recognized an immaterial amount of accrued interest on its consolidated balance sheet.

Note I – Financial Information by Business Segment

The financial data for the business segments are as follows:

(Millions of Dollars)	For the Three Months Ended March 31,							
	Operating revenues		Inter-segment revenues		Depreciation and amortization		Operating income	
	2015	2014	2015	2014	2015	2014	2015	2014
Electric	\$156	\$163	\$-	\$-	\$12	\$10	\$18	\$12
Gas	77	93	-	-	5	4	27	27
Total O&R	\$233	\$256	\$-	\$-	\$17	\$14	\$45	\$39

Note J – Derivative Instruments and Hedging Activities

The Company hedges market price fluctuations associated with physical purchases and sales of electricity natural gas and, to a lesser extent, refined fuels by using derivative instruments including futures, forwards and options. Derivatives are recognized on the balance sheet at fair value (see Note K), unless an exception is available under the accounting rules for derivatives and hedging. Qualifying derivative contracts that have been designated as normal purchases or normal sales contracts are not reported at fair value under the accounting rules.

Notes to the Financial Statements (Unaudited) - Continued

The fair values of the Company's commodity derivatives including the offsetting of assets and liabilities on the consolidated balance sheet at March 31, 2015 and December 31, 2014 were:

(Millions of Dollars)	2015			2014		
Balance Sheet Location	Gross Amounts of Recognized Assets/ (Liabilities)	Gross Amounts Offset	Net Amounts of Assets/ (Liabilities)(a)	Gross Amounts of Recognized Assets/ (Liabilities)	Gross Amounts Offset	Net Amounts of Assets/ (Liabilities)(a)
Fair value of derivative assets						
Current	\$3	\$(2)	\$1(b)	\$2	\$(2)	\$-
Noncurrent	1	(1)	-	3	(2)	1
Total fair value of derivative assets	\$4	\$(3)	\$1	\$5	\$(4)	\$1
Fair value of derivative liabilities						
Current	\$(5)	\$3	\$(2)	\$(6)	\$2	\$(4)
Noncurrent	(5)	1	(4)	(4)	3	(1)
Total fair value of derivative liabilities	\$(10)	\$4	\$(6)	\$(10)	\$5	\$(5)
Net fair value derivative assets/(liabilities)	\$(6)	\$1	\$(5)(b)	\$(5)	\$1	\$(4)

- (a) Derivative instruments and collateral were offset on the consolidated balance sheet as applicable under the accounting rules. The Company enters into master agreements for its commodity derivatives. These agreements typically provide offset in the event of contract termination. In such case, generally the non-defaulting party's payable will be offset by the defaulting party's payable. The non-defaulting party will customarily notify the defaulting party within a specific time period and come to an agreement on the early termination amount.
- (b) At March 31, 2015, margin deposits of \$1 million were classified as derivative assets on the balance sheet, but not included in the table. Margin is collateral, typically cash, that the holder of a derivative instrument is required to deposit in order to transact on an exchange and to cover its potential losses with its broker or the exchange.

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

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

Notes to the Financial Statements (Unaudited) - Continued

The following table presents the realized and unrealized gains or losses on commodity derivatives that have been deferred for the three months ended March 31, 2015 and 2014:

(Millions of Dollars)	Balance Sheet Location	2015	2014
Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations:			
Current	Deferred derivative gains	\$1	\$5
Noncurrent	Deferred derivative gains	-	1
Total deferred gains/(losses)		\$1	\$6
Current	Deferred derivative losses	\$1	\$-
Current	Recoverable energy costs	2	18
Noncurrent	Deferred derivative losses	(2)	1
Total deferred gains/(losses)		\$1	\$19
Net deferred gains/(losses)		\$2	\$25

The following table presents the hedged volume of the Company's derivative transactions at March 31, 2015:

Electric Energy (MWHs)(a)	Natural Gas (Dt)(a)
1,116,230	4,280,000

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

The Company is exposed to credit risk related to transactions entered into primarily for the various electric supply and hedging activities. Credit risk relates to the loss that may result from a counterparty's nonperformance. The Company uses credit policies to manage this risk, including an established credit approval process, monitoring of counterparty limits, netting provisions within agreements and collateral or prepayment arrangements. The Company measures credit risk exposure as the replacement cost for open energy commodity and derivative positions plus amounts owed from counterparties for settled transactions. The replacement cost of open positions represents unrealized gains, net of any unrealized losses where the Company has a legally enforceable right of offset.

At March 31, 2015, the Company had \$1 million of credit exposure in connection with energy supply and hedging activities, net of collateral. The net credit exposure was primarily with commodity exchange brokers.

The collateral requirements associated with, and settlement of, derivative transactions are included in net cash flows from operating activities in the Company's consolidated statement of cash flows. Most derivative instrument contracts contain provisions that may require a party to provide collateral on its derivative instruments that are in a net liability position. The amount of collateral to be provided will depend on the fair value of the derivative instruments and the party's credit ratings.

The following table presents the aggregate fair value of the Company's derivative instruments with credit-risk-related contingent features that are in a net liability position, the collateral posted for such positions and the additional collateral that would have been required to be posted had the lowest applicable credit rating been reduced one level and to below investment grade at March 31, 2015:

Notes to the Financial Statements (Unaudited) - Continued

(Millions of Dollars)

Aggregate fair value – net liabilities(a)	\$5
Collateral posted	\$-
Additional collateral(b) (downgrade one level from current ratings)	\$-
Additional collateral(b) (downgrade to below investment grade from current ratings)	\$6(c)

(a) Non-derivative transactions for the purchase and sale of electricity, gas and qualifying derivative instruments, which have been designated as normal purchases or normal sales, are excluded from the table. These transactions primarily include purchases of electricity from independent system operators. In the event the Company was no longer extended unsecured credit for such purchases, the Company would be not be required to post collateral at March 31, 2015. For certain other such non-derivative transactions, the Company could be required to post collateral under certain circumstances, including in the event counterparties had reasonable grounds for insecurity.

(b) The additional collateral amounts shown above are based upon the estimated O&R allocation of the Utilities' collateral requirements. The Utilities measure the collateral requirements by taking into consideration the fair value amounts of derivative instruments that contain credit-risk-related contingent features that are in a net liabilities position plus amounts owed to counterparties for settled transactions and amounts required by counterparties for minimum financial security. The fair value amounts represent unrealized losses, net of any unrealized gains where the Company has a legally enforceable right of offset.

(c) Derivative instruments that are net assets have been excluded from the table. At March 31, 2015, if the Company had been downgraded to below investment grade, it would have been required to post an immaterial amount of additional collateral.

Note K – Fair Value Measurements

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

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

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

Notes to the Financial Statements (Unaudited) - Continued

- 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 March 31, 2015 and December 31, 2014 are summarized below.

(Millions of Dollars)	2015					2014				
	Level 1	Level 2	Level 3	Netting Adjustment (e)	Total	Level 1	Level 2	Level 3	Netting Adjustment (e)	Total
Derivative assets:										
Commodity(a)(b)(c)	\$-	\$-	\$-	\$2	\$2	\$-	\$1	\$-	\$-	\$1
Other(a)(b)(d)	8	10	-	-	18	8	10	-	-	18
Total assets	\$8	\$10	\$-	\$2	\$20	\$8	\$11	\$-	\$-	\$19
Derivative liabilities:										
Commodity(a)(b)(c)	\$-	\$6	\$-	\$-	\$6	\$-	\$6	\$-	\$(1)	\$5

- (a) The Company's policy is to review the fair value hierarchy and recognize transfers into and transfers out of the levels at the end of each reporting period. There were no transfers between levels 1, 2 and 3 for the three months ended March 31, 2015 and the year ended December 31, 2014.
- (b) Level 2 assets and liabilities include investments held in the deferred compensation plan and/or non-qualified retirement plans, exchange-traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1, and certain over-the-counter derivative instruments for electricity and natural gas. Derivative instruments classified as Level 2 are valued using industry standard models that incorporate corroborated observable inputs; such as pricing services or prices from similar instruments that trade in liquid markets, time value and volatility factors.
- (c) The accounting rules for fair value measurements and disclosures require consideration of the impact of nonperformance risk (including credit risk) from a market participant perspective in the measurement of the fair value of assets and liabilities. At March 31, 2015 and December 31, 2014, the Company determined that nonperformance risk would have no material impact on its financial position or results of operation.
- (d) Other assets are comprised of assets such as life insurance contracts within the deferred compensation plan and non-qualified retirement plans.
- (e) Amounts represent the impact of legally-enforceable master netting agreements that allow the Company to net gain and loss positions and cash collateral held or placed with the same counterparties.

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

Notes to the Financial Statements (Unaudited) - Continued

Note L – Related Party Transactions

The Company provides and receives administrative and other services to and from Con Edison and its subsidiaries pursuant to cost allocation procedures developed in accordance with rules approved by the NYSPSC and/or other regulatory authorities, as applicable. The services received include substantial administrative support operations, such as corporate secretarial and associated managerial duties, accounting, treasury, investor relations, information resources, legal, human resources, fuel supply, and energy management services. The costs of administrative and other services provided by the Company, and received from Con Edison and its other subsidiaries for the three months ended March 31, 2015 and 2014 were as follows:

<u>(Millions of Dollars)</u>	<u>2015</u>	<u>2014</u>
Cost of services provided	\$4	\$4
Cost of services received	\$11	\$10

At March 31, 2015 and December 31, 2014, O&R's payable to Con Edison and its other subsidiaries associated with these services was \$6 million and \$7 million, respectively.

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY \$24 million and \$34 million of natural gas for the three months ended March 31, 2015 and 2014, respectively. These amounts are net of the effect of related hedging transactions. At March 31, 2015 and December 31, 2014, O&R's net payable to CECONY associated with these gas purchases was \$6 million and \$3 million, respectively. At March 31, 2015 and December 31, 2014, O&R's payable to Con Edison's competitive energy businesses associated with electricity purchases and retail services was \$1 million.

At March 31, 2015 and December 31, 2014, the Company's payable to Con Edison for income taxes was \$14 million and \$6 million, respectively.

FERC has authorized CECONY through 2015 to periodically lend funds to O&R, for periods of not more than 12 months, in amounts not to exceed \$250 million outstanding at any time, at prevailing market rates. At March 31, 2015 and December 31, 2014, there were no loans outstanding for O&R.

Note M – New Financial Accounting Standards

In January 2015, the Financial Accounting Standards Board (FASB) issued amendments on income statement guidance through Accounting Standards Update (ASU) No. 2015-01, "Income Statement—Extraordinary and Unusual Items (Subtopic 225-20)." The amendments reduce the complexity of accounting standards related to the income statement by eliminating the requirement to report extraordinary items separately. The amendments are effective for reporting periods beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and liquidity.

Notes to the Financial Statements (Unaudited) - Continued

In February 2015, the FASB issued amendments on consolidation guidance through ASU No. 2015-02, "Consolidation (Topic 810)." The amendments provide additional guidance for VIE accounting of limited partnerships and similar legal entities, fees paid to decision makers of a VIE, the effect of fee arrangements on primary beneficiary determination, the effect of related parties on primary beneficiary determination. The amendments are effective prospectively for reporting periods beginning on or after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the application and impact of the new guidance on the Company's financial position, results of operations and liquidity.

In April 2015, the FASB issued amendments on debt issuance costs guidance through ASU No. 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments provide additional guidance requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability rather than as a deferred cost (i.e. an asset) as required by current guidance. The amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company is in the process of evaluating the application and impact of the new guidance on the Company's financial position, results of operations and liquidity.

In April 2015, the FASB issued amendments on internal-use software guidance through ASU No. 2015-05, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The amendments provide guidance to customers about whether a cloud computing arrangement would be accounted for as a license of internal use software. If the arrangement is not deemed to contain a software license, it would be accounted for as a service contract. The amendments are effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted. The Company is in the process of evaluating the application and impact of the new guidance on the Company's financial position, results of operations and liquidity.