

**Orange and Rockland Utilities, Inc.**  
**Financial Statements**  
**December 31, 2017 and 2016**



## **Report of Independent Auditors**

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

We have audited the accompanying consolidated financial statements of Orange and Rockland Utilities, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets and consolidated statements of capitalization as of December 31, 2017 and 2016, and the related consolidated statements of income, of comprehensive income, of shareholder's equity and of cash flows for each of the three years in the period ended December 31, 2017.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orange and Rockland Utilities, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

March 6, 2018

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Report of Independent Auditors

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## Orange and Rockland Utilities, Inc. Consolidated Income Statement

<i>(Millions of Dollars)</i>	For the Years Ended December 31,		
	2017	2016	2015
<b>OPERATING REVENUES</b>			
Electric	\$642	\$637	\$663
Gas	232	184	182
<b>TOTAL OPERATING REVENUES</b>	<b>874</b>	<b>821</b>	<b>845</b>
<b>OPERATING EXPENSES</b>			
Purchased power	191	197	210
Gas purchased for resale	73	47	51
Other operations and maintenance	316	301	333
Depreciation and amortization	71	67	68
Taxes, other than income taxes	82	79	62
<b>TOTAL OPERATING EXPENSES</b>	<b>733</b>	<b>691</b>	<b>724</b>
<b>OPERATING INCOME</b>	<b>141</b>	<b>130</b>	<b>121</b>
<b>OTHER INCOME (DEDUCTIONS)</b>			
Investment and other income (deductions)	—	—	(5)
Allowance for equity funds used during construction	1	1	1
<b>TOTAL OTHER INCOME (DEDUCTIONS)</b>	<b>1</b>	<b>1</b>	<b>(4)</b>
<b>INCOME BEFORE INTEREST AND INCOME TAX EXPENSE</b>	<b>142</b>	<b>131</b>	<b>117</b>
<b>INTEREST EXPENSE</b>			
Interest on long-term debt	36	36	33
Other interest	1	1	3
Allowance for borrowed funds used during construction	(1)	(1)	(1)
<b>NET INTEREST EXPENSE</b>	<b>36</b>	<b>36</b>	<b>35</b>
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	<b>106</b>	<b>95</b>	<b>82</b>
<b>INCOME TAX EXPENSE</b>	<b>42</b>	<b>36</b>	<b>30</b>
<b>NET INCOME</b>	<b>\$64</b>	<b>\$59</b>	<b>\$52</b>

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

**Orange and Rockland Utilities, Inc.**  
**Consolidated Statement of Comprehensive Income**

<i>(Millions of Dollars)</i>	For the Years Ended December 31,		
	2017	2016	2015
NET INCOME	\$64	\$59	\$52
OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES			
Pension and other postretirement benefit plan liability adjustments, net of taxes	1	3	9
TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES	1	3	9
COMPREHENSIVE INCOME	\$65	\$62	\$61

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

## Orange and Rockland Utilities, Inc. Consolidated Statement of Cash Flows

<i>(Millions of Dollars)</i>	For the Years Ended December 31,		
	2017	2016	2015
<b>OPERATING ACTIVITIES</b>			
Net income	\$64	\$59	\$52
<b>PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME</b>			
Depreciation and amortization	71	67	68
Deferred income taxes	12	8	7
Rate case amortizations	18	17	22
Other non-cash items, net	8	(7)	13
<b>CHANGES IN ASSETS AND LIABILITIES</b>			
Accounts receivable - customers	(10)	(3)	14
Accounts receivable from affiliated companies	(1)	11	1
Materials and supplies, including gas in storage	(4)	1	5
Prepayments, other receivables and other current assets	(11)	(19)	21
Accounts payable	—	10	(11)
Accounts payable to affiliated companies	—	3	(9)
Pensions and retiree benefits obligations, net	42	31	43
Pensions and retiree benefits contributions	(46)	(39)	(53)
Accrued taxes	—	—	(1)
Accrued taxes to affiliated companies	19	—	(4)
Accrued interest	—	(1)	2
Accrued wages	—	1	(2)
System benefit charge	17	22	1
Superfund and environmental remediation costs, net	(2)	(9)	2
Deferred charges, noncurrent assets and other regulatory assets	109	(2)	(13)
Deferred credits and other regulatory liabilities	(80)	21	23
Other current and noncurrent liabilities	10	(13)	2
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>216</b>	<b>158</b>	<b>183</b>
<b>INVESTING ACTIVITIES</b>			
Utility construction expenditures	(189)	(167)	(153)
Cost of removal less salvage	(7)	(3)	(7)
Proceeds from sale of Pike	—	15	—
Other investing activities	1	12	—
<b>NET CASH FLOWS USED IN INVESTING ACTIVITIES</b>	<b>(195)</b>	<b>(143)</b>	<b>(160)</b>
<b>FINANCING ACTIVITIES</b>			
Net issuance/(payment) of short-term debt	26	10	(16)
Issuance of long-term debt	—	75	220
Retirement of long-term debt	(4)	(79)	(143)
Debt issuance costs	—	(1)	(3)
Capital contribution by parent	—	20	—
Dividend to parent	(44)	(42)	(81)
<b>NET CASH FLOWS USED IN FINANCING ACTIVITIES</b>	<b>(22)</b>	<b>(17)</b>	<b>(23)</b>
<b>CASH AND TEMPORARY CASH INVESTMENTS:</b>			
<b>NET CHANGE FOR THE PERIOD</b>	<b>(1)</b>	<b>(2)</b>	<b>—</b>
<b>BALANCE AT BEGINNING OF PERIOD</b>	<b>47</b>	<b>45</b>	<b>49</b>
<b>BALANCE AT END OF PERIOD</b>	<b>46</b>	<b>43</b>	<b>49</b>
<b>LESS: CHANGE IN CASH BALANCES HELD FOR SALE</b>	<b>—</b>	<b>(4)</b>	<b>4</b>
<b>BALANCE AT END OF PERIOD EXCLUDING HELD FOR SALE</b>	<b>\$46</b>	<b>\$47</b>	<b>\$45</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH INFORMATION</b>			
Cash paid during the period for:			
Interest	\$36	\$37	\$28
Income taxes	\$10	\$19	\$37
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION</b>			
Construction expenditures in accounts payable	\$25	\$24	\$22

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

## Orange and Rockland Utilities, Inc. Consolidated Balance Sheet

<i>(Millions of Dollars)</i>	December 31, 2017	December 31, 2016
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and temporary cash investments	\$46	\$47
Accounts receivable – customers, less allowance for uncollectible accounts of \$4 in 2017 and 2016	71	61
Other receivables, less allowance for uncollectible accounts of \$1 in 2017 and 2016	8	4
Accrued unbilled revenue	45	48
Accounts receivable from affiliated companies	4	3
Gas in storage, at average cost	12	10
Materials and supplies, at average cost	20	18
Prepayments	26	27
Regulatory assets	4	10
Restricted cash	1	2
Other current assets	12	1
<b>TOTAL CURRENT ASSETS</b>	<b>249</b>	<b>231</b>
<b>INVESTMENTS</b>	<b>29</b>	<b>27</b>
<b>UTILITY PLANT, AT ORIGINAL COST</b>		
Electric	1,694	1,625
Gas	758	710
General	256	229
<b>TOTAL</b>	<b>2,708</b>	<b>2,564</b>
Less: Accumulated depreciation	743	704
Net	1,965	1,860
Construction work in progress	103	71
<b>NET UTILITY PLANT</b>	<b>2,068</b>	<b>1,931</b>
<b>OTHER NONCURRENT ASSETS</b>		
Regulatory assets	403	556
Other deferred charges and noncurrent assets	24	17
<b>TOTAL OTHER NONCURRENT ASSETS</b>	<b>427</b>	<b>573</b>
<b>TOTAL ASSETS</b>	<b>\$2,773</b>	<b>\$2,762</b>

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

## Orange and Rockland Utilities, Inc. Consolidated Balance Sheet

<i>(Millions of Dollars)</i>	December 31, 2017	December 31, 2016
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Long-term debt due within one year	\$54	\$4
Notes payable	96	70
Accounts payable	76	75
Accounts payable to affiliated companies	18	18
Customer deposits	12	15
Accrued taxes	3	3
Accrued taxes to affiliated companies	21	2
Accrued interest	8	8
Accrued wages	10	10
Fair value of derivative liabilities	3	5
Regulatory liabilities	36	38
System benefit charge	53	36
Other current liabilities	22	15
<b>TOTAL CURRENT LIABILITIES</b>	<b>412</b>	<b>299</b>
<b>NONCURRENT LIABILITIES</b>		
Provision for injuries and damages	5	6
Pensions and retiree benefits	305	304
Superfund and other environmental costs	100	98
Deferred income taxes and unamortized investment tax credits	288	536
Regulatory liabilities	348	194
Other deferred credits and noncurrent liabilities	42	19
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>1,088</b>	<b>1,157</b>
<b>LONG-TERM DEBT</b>	<b>607</b>	<b>661</b>
<b>SHAREHOLDER'S EQUITY (See Statement of Shareholder's Equity)</b>	<b>666</b>	<b>645</b>
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>	<b>\$2,773</b>	<b>\$2,762</b>

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



**Orange and Rockland Utilities, Inc.**  
**Consolidated Statement of Shareholder's Equity**

<i>(In Millions, except share data)</i>	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
	Shares	Amount				
BALANCE AS OF DECEMBER 31, 2014	1,000	\$—	\$304	\$354	\$(33)	\$625
Net income				52		52
Common stock dividend to parent				(81)		(81)
Other comprehensive income					9	9
BALANCE AS OF DECEMBER 31, 2015	1,000	\$—	\$304	\$325	\$(24)	\$605
Net income				59		59
Common stock dividend to parent				(42)		(42)
Capital contribution by parent			20			20
Other comprehensive income					3	3
BALANCE AS OF DECEMBER 31, 2016	1,000	\$—	\$324	\$342	\$(21)	\$645
Net income				64		64
Common stock dividend to parent				(44)		(44)
Other comprehensive income					1	1
BALANCE AS OF DECEMBER 31, 2017	1,000	\$—	\$324	\$362	\$(20)	\$666

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

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

<i>(In Millions, except share data)</i>	Shares outstanding December 31,		At December 31,	
	2017	2016	2017	2016
TOTAL SHAREHOLDER'S EQUITY (See Statement of Shareholder's Equity)	1,000	1,000	\$666	\$645
<b>LONG-TERM DEBT (Millions of Dollars)</b>			<b>At December 31,</b>	
Maturity	Interest Rate	Series	2017	2016
DEBENTURES:				
2018	6.15	2008A	50	50
2019	4.96	2009A	60	60
2027	6.50	1997F	80	80
2039	6.00	2009B	60	60
2040	5.50	2010B	115	115
2045	4.95	2015A	120	120
2045	4.69	2015B	100	100
2046	3.88	2016A	75	75
TOTAL DEBENTURES			660	660
TRANSITION BONDS:				
2019 (a)	5.22%	2004-1	7	11
TOTAL TRANSITION BONDS			7	11
Unamortized debt expense			(5)	(5)
Unamortized debt discount			(1)	(1)
TOTAL			661	665
Less: Long-term debt due within one year			54	4
TOTAL LONG-TERM DEBT			607	661
TOTAL CAPITALIZATION			\$1,273	\$1,306

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

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 one regulated utility subsidiary: Rockland Electric Company (RECO). In August 2016, O&R sold its Pennsylvania subsidiary, Pike County Light & Power Company (Pike) to Corning Natural Gas Holding Corporation (see Note Q). For the years ended December 31, 2017, 2016 and 2015, operating revenues for RECO were 20.4 percent, 22.9 percent and 22.7 percent, respectively, of O&R's consolidated operating revenues. O&R, along with RECO, provides electric service in southeastern New York and adjacent areas of northern New Jersey and gas service in southeastern New York. 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) and the New Jersey Board of Public Utilities (NJBPU) with respect to rates and accounting.

The Company has, pursuant to the accounting rules for subsequent events, evaluated events or transactions that occurred after December 31, 2017 through the posting on its website (March 6, 2018) of the Annual Financial Statements for potential recognition or disclosure in the consolidated financial statements.

### Note A – Summary of Significant Accounting Policies

#### Principles of Consolidation

The Company's consolidated financial statements include the accounts of its subsidiaries. All intercompany balances and transactions have been eliminated.

#### Accounting Policies

The accounting policies of the Company conform to generally accepted accounting principles in the United States of America (GAAP). The Company is subject to the accounting rules for regulated operations and the accounting requirements of the FERC and the state regulators having jurisdiction.

The accounting rules for regulated operations specify the economic effects that result from the causal relationship of costs and revenues in the rate-regulated environment and how these effects are to be accounted for by a regulated enterprise. Revenues intended to cover some costs may be recorded either before or after the costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, these costs would be recorded as deferred charges or "regulatory assets" under the accounting rules for regulated operations. If revenues are recorded for costs that are expected to be incurred in the future, these revenues would be recorded as deferred credits or "regulatory liabilities" under the accounting rules for regulated operations.

## Notes to the Financial Statements - Continued

The Company's principal regulatory assets and liabilities are detailed in Note B. The Company is generally receiving or being credited with a return on its regulatory assets for which a cash outflow has been made, and is paying or being charged with a return on its regulatory liabilities for which a cash inflow has been received. The Company is not receiving or being credited with a return on its regulatory asset for RECO's transition bond cost as to which Transition Bonds have been issued (see Note C) or RECO's deferred storm costs. 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 state regulators.

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 (AFUDC). The original cost of property is charged to expense over the estimated useful lives of the assets. Upon retirement, the original cost of property is charged to accumulated depreciation. See Note N.

Rates used for AFUDC 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 AFUDC rates for the Company were 2.5 percent, 3.5 percent and 0.4 percent for 2017, 2016 and 2015, 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 rates for the Company were 2.9 percent for 2017 and 2016 and 3.0 percent for 2015.

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

## Notes to the Financial Statements - Continued

At December 31, 2017 and 2016, the capitalized cost of the Company's utility plant, net of accumulated depreciation, was as follows:

<i>(Millions of Dollars)</i>	2017	2016
Electric		
Transmission	\$220	\$222
Distribution	963	916
Gas (a)	573	536
General	200	177
Held for future use	9	9
Construction work in progress	103	71
Net Utility Plant	\$2,068	\$1,931

(a) Primarily distribution

Under O&R's rate plans, the aggregate annual depreciation allowance in effect for the period ended December 31, 2017 was \$69 million.

### Long-Lived Assets

The Company evaluates the impairment of long-lived assets, based on projections of undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. In the event an evaluation indicates that such cash flows cannot be expected to be sufficient to fully recover the assets, the assets are written down to their estimated fair value. In 2015, the Company recorded a \$5 million (\$3 million, net of taxes) impairment charge on the assets held for sale of Pike, a former O&R subsidiary that was sold in August 2016. No impairment charges on long-lived assets were recognized in 2017 or 2016.

### Revenues

The Company recognizes revenues for energy service on a monthly billing cycle basis. The Company defers over a 12-month period net interruptible gas revenues, other than those authorized by the NYSPSC to be retained by the Company, for refund to firm gas sales and transportation customers. The Company accrues revenues at the end of each month for estimated energy service not yet billed to customers. Revenues as energy is delivered or services provided and billed to customers are recorded in accounts receivable – customers. O&R's accounts receivable – customers balance also reflects O&R's purchase of receivables from energy service companies to support retail choice programs. Accrued revenues not yet billed to customers are recorded as accrued unbilled revenues.

O&R's New York electric and gas rate plans each contain a revenue decoupling mechanism under which the Company's actual energy delivery revenues are compared with the authorized delivery revenues and the difference accrued, with interest, for refund to, or recovery from, customers, as applicable. See "Rate Plans" in Note B.

O&R is required to record gross receipts tax as revenues and expenses on a gross income statement presentation basis (i.e., included in both revenue and expense). The recovery of this tax is included in the

## Notes to the Financial Statements - Continued

revenue requirement within the approved rate plan. O&R recorded \$10.6 million, \$10.2 million, and \$8.9 million, of gross receipts tax in 2017, 2016 and 2015, respectively. Pike recorded \$0.3 million and \$0.5 million, of gross receipts tax in 2016 and 2015, respectively.

For information about changes to the accounting rules for revenue recognition, see Note P.

### **Recoverable Energy Costs**

O&R generally recovers all of its prudently incurred purchased power and gas costs, including hedging gains and losses, in accordance with rate provisions approved by the applicable state public utility commissions. If the actual energy supply costs for a given month are more or less than the amounts billed to customers for that month, the difference in most cases is recoverable from or refundable to customers.

For each billing cycle, O&R bills its energy costs to customers based upon its estimate of the cost to supply energy for that billing cycle. Differences between actual and billed electric supply costs are generally deferred for charge or refund to customers during the next billing cycle (normally within one or two months). For O&R's gas costs, differences between actual and billed gas costs during the 12-month period ending each August are charged or refunded to customers during a subsequent 12-month period.

RECO purchases electric energy under a competitive bidding process supervised by the NJBPU for contracts ranging from one to three years. For RECO, approximately 90 percent of the energy supply is covered by fixed price contracts ranging from one to three years that are competitively bid through the NJBPU auction process and provided through the independent system operator, PJM Interconnection LLC (PJM). 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.

### **New York Independent System Operator (NYISO)**

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

### **Temporary Cash Investments**

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

## Notes to the Financial Statements - Continued

### Investments

Investments are recorded at fair value and include the non-qualified supplemental retirement plan assets.

### Pension and Other Postretirement Benefits

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

For O&R pension and other postretirement benefits regulatory accounting treatment is applied in accordance with the accounting rules for regulated operations. RECO pension and other postretirement benefits do not have regulatory accounting treatment. For benefits subject to regulatory accounting treatment, unrecognized prior service costs or credits and unrecognized actuarial gains and losses are recorded to regulatory assets or liabilities, rather than OCI. See Notes E and F.

The total periodic benefit costs are recognized in accordance with the accounting rules for retirement benefits. Investment gains and losses are recognized in expense over a 15-year period and other actuarial gains and losses are recognized in expense over a 10-year period, subject to the deferral provisions in the rate plans.

In accordance with the Statement of Policy issued by the NYSPSC and its current electric and gas rate plans, O&R defers for payment to or recovery from customers the difference between such expenses for the Company's New York business and the amounts for such expenses reflected in O&R's rates. RECO's rate plan does not have comparable deferral provisions for retirement benefits. See Note B.

The Company calculates the expected return on pension and other postretirement benefit plan assets by multiplying the expected rate of return on plan assets by the market-related value (MRV) of plan assets at the beginning of the year, taking into consideration anticipated contributions and benefit payments that are to be made during the year. The accounting rules allow the MRV of plan assets to be either fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. The Company uses a calculated value when determining the MRV of the plan assets that adjusts for 20 percent of the difference between fair value and expected MRV of plan assets. This calculated value has the effect of stabilizing variability in assets to which the Company applies the expected return.

## Notes to the Financial Statements - Continued

### Federal Income Tax

In accordance with the accounting rules for income taxes, the Company has recorded an accumulated deferred federal income tax liability at current tax rates for temporary differences between the book and tax basis of assets and liabilities. In accordance with rate plans, 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 deferred tax liability, the Company has established regulatory assets for the net revenue requirements to be recovered from customers for the related future tax expense pursuant to the NYSPSC’s 1993 Policy Statement approving accounting procedures consistent with accounting rules for income taxes and providing assurance that these future increases in taxes will be recoverable in rates. Upon enactment of the Tax Cuts and Jobs Act of 2017 on December 22, 2017 (the TCJA), O&R re-measured its deferred tax assets and liabilities based upon the 21 percent corporate income tax rate under the TCJA. As a result, O&R decreased its net deferred tax liabilities by \$261 million (including \$45 million for RECO), decreased its regulatory asset for future income tax by \$68 million (including \$17 million for RECO), decreased its regulatory asset for revenue taxes by \$4 million, and accrued a regulatory liability for future income tax of \$189 million (including \$28 million for RECO). See Notes B and 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 a consolidated tax allocation agreement. Tax loss and tax credit carryforwards are allocated among members in accordance with consolidated tax return regulations.

### 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’s share of the New York State tax is 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.

### Reclassification

Certain prior year amounts have been reclassified to conform with the current year presentation.



## Notes to the Financial Statements - Continued

### Estimates

The preparation of financial statements in conformity with GAAP 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.

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

Changes to accumulated OCI are as follows:

*(Millions of Dollars)*

Accumulated OCI, net of taxes, at December 31, 2014 (a)	\$(33)
OCI before reclassifications, net of tax of \$(3)	4
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(3) (a)(b)	5
Total OCI, net of taxes, at December 31, 2015	9
Accumulated OCI, net of taxes, at December 31, 2015 (a)	\$(24)
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(3) (a)(b)	3
Total OCI, net of taxes, at December 31, 2016	3
Accumulated OCI, net of taxes, at December 31, 2016 (a)	\$(21)
OCI before reclassifications, net of tax of \$2	(3)
Amounts reclassified from accumulated OCI related to pension plan liabilities, net of tax of \$(2) (a)(b)	4
Total OCI, net of taxes, at December 31, 2017	1
Accumulated OCI, net of taxes, at December 31, 2017 (a)	\$(20)

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

(b) Only RECO's portion of unrecognized pension and other postretirement benefit 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.

### Note B – Regulatory Matters

#### Rate Plans

The Company provides service to New York customers according to the terms of tariffs approved by the NYSPPSC. Tariffs for service to customers of RECO, the Company's New Jersey regulated utility subsidiary, are approved by utility regulators in that state. The tariffs include schedules of rates for service that limit the rates charged by the Company to amounts that recover from its customers costs approved by the regulator, including capital costs, of providing service to customers as defined by the tariff. The tariffs implement rate plans adopted by state utility regulators in rate orders issued at the conclusion of rate proceedings. Pursuant to the Company's rate plans, there generally can be no change to the charges to customers during the respective terms of the rate plans other than specified adjustments provided for in the rate plans. The Company's rate plans each cover specified periods, but rates determined pursuant to a plan generally continue in effect until a new rate plan is approved by the state utility regulator.

Common provisions of the Company's New York rate plans include:

*Recoverable energy costs* that allows the Company to recover on a current basis the costs for the energy it supplies with no mark-up to their full-service customers.

## Notes to the Financial Statements - Continued

*Cost reconciliations* that reconcile pension and other postretirement benefit costs, environmental remediation costs, property taxes, and certain other costs to amounts reflected in delivery rates for such costs. In addition, changes in the Company's costs not reflected in rates, in excess of certain amounts, resulting from changes in tax or other law, rule, regulation, order, or other requirement or interpretation are deferred as a regulatory asset or regulatory liability to be reflected in the Company's next rate plan or in a manner to be determined by the NYSPSC. See "Other Regulatory Matters," below. Also, the Company generally retains the right to petition for recovery or accounting deferral of extraordinary and material cost increases and provision is sometimes made for the utility to retain a share of cost reductions, for example, property tax refunds.

*Revenue decoupling mechanisms* that reconcile actual energy delivery revenues to the authorized delivery revenues approved by the NYSPSC. The difference is accrued with interest for refund to, or recovery from customers, as applicable.

*Earnings sharing* that requires the Company to defer for customer benefit a portion of earnings over specified rates of return on common equity. There is no symmetric mechanism for earnings below specified rates of return on common equity.

*Negative revenue adjustments* for failure to meet certain performance standards relating to service, reliability, safety and other matters.

*Net utility plant reconciliations* that require deferral as a regulatory liability of the revenue requirement impact of the amount, if any, by which actual average net utility plant balances are less than amounts reflected in rates. There is generally no symmetric mechanism if actual average net utility plant balances are more than amounts reflected in rates.

*Rate base* as reflected in rate plans, is, in general, the sum of the Company's net plant, working capital and certain regulatory assets less deferred taxes and certain regulatory liabilities. For each rate plan, the NYSPSC uses a forecast of the average rate base for each year that new rates would be in effect ("rate year"). The NJBPU uses the rate base balances that exist at the end of the historical 12-month period on which base rates are set.

*Weighted average cost of capital* is determined based on the authorized common equity ratio, return on common equity, cost of long-term debt and customer deposits reflected in each rate plan. For each rate plan, the revenues designed to provide the utility a return on invested capital for each rate year is determined by multiplying its rate base by its pre-tax weighted average cost of capital. The Company's actual return on common equity will reflect its actual operations for each rate year, and may be more or less than the authorized return on equity reflected in its rate plan (and if more, may be subject to earnings sharing).

## Notes to the Financial Statements - Continued

The following tables contain a summary of the rate plans:

### O&R New York – Electric

Effective period	July 2012 – October 2015	November 2015 - October 2017 (a)
Base rate changes	Yr. 1 – \$19.4 million Yr. 2 – \$8.8 million Yr. 3 – \$15.2 million	Yr. 1 – \$9.3 million Yr. 2 – \$8.8 million
Amortizations to income of net regulatory (assets) and liabilities	\$(32.2) million over three years	Yr. 1 – \$(8.5) million (b) Yr. 2 – \$(9.4) million (b)
Revenue decoupling mechanisms	In 2012, 2013 and 2014, the company deferred for the customer's benefit \$2.6 million, \$3.2 million and \$(3.4) million, respectively.	In 2015, 2016 and 2017, the company deferred for the customer's benefit an immaterial amount, \$6.3 million as regulatory liabilities and \$11.2 million as regulatory assets, respectively.
Recoverable energy costs	Current rate recovery of purchased power and fuel costs.	Continuation of current rate recovery of purchased power costs.
Negative revenue adjustments	Potential penalties (up to \$3 million annually) if certain customer service and system reliability performance targets are not met. In 2012, 2013 and 2014, the company did not record any negative revenue adjustments.	Potential penalties (up to \$4 million annually) if certain performance targets are not met. In 2015 the company recorded \$1.25 million in negative revenue adjustments. In 2016 and 2017, the company did not record any negative revenue adjustments.
Cost reconciliations	In 2012, 2013 and 2014, the company deferred \$7.8 million, \$4.1 million and \$(0.2) million as a net increase/(decrease) to regulatory assets, respectively.	In 2015, 2016 and 2017, the company deferred \$0.3 million, \$7.4 million and \$3.2 million as net decreases to regulatory assets, respectively.
Net utility plant reconciliations	Target levels reflected in rates were: Yr. 1 – \$678 million; Yr. 2 – \$704 million; Yr. 3 – \$753 million The company increased its regulatory liability by \$4.2 million in 2012. The company reduced its regulatory liability by \$1.1 million and \$2.3 million in 2013 and 2014, respectively.	Target levels reflected in rates are: Yr. 1 – \$928 million (c) Yr. 2 – \$970 million (c) The company increased/(reduced) its regulatory asset by \$2.2 million, \$(1.9) million and \$(1.9) million in 2015, 2016 and 2017, respectively.
Average rate base	Yr. 1 – \$671 million Yr. 2 – \$708 million Yr. 3 – \$759 million	Yr. 1 – \$763 million Yr. 2 – \$805 million
Weighted average cost of capital (after-tax)	Yr. 1 – 7.61 percent Yr. 2 – 7.65 percent Yr. 3 – 7.48 percent	Yr. 1 – 7.10 percent Yr. 2 – 7.06 percent
Authorized return on common equity	Yr. 1 – 9.4 percent Yr. 2 – 9.5 percent Yr. 3 – 9.6 percent	9.0 percent
Actual return on common equity	Yr. 1 – 12.9 percent Yr. 2 – 8.7 percent Yr. 3 – 9.4 percent	Yr. 1 – 10.8 percent Yr. 2 – 9.7 percent
Earnings sharing	The company recorded a regulatory liability of \$1 million for earnings above the sharing threshold under the rate plan as of December 31, 2014.	Most earnings above an annual earnings threshold of 9.6 percent are to be applied to reduce regulatory assets. In 2015, earnings did not exceed the earnings threshold. Actual earnings were \$6.1 million and \$0.3 million above the threshold for 2016 and 2017, respectively.
Cost of long-term debt	Yr. 1 – 6.07 percent Yr. 2 – 6.07 percent Yr. 3 – 5.64 percent	Yr. 1 – 5.42 percent Yr. 2 – 5.35 percent
Common equity ratio	48 percent	48 percent

- (a) Rates determined pursuant to this rate plan continue in effect until a new rate plan is approved by the NYSPSC.
- (b) \$59.3 million of the regulatory asset for deferred storm costs is to be recovered from customers over a five year period, including \$11.85 million in each of years 1 and 2, \$1 million of the regulatory asset for such costs will not be recovered from customers, and all outstanding issues related to Superstorm Sandy and other past major storms prior to November 2014 are resolved. Approximately \$4 million of regulatory assets for property tax and interest rate reconciliations will not be recovered from customers. Amounts that will not be recovered from customers were charged-off in June 2015.
- (c) Excludes electric AMI as to which the company will be required to defer as a regulatory liability the revenue requirement impact of the amount, if any, by which actual average net utility plant balances are less than amounts reflected in rates: \$1 million in year 1 and \$9 million in year 2.

In January 2018, O&R filed a request with the NYSPSC for an increase in the rates it charges for electric service rendered in New York, effective January 1, 2019, of \$20.3 million. The filing reflects a return on common equity of 9.75 percent and a common equity ratio of 48 percent. The filing proposes continuation of the provisions with respect to recovery from customers of the cost of purchased power, and the reconciliation of

## Notes to the Financial Statements - Continued

actual expenses allocable to the electric business to the amounts for such costs reflected in electric rates for storm costs, pension and other postretirement benefit costs, environmental remediation and property taxes.

## Notes to the Financial Statements - Continued

### O&R New York – Gas

Effective period	November 2009 – October 2015	November 2015 – October 2018
Base rate changes	Yr. 1 – \$9 million Yr. 2 – \$9 million Yr. 3 – \$4.6 million Yr. 3 – \$4.3 million collected through a surcharge Yr. 4 – None Yr. 5 – None	Yr. 1 – \$16.4 million Yr. 2 – \$16.4 million Yr. 3 – \$5.8 million Yr. 3 – \$10.6 million collected through a surcharge
Amortization to income of net regulatory (assets) and liabilities	\$(2) million over three years	Yr. 1 – \$(1.7) million (a) Yr. 2 – \$(2.1) million (a) Yr. 3 – \$(2.5) million (a)
Revenue decoupling mechanisms	In 2012, 2013 and 2014, the company deferred \$4.7 million, \$0.7 million and \$(0.1) million of regulatory liabilities, respectively.	In 2015 and 2016, the company deferred \$0.8 million regulatory assets and \$6.2 million of regulatory liabilities, respectively. In 2017, the company deferred \$1.7 million in regulatory liabilities.
Recoverable energy costs	Current rate recovery of purchased gas costs.	Current rate recovery of purchased gas costs.
Negative revenue adjustments	Potential penalties (up to \$1.4 million annually) if certain operations and customer service requirements are not met. In 2012, 2013 and 2014, the company did not record any negative revenue adjustments.	Potential penalties (up to \$3.7 million in Yr. 1, \$4.7 million in Yr. 2 and \$4.9 million in Yr. 3) if certain performance targets are not met. In 2015, 2016 and 2017, the company did not record any negative revenue adjustments.
Cost reconciliations	In 2012, 2013 and 2014, the company deferred \$0.7 million, \$8.3 million and \$8.3 million as net regulatory assets, respectively.	In 2015 and 2016, the company deferred \$4.5 million and \$6.6 million as net regulatory liabilities and assets, respectively. In 2017, the company deferred \$3.5 million as net regulatory liabilities.
Net utility plant reconciliations	The company deferred \$0.7 million in 2012 as a regulatory asset and no deferrals were recorded for 2013 or 2014.	Target levels reflected in rates are: Yr. 1 – \$492 million (b) Yr. 2 – \$518 million (b) Yr. 3 – \$546 million (b) No deferral was recorded for 2015 and immaterial amounts were recorded as regulatory liabilities in 2016 and 2017.
Average rate base	Yr. 1 – \$280 million Yr. 2 – \$296 million Yr. 3 – \$309 million	Yr. 1 – \$366 million Yr. 2 – \$391 million Yr. 3 – \$417 million
Weighted average cost of capital (after-tax)	8.49 percent	Yr. 1 – 7.10 percent Yr. 2 – 7.06 percent Yr. 3 – 7.06 percent
Authorized return on common equity	10.4 percent	9.0 percent
Actual return on common equity	Yr. 1 – 10.2 percent Yr. 2 – 9.6 percent Yr. 3 – 12.6 percent Yr. 4 – 10.2 percent Yr. 5 – 6.1 percent	Yr. 1 – 11.2 percent Yr. 2 – 9.7 percent
Earnings sharing	Earnings above an annual earnings threshold of 11.4 percent are to be applied to reduce regulatory assets. In 2012, 2013 and 2014, earnings did not exceed the earnings threshold.	Most earnings above an annual earnings threshold of 9.6 percent are to be applied to reduce regulatory assets. In 2015, earnings did not exceed the earnings threshold. Actual earnings were \$4 million and \$0.2 million above the threshold for 2016 and 2017, respectively.
Cost of long-term debt	6.81 percent	Yr. 1 – 5.42 percent Yr. 2 – 5.35 percent Yr. 3 – 5.35 percent
Common equity ratio	48 percent	48 percent

(a) Reflects that the company will not recover from customers a total of approximately \$14 million of regulatory assets for property tax and interest rate reconciliations. Amounts that will not be recovered from customers were charged-off in June 2015.

(b) Excludes gas AMI as to which the company will be required to defer as a regulatory liability the revenue requirement impact of the amount, if any, by which actual average net utility plant balances are less than amounts reflected in rates: \$0.5 million in year 1, \$4.2 million in year 2 and \$7.2 million in year 3.

In January 2018, O&R filed a request with the NYSPSC for an increase in the rates it charges for gas service rendered in New York, effective January 1, 2019, of \$4.5 million. The filing reflects a return on common equity of 9.75 percent and a common equity ratio of 48 percent. The filing proposes continuation of the provisions with respect to recovery from customers of the cost of purchased gas, and the reconciliation of actual expenses

## Notes to the Financial Statements - Continued

allocable to the gas business to the amounts for such costs reflected in gas rates for pension and other postretirement benefit costs, environmental remediation and property taxes.

## Notes to the Financial Statements - Continued

### RECO

Effective period	August 2014 – February 2017	March 2017 (a)
Base rate changes	Yr. 1 – \$13.0 million	Yr. 1 – \$1.7 million
Amortization to income of net regulatory (assets) and liabilities	\$0.4 million over three years and \$(25.6) million of deferred storm costs over four years	\$0.2 million over three years and continuation of \$(25.6) million of deferred storm costs over four years expiring July 31, 2018 (b)
Recoverable energy costs	Current rate recovery of purchased power costs.	Current rate recovery of purchased power costs.
Cost reconciliations	None	None
Average rate base	\$172.2 million	Yr. 1 – \$178.7 million
Weighted average cost of capital (after-tax)	7.83 percent	7.47 percent
Authorized return on common equity	9.75 percent	9.6 percent
Actual return on common equity	Yr. 1 – 9.2 percent Yr. 2 – 8.7 percent	(c)
Cost of long-term debt	5.89 percent	5.37 percent
Common equity ratio	50 percent	49.7 percent

(a) Effective until a new rate plan approved by the NJBPU goes into effect.

(b) In January 2016, the NJBPU approved RECO's plan to spend \$15.7 million in capital over three years to harden its electric system against storms, the costs of which RECO, beginning in 2017, is collecting through a customer surcharge.

(c) Actual return on common equity for first rate year of current rate plan not determinable until March 31, 2018 end of rate year.

In November 2017, FERC approved a September 2017 settlement agreement among RECO, the New Jersey Division of Rate Counsel and the NJBPU that increases RECO's annual transmission revenue requirement from \$11.8 million to \$17.7 million, effective April 2017. The revenue requirement reflects a return on common equity of 10.0 percent.

### Other Regulatory Matters

In December 2017, the NYSPSC issued an order initiating a proceeding to study the potential effects of the TCJA on the tax expenses and liabilities of New York State utilities and the regulatory treatment to preserve the resulting benefits for customers. In January 2018, the NJBPU issued an order initiating a proceeding to consider the TCJA. In March 2018, RECO filed a petition with the NJBPU proposing, effective April 1, 2018, to reduce electric rate base rates by approximately \$2.9 million to reflect the reduction of the company's annual tax expense resulting from the TCJA's reduction in the corporate federal income tax rate. Upon enactment of the TCJA, O&R and RECO re-measured their deferred tax assets and liabilities based upon the TCJA's 21 percent corporate federal income tax rate. As a result: O&R and RECO decreased their net deferred tax liabilities by \$216 million and \$45 million, respectively and decreased their regulatory asset for future income tax by \$51 million and \$17 million, respectively; O&R decreased its regulatory asset for revenue taxes by \$4 million; and O&R and RECO accrued a regulatory liability for future income tax of \$161 million and \$28 million, respectively. See Note I. In January 2018, the NYSPSC issued an order initiating a focused operations audit of the income tax accounting of certain utilities, including O&R.

## Notes to the Financial Statements - Continued

### Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2017 and 2016 were comprised of the following items:

<i>(Millions of Dollars)</i>	2017	2016
<b>Regulatory assets</b>		
Unrecognized pension and other postretirement costs	\$150	\$144
Future income tax (a)	—	114
Environmental remediation costs	116	112
Deferred storm costs (b)	38	57
Property tax reconciliation	26	37
Pension and other postretirement benefits deferrals	22	30
Revenue taxes	11	15
Transition bond charges (b)	9	15
Recoverable energy costs	8	5
Deferred derivative losses	7	6
Other	16	21
<b>Regulatory assets – noncurrent</b>	<b>403</b>	<b>556</b>
Deferred derivative losses	2	5
Recoverable energy costs	2	5
<b>Regulatory assets – current</b>	<b>4</b>	<b>10</b>
<b>Total Regulatory Assets</b>	<b>\$407</b>	<b>\$566</b>
<b>Regulatory liabilities</b>		
Future federal income tax (a)	\$145	\$—
Allowance for cost of removal less salvage	127	114
Pension and other postretirement benefit deferrals	26	31
Carrying charges on deferred tax liability	14	16
Earnings sharing - electric and gas	10	10
Long-term debt interest reconciliation	3	7
Other	23	16
<b>Regulatory liabilities – noncurrent</b>	<b>348</b>	<b>194</b>
Refundable energy costs	25	24
Revenue decoupling mechanism	8	10
Deferred derivative gains	3	4
<b>Regulatory liabilities – current</b>	<b>36</b>	<b>38</b>
<b>Total Regulatory Liabilities</b>	<b>\$384</b>	<b>\$232</b>

(a) See "Federal Income Tax" in Note A, "Other Regulatory Matters," above, and Note I.

(b) See "Accounting Policies" in Note A.

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

*Deferred storm costs* represent response and restoration costs, other than capital expenditures, in connection with Superstorm Sandy and other major storms that were deferred by the Company.

### Note C – Capitalization

#### Common Stock

At December 31, 2017 and 2016, all of the outstanding common stock (\$5.00 par value) of the Company was owned by Con Edison. In accordance with NYSPSC requirements, the dividends that the Company generally may pay to Con Edison are limited to not more than 100 percent of its income available for dividends calculated on a two-year rolling average basis. Excluded from the calculation of "income available for dividends" are non-



## Notes to the Financial Statements - Continued

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 2018-2022 is as follows:

*(Millions of Dollars)*

2018	\$55
2019	62
2020	—
2021	—
2022	—

The carrying amounts and fair values of long-term debt at December 31, 2017 and 2016 are:

<i>(Millions of Dollars)</i>	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-Term Debt (including current portion) (a)	\$661	\$759	\$665	\$751

(a) Amounts shown are net of unamortized debt expense and unamortized debt discount of \$6 million as of December 31, 2017 and 2016.

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

Long-term debt included \$7 million and \$11 million at December 31, 2017 and 2016, respectively, of Transition Bonds issued by Transition Funding in July 2004. The proceeds from the Transition Bonds were used to purchase from RECO the right to be paid a Transition Bond Charge and associated tax charges by its customers relating to previously deferred purchased power costs for which the NJBPU had authorized recovery.

### Significant Debt Covenants

There are no significant debt covenants under the financing arrangements for the debentures of O&R, other than obligations to pay principal and interest when due and covenants not to consolidate with or merge into any other corporation unless certain conditions are met, and no cross default provisions. The Company was in compliance with its significant debt covenants at December 31, 2017.

The failure to comply with debt covenants would, except as otherwise provided, constitute an event of default for 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 provisions applied might and, in certain circumstances would, become due and payable immediately.

### Note D – Short-Term Borrowing

In December 2016, O&R, along with Con Edison and Consolidated Edison Company of New York, Inc. (CECONY), entered into a credit agreement (Credit Agreement), under which banks are committed to provide

## Notes to the Financial Statements - Continued

loans and letters of credit on a revolving credit basis. The Credit Agreement expires in December 2022. There is a maximum of \$200 million of credit available to O&R (subject to increase to \$250 million of credit if the necessary regulatory approvals are requested and obtained). The Credit Agreement supports the Company's commercial paper programs. The Company has not borrowed under the Credit Agreement. At December 31, 2017 and 2016, O&R had \$96 million and \$70 million of commercial paper outstanding, respectively. At December 31, 2017 and 2016, an immaterial amount of letters of credit were outstanding for O&R under the Credit Agreement.

The banks' commitments under the Credit Agreement are subject to certain conditions, including that there be no event of default. The commitments are not subject to maintenance of credit rating levels or the absence of a material adverse change. Upon a change of control of, or upon an event of default by the Company, the banks may terminate their commitments with respect to the Company, declare any amounts owed by the Company under the Credit Agreement immediately due and payable and require the Company to provide cash collateral relating to the letters of credit issued for it under the Credit Agreement. Events of default include the exceeding at any time of a ratio of consolidated debt to consolidated total capital of 0.65 to 1 (at December 31, 2017 this ratio was 0.53 to 1); having liens on its assets in an aggregate amount exceeding five percent of its consolidated total capital, subject to certain exceptions; and the failure, following any applicable notice period, to meet certain other customary covenants. Interest and fees charged for the revolving credit facilities and any loans made or letters of credit issued under the Credit Agreement reflect the Company's credit ratings. The Company was in compliance with its covenants at December 31, 2017.

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

### **Note E – Pension Benefits**

Substantially all employees of O&R are covered by a tax-qualified, non-contributory pension plan maintained by Con Edison, which also covers substantially all employees of CECONY, Con Edison Transmission, Inc. and certain employees of Con Edison's Clean Energy Businesses, Inc. The plan is designed to comply with the Internal Revenue Code and the Employee Retirement Income Security Act of 1974. In addition, Con Edison maintains additional non-qualified supplemental pension plans.

## Notes to the Financial Statements - Continued

### Total Periodic Benefit Cost

The components of the Company's total periodic benefit costs for 2017, 2016 and 2015 were as follows:

<i>(Millions of Dollars)</i>	2017	2016	2015
Service cost – including administrative expenses	\$18	\$17	\$19
Interest cost on projected benefit obligation	37	37	35
Expected return on plan assets	(50)	(48)	(45)
Recognition of net actuarial loss	31	31	42
Recognition of prior service costs	2	2	2
<b>TOTAL PERIODIC BENEFIT COST</b>	<b>\$38</b>	<b>\$39</b>	<b>\$53</b>
Cost capitalized	(12)	(12)	(16)
Reconciliation to rate level	6	(4)	(1)
Cost charged to operating expenses	\$32	\$23	\$36

### Funded Status

The funded status at December 31, 2017, 2016 and 2015, as related to O&R, was as follows:

<i>(Millions of Dollars)</i>	2017	2016	2015
<b>CHANGE IN PROJECTED BENEFIT OBLIGATION</b>			
Projected benefit obligation at beginning of year	\$885	\$888	\$938
Service cost – excluding administrative expenses	17	17	19
Interest cost on projected benefit obligation	37	37	35
Net actuarial (gain)/loss	60	(20)	(64)
Plan amendments	7	3	—
Benefits paid	(43)	(40)	(40)
<b>PROJECTED BENEFIT OBLIGATION AT END OF YEAR</b>	<b>\$963</b>	<b>\$885</b>	<b>\$888</b>
<b>CHANGE IN PLAN ASSETS</b>			
Fair value of plan assets at beginning of year	\$650	\$611	\$592
Actual return on plan assets	105	42	8
Employer contributions	38	39	53
Benefits paid	(43)	(40)	(40)
Administrative expenses	(2)	(2)	(2)
<b>FAIR VALUE OF PLAN ASSETS AT END OF YEAR</b>	<b>\$748</b>	<b>\$650</b>	<b>\$611</b>
<b>FUNDED STATUS</b>	<b>\$(215)</b>	<b>\$(235)</b>	<b>\$(277)</b>
Unrecognized net loss	\$136	\$160	\$203
Unrecognized prior service costs	19	14	13
Accumulated benefit obligation	919	843	849

The increase in the fair value of the pension plan's assets was the primary cause of the decreased pension liability at O&R of \$20 million compared with December 31, 2016. This decrease in pension liability corresponds with a decrease to regulatory assets of \$14 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility business consistent with the accounting rules for regulated operations, a credit to OCI of \$3 million (net of taxes) for the unrecognized net losses and an immaterial change to OCI (net of taxes) for the unrecognized prior service costs associated with RECO.

A portion of the unrecognized net loss and prior service cost for the pension plan, equal to \$35 million and \$2 million, respectively, will be recognized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R.

## Notes to the Financial Statements - Continued

At December 31, 2017 and 2016, the Company's investments included \$29 million and \$27 million, respectively, held in external trust accounts for benefit payments pursuant to the supplemental retirement plan. See Note M. The accumulated benefit obligations for the supplemental retirement plan for O&R were \$34 million and \$35 million as of December 31, 2017 and 2016, respectively.

### Assumptions

The actuarial assumptions were as follows:

	2017	2016	2015
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount rate	3.70%	4.25%	4.25%
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	4.25%	4.25%	3.90%
Expected return on plan assets	7.50%	7.80%	7.80%
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.

### Discount Rate Assumption

To determine the assumed discount rate, the Company uses a model that produces a yield curve based on yields on selected highly rated (Aa or higher by either Moody's Investor Service or S&P Global Ratings) 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 (with the exception of "make-whole" callable bonds), and the amount of the bond issue outstanding must be in excess of \$50 million. The spot rates defined by the yield curve and the plan's projected benefit payments are used to develop a weighted average discount rate.

### Expected Benefit Payments

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

<i>(Millions of Dollars)</i>	2018	2019	2020	2021	2022	2023-2027
O&R	\$51	\$52	\$52	\$53	\$54	\$277

### Expected Contributions

Based on estimates as of December 31, 2017, O&R expects to make contributions to the pension plan during 2018 of \$37 million. O&R's policy is to fund the total periodic benefit cost of the qualified plan to the extent tax deductible.

## Notes to the Financial Statements - Continued

### Plan Assets

The asset allocations for the pension plan at the end of 2017, 2016 and 2015, and the target allocation for 2018 are as follows:

Asset Category	Target Allocation Range	Plan Assets at December 31,		
	2018	2017	2016	2015
Equity Securities	53% - 63%	58%	58%	57%
Debt Securities	28% - 38%	33%	33%	33%
Real Estate	7% - 11%	9%	9%	10%
Total	100%	100%	100%	100%

Con Edison has established a pension trust for the investment of assets to be used for the exclusive purpose of providing retirement benefits to participants and beneficiaries and payment of plan expenses.

Pursuant to resolutions adopted by Con Edison's Board of Directors, the Management Development and Compensation Committee of the Board of Directors (the Committee) has general oversight responsibility for Con Edison's pension and other employee benefit plans. The pension plan's named fiduciaries have been granted the authority to control and manage the operation and administration of the plans, including overall responsibility for the investment of assets in the trust and the power to appoint and terminate investment managers.

The investment objectives of the Con Edison pension plan are to maintain a level and form of assets adequate to meet benefit obligations to participants, to achieve the expected long-term total return on the trust assets within a prudent level of risk and maintain a level of volatility that is not expected to have a material impact on the Company's expected contribution and expense or the Company's ability to meet plan obligations. The assets of the plan have no significant concentration of risk in one country (other than the United States), industry or entity.

The strategic asset allocation is intended to meet the objectives of the pension plan by diversifying its funds across asset classes, investment styles and fund managers. An asset/liability study typically is conducted every few years to determine whether the current strategic asset allocation continues to represent the appropriate balance of expected risk and reward for the plan to meet expected liabilities. Each study considers the investment risk of the asset allocation and determines the optimal asset allocation for the plan. The target asset allocation for 2018 reflects the results of such a study conducted in 2016.

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

## Notes to the Financial Statements - Continued

rebalances the portfolio as appropriate. At the direction of the named fiduciaries, such changes are reported to the Committee.

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

The fair values of the pension plan assets at December 31, 2017 by asset category are as follows:

<i>(Millions of Dollars)</i>	Level 1	Level 2	Total
<b>Investments within the fair value hierarchy</b>			
U.S. Equity (a)	\$3,872	\$28	\$3,900
International Equity (b)	4,132	—	4,132
U.S. Government Issued Debt (c)	—	1,786	1,786
Corporate Bonds Debt (d)	—	2,450	2,450
Structured Assets Debt (e)	—	3	3
Other Fixed Income Debt (f)	—	125	125
Cash and Cash Equivalents (g)	124	352	476
Futures (h)	308	—	308
<b>Total investments within the fair value hierarchy</b>	<b>\$8,436</b>	<b>\$4,744</b>	<b>\$13,180</b>
<b>Investments measured at NAV per share (n)</b>			
Private Equity (i)			336
Real Estate (j)			1,214
Hedge Funds (k)			251
<b>Total investments valued using NAV per share</b>			<b>\$1,801</b>
Funds for retiree health benefits (l)	(168)	(94)	(262)
Funds for retiree health benefits measured at NAV per share (l)(n)			(36)
<b>Total funds for retiree health benefits</b>			<b>\$(298)</b>
<b>Investments (excluding funds for retiree health benefits)</b>	<b>\$8,268</b>	<b>\$4,650</b>	<b>\$14,683</b>
Pending activities (m)			(409)
<b>Total fair value of plan net assets</b>			<b>\$14,274</b>

- (a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and actively-managed small-capitalization equities.
- (b) International Equity includes international equity index funds and actively-managed international equities.
- (c) U.S. Government Issued Debt includes agency and treasury securities.
- (d) Corporate Bonds Debt consists of debt issued by various corporations.
- (e) Structured Assets Debt includes commercial-mortgage-backed securities and collateralized mortgage obligations.
- (f) Other Fixed Income Debt includes municipal bonds, sovereign debt and regional governments.
- (g) Cash and Cash Equivalents include short term investments, money markets, foreign currency and cash collateral.
- (h) Futures consist of exchange-traded financial contracts encompassing U.S. Equity, International Equity and U.S. Government indices.
- (i) Private Equity consists of global equity funds that are not exchange-traded.
- (j) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.
- (k) Hedge Funds are within a commingled structure which invests in various hedge fund managers who can invest in all financial instruments.
- (l) The Company sets aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Companies' other postretirement benefit obligation. See Note F.
- (m) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received and reflects adjustments for available estimates at year end.
- (n) In accordance with ASU 2015-07, Fair Value Measurements (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or its equivalent), certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

## Notes to the Financial Statements - Continued

The fair values of the pension plan assets at December 31, 2016 by asset category are as follows:

<i>(Millions of Dollars)</i>	Level 1	Level 2	Total
<b>Investments within the fair value hierarchy</b>			
U.S. Equity (a)	\$3,466	\$—	\$3,466
International Equity (b)	3,187	371	3,558
U.S. Government Issued Debt (c)	—	1,337	1,337
Corporate Bonds Debt (d)	—	2,140	2,140
Structured Assets Debt (e)	—	1	1
Other Fixed Income Debt (f)	—	200	200
Cash and Cash Equivalents (g)	147	389	536
Futures (h)	296	68	364
<b>Total investments within the fair value hierarchy</b>	<b>\$7,096</b>	<b>\$4,506</b>	<b>\$11,602</b>
<b>Investments measured at NAV per share (n)</b>			
Private Equity (i)			247
Real Estate (j)			1,139
Hedge Funds (k)			229
<b>Total investments valued using NAV per share</b>			<b>\$1,615</b>
Funds for retiree health benefits (l)	(165)	(105)	(270)
Funds for retiree health benefits measured at NAV per share (l)(n)			(37)
<b>Total funds for retiree health benefits</b>			<b>\$(307)</b>
<b>Investments (excluding funds for retiree health benefits)</b>	<b>\$6,931</b>	<b>\$4,401</b>	<b>\$12,910</b>
Pending activities (m)			(438)
<b>Total fair value of plan net assets</b>			<b>\$12,472</b>

(a) - (n) Reference is made to footnotes (a) through (n) in the above table of pension plan assets at December 31, 2017 by asset category.

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

<i>(Millions of Dollars)</i>	<b>For the Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
O&R	\$4	\$3	\$3

### Note F – Other Postretirement Benefits

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

## Notes to the Financial Statements - Continued

### Total Periodic Benefit Cost

The components of the Company's total periodic other postretirement benefit costs for 2017, 2016 and 2015 were as follows:

<i>(Millions of Dollars)</i>	2017	2016	2015
Service cost – including administrative expenses	\$6	\$5	\$5
Interest cost on projected other postretirement benefit obligation	9	8	7
Expected return on plan assets	(9)	(10)	(9)
Recognition of net actuarial loss	6	2	3
Recognition of prior service costs	(6)	(6)	(6)
<b>TOTAL PERIODIC OTHER POSTRETIREMENT BENEFIT COST</b>	<b>\$6</b>	<b>\$(1)</b>	<b>\$—</b>
Cost capitalized	(2)	1	—
Reconciliation to rate level	(2)	—	8
Cost charged to operating expenses	\$2	\$—	\$8

### Funded Status

The funded status of the programs at December 31, 2017, 2016 and 2015 were as follows:

<i>(Millions of Dollars)</i>	2017	2016	2015
<b>CHANGE IN BENEFIT OBLIGATION</b>			
Benefit obligation at beginning of year	\$191	\$193	\$208
Service cost	6	5	5
Interest cost on accumulated postretirement benefit obligation	9	8	7
Net actuarial loss/(gain)	37	(5)	(18)
Benefits paid and administrative expenses	(10)	(11)	(10)
Participant contributions	1	1	1
<b>BENEFIT OBLIGATION AT END OF YEAR</b>	<b>\$234</b>	<b>\$191</b>	<b>\$193</b>
<b>CHANGE IN PLAN ASSETS</b>			
Fair value of plan assets at beginning of year	\$122	\$123	\$133
Actual return on plan assets	20	8	(2)
EGWP payments	3	1	2
Employer contributions	8	—	—
Participant contributions	1	1	1
Benefits paid	(10)	(11)	(11)
<b>FAIR VALUE OF PLAN ASSETS AT END OF YEAR</b>	<b>\$144</b>	<b>\$122</b>	<b>\$123</b>
<b>FUNDED STATUS</b>	<b>\$(90)</b>	<b>\$(69)</b>	<b>\$(70)</b>
Unrecognized net loss	\$38	\$18	\$23
Unrecognized prior service costs	(7)	(13)	(19)

The increase in the other postretirement benefit plan obligation was the primary cause of the increased liability for other postretirement benefits at O&R of \$21 million compared with December 31, 2016. This increased liability corresponds with an increase to regulatory assets of \$21 million for unrecognized net losses and unrecognized prior service costs associated with O&R's New York utility business consistent with the accounting rules for regulated operations, a debit to OCI of \$2 million (net of taxes) for the unrecognized net losses and a debit to OCI of \$1 million (net of taxes) for the unrecognized prior service costs associated with RECO.



## Notes to the Financial Statements - Continued

A portion of the unrecognized net losses and prior service costs for the other postretirement benefits, equal to \$7 million and \$(4) million, respectively, will be recognized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for O&R.

### Assumptions

The actuarial assumptions were as follows:

	2017	2016	2015
Weighted-average assumptions used to determine benefit obligations at December 31:			
Discount Rate	3.70%	4.20%	4.20%
Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:			
Discount Rate	4.20%	4.20%	3.85%
Expected Return on Plan Assets	7.50%	7.00%	7.75%

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, 2017 was 5.80 percent, which is assumed to decrease gradually to 4.50 percent by 2024 and remain at that level thereafter. The health care cost trend rate used to determine benefit obligations as of December 31, 2017 was 5.60 percent, which is assumed to decrease gradually to 4.50 percent by 2024 and remain at that level thereafter.

A one percentage point change in the assumed health care cost trend rate would have the following effects in 2017:

<i>(Millions of Dollars)</i>	One Percentage Point	
	Increase	Decrease
Effect on accumulated other postretirement benefit obligation	\$32	\$(24)
Effect on service cost and interest cost components for 2017	3	(2)

### Expected Benefit Payments

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

<i>(Millions of Dollars)</i>	2018	2019	2020	2021	2022	2023-2027
O&R	\$10	\$10	\$11	\$11	\$11	\$59

### Expected Contributions

Based on estimates as of December 31, 2017, O&R expects to make an immaterial contribution to the other postretirement benefit plans in 2018.

## Notes to the Financial Statements - Continued

### Plan Assets

The asset allocations for O&R's other postretirement benefit plans at the end of 2017, 2016 and 2015 and the target allocation for 2018 are as follows:

Asset Category	Target Allocation Range	Plan Assets at December 31,		
	2018	2017	2016	2015
Equity Securities	75% -85%	80%	60%	59%
Debt Securities	15% - 25%	20%	40%	41%
Total	100%	100%	100%	100%

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

Refer to Note E for a discussion of Con Edison's investment policy for the assets held by its benefit plans.

The fair values of the plan assets at December 31, 2017 by asset category as defined by the accounting rules for fair value measurements (see Note M) are as follows:

<i>(Millions of Dollars)</i>	Level 1	Level 2	Total
Equity (a)	\$—	\$113	\$113
Other Fixed Income Debt (b)	—	28	28
Cash and Cash Equivalents (c)	—	1	1
Total investments	\$—	\$142	\$142
Pending activities (d)			2
Total fair value of plan net assets			\$144

- (a) Equity includes a passively managed commingled index fund benchmarked to the MSCI All Country World Index.  
 (b) Other Fixed Income Debt includes a passively managed commingled index fund benchmarked to the Barclays Capital Aggregate Index.  
 (c) Cash and Cash Equivalents include short term investments and money markets.  
 (d) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received, and reflects adjustments for available estimates at year end.

The fair values of the plan assets at December 31, 2016 by asset category (see Note M) are as follows:

<i>(Millions of Dollars)</i>	Level 1	Level 2	Total
Equity (a)	\$—	\$73	\$73
Other Fixed Income Debt (b)	—	48	48
Cash and Cash Equivalents (c)	—	1	1
Total investments	\$—	\$122	\$122
Pending activities (d)			—
Total fair value of plan net assets			\$122

(a) - (d) Reference is made to footnotes (a) through (d) in the above table of other postretirement benefit plan assets at December 31, 2017 by asset category.

### 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.

## Notes to the Financial Statements - Continued

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 December 31, 2017 and 2016 were as follows:

<i>(Millions of Dollars)</i>	2017	2016
Accrued Liabilities:		
Manufactured gas plant sites	\$99	\$97
Other Superfund Sites	1	1
Total	\$100	\$98
Regulatory assets	\$116	\$112

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. O&R estimates that in 2018, it will incur costs for remediation of approximately \$13 million. 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 electric and gas rate plans, the Company is permitted to recover or defer as regulatory assets (for subsequent recovery through rates) prudently incurred site investigation and remediation costs. The amount of site investigation and remediation costs to be recovered is reduced by, among other things, insurance recoveries. The June 2015 Joint Proposal for the electric and gas rate plans provides that the NYSPSC may

## Notes to the Financial Statements - Continued

consider and address the amount of any claims for site investigation and remediation costs under third-party liability policies denied by an insurer with which O&R was then engaged in litigation. The insurer has denied coverage of claims submitted by O&R for approximately \$15 million of site investigation and remediation costs (which costs have been deferred as regulatory assets). In September 2015, the New York State Court of Appeals denied O&R's motion for leave to appeal adverse coverage determinations by lower courts. In December 2015, at the NYSPSC's direction, O&R made a filing explaining why the site investigation and remediation costs that were the subject of the litigation over insurance coverage should be recovered through rates.

Environmental remediation costs incurred related to Superfund Sites for the years ended December 31, 2017 and 2016 were as follows:

<i>(Millions of Dollars)</i>	2017	2016
Remediation costs incurred	\$5	\$13

No insurance recoveries were received by the Company for the years ended December 31, 2017 and 2016.

In 2017, 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 \$156 million. These estimates were based on assumptions regarding the extent of contamination and the type and extent of remediation that may be required. Actual experience may be materially different.

## Notes to the Financial Statements - Continued

### Asbestos Proceedings

Suits have been brought in New York State and federal courts against O&R and many other defendants, wherein a large number of plaintiffs sought large amounts of compensatory and punitive damages for deaths and injuries allegedly caused by exposure to asbestos at various O&R premises. The suits that have been resolved, which are many, have been resolved without any payment by O&R, or for amounts that were not, in the aggregate, material to the Company. The amounts specified in all the remaining suits total billions of dollars; however, the Company believes that these amounts are greatly exaggerated, based on the disposition of previous claims. At December 31, 2017 and 2016, 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 as shown in the following table. The estimates were based upon a combination of modeling, historical data analysis and risk factor assessment. Courts have begun, and unless otherwise determined on appeal may continue, to apply different standards 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 December 31, 2017 and 2016 were as follows:

<i>(Millions of Dollars)</i>	2017	2016
Accrued liability – asbestos suits	\$0.4	\$0.4
Regulatory assets – asbestos suits	0.4	0.4
Accrued liability – workers' compensation	\$4.1	\$4.4

### Note H - Leases

O&R's leases include rights of way for electric and gas distribution facilities, office buildings and automobiles. In accordance with the accounting rules for leases, these leases are classified as either capital or operating leases. Generally, it is expected that leases will be renewed or replaced in the normal course of business.

Capital leases: For ratemaking purposes capital leases are treated as operating leases; therefore, in accordance with the accounting rules for regulated operations, the amortization of the leased asset is based on the rental payments recovered from customers. The following asset under capital leases is included in O&R's balance sheet at December 31, 2017 and 2016:

<i>(Millions of Dollars)</i>	2017	2016
Utility Plant - General	\$0.7	\$0.9

## Notes to the Financial Statements - Continued

The accumulated amortization of the capital lease was \$1.4 million and \$1.2 million at December 31, 2017 and 2016, respectively.

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

Operating leases: The future minimum lease commitments under the Company's operating lease agreements that are not cancellable by the Company are as follows:

<i>(Millions of Dollars)</i>	
2018	\$0.9
2019	1.0
2020	0.9
2021	0.9
2022	0.5
All years thereafter	0.3
<b>Total</b>	<b>\$4.5</b>

For information about changes to the accounting rules for leases, see Note P.

### Note I – Income Tax

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

<i>(Millions of Dollars)</i>	2017	2016	2015
State			
Current	\$7	\$5	\$6
Deferred	(1)	—	1
Federal			
Current	23	23	17
Deferred	13	8	6
<b>Total income tax expense</b>	<b>\$42</b>	<b>\$36</b>	<b>\$30</b>

## Notes to the Financial Statements - Continued

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

<i>(Millions of Dollars)</i>	2017	2016
Deferred tax liabilities:		
Property basis differences	\$385	\$558
Regulatory assets:		
Unrecognized pension and other postretirement costs	42	58
Future income tax	—	46
Environmental remediation costs	32	45
Deferred storm costs	11	22
Other regulatory assets	28	56
<b>Total deferred tax liabilities</b>	<b>498</b>	<b>785</b>
Deferred tax assets:		
Accrued pension and other postretirement costs	\$74	\$109
Regulatory liabilities		
Future income tax	40	—
Other regulatory liabilities	66	94
Superfund and other environmental costs	28	39
Other	3	8
<b>Total deferred tax assets</b>	<b>211</b>	<b>250</b>
<b>Net deferred tax liabilities</b>	<b>\$287</b>	<b>\$535</b>
Unamortized investment tax credits	1	1
<b>Net deferred tax liabilities and unamortized investment tax credits</b>	<b>\$288</b>	<b>\$536</b>

The TCJA includes significant changes affecting the taxation of regulated public utilities, such as O&R and RECO. Substantially all of the provisions of the TCJA are effective for taxable years beginning after December 31, 2017. The TCJA reduces the corporate federal income tax rate from 35 percent to 21 percent. The specific provisions related to regulated public utilities in the TCJA generally allow for the continued deductibility of interest expense, do not allow for full expensing for tax purposes of certain property acquired after September 27, 2017, and continue certain rate normalization requirements for accelerated depreciation benefits.

In accordance with the accounting rules for income taxes (see “Federal Income Tax” in Note A), the tax effects of changes in tax laws are to be recognized in the period in which the law is enacted and deferred tax assets and liabilities are to be re-measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. For O&R and RECO, in accordance with their New York and New Jersey rate plans, respectively, and the accounting rules for regulated operations, the change in deferred taxes was recorded as either an offset to a regulatory asset or a regulatory liability. See “Accounting Policies” in Note A and “Rate Plans” in Note B.

Upon enactment of the TCJA, O&R re-measured its deferred tax assets and liabilities based upon the TCJA’s 21 percent corporate federal income tax rate. As a result, O&R, decreased its net deferred tax liabilities by \$261 million (including \$45 million for RECO), decreased its regulatory asset for future income tax by \$68 million (including \$17 million for RECO), decreased its regulatory asset for revenue taxes by \$4 million, and accrued a regulatory liability for future income tax of \$189 million (including \$28 million for RECO). Since O&R is in a net regulatory liability position with respect to these income tax matters, O&R netted the regulatory asset for future income tax against the regulatory liability for future income tax. Under the rate normalization requirements

## Notes to the Financial Statements - Continued

continued by the TCJA, \$142 million of the net regulatory liability (including \$16 million for RECO) related to certain accelerated tax depreciation benefits is to be amortized over the remaining lives of the related assets. The remainder of the net regulatory liability is to be refunded (or credited) to customers as determined by the NYSPPSC or NJBPU, as applicable. See “Other Regulatory Matters” in Note B. The re-measurement had no impact on O&R’s net income or cash flows for 2017.

O&R made an accounting policy election to apply SEC Staff Accounting Bulletin 118 (SAB 118) when the TCJA was enacted. SAB 118 clarifies accounting for income taxes if information is not yet available or complete and provides for up to a one year period in which to complete the required analyses and accounting. SAB 118 describes three scenarios associated with a company’s status of accounting for income tax reform: (1) a company is complete with its accounting for certain effects of tax reform, (2) a company is able to determine a reasonable estimate for certain effects of tax reform and records that estimate as a provisional amount, or (3) a company is not able to determine a reasonable estimate and therefore continues to apply the accounting rules for income taxes, based on the provisions of the tax laws that were in effect immediately prior to the TCJA being enacted. O&R has completed the required analysis and accounting for substantially all the effects of the TCJA’s enactment and has made a reasonable estimate as to the other effects, and has reflected the measurement and accounting of the effects in its 2017 consolidated financial statements. The items reflected as provisional amounts include tax depreciation and amortization and other book/tax differences. O&R has accounted for these items based on its interpretation of the TCJA. Further interpretive guidance on the TCJA from the Internal Revenue Service (IRS), U.S. Treasury Department, or the Joint Committee on Taxation may require adjustments to O&R’s accounting. In accordance with SAB 118, adjustments, if any, will be recorded in 2018. O&R did not identify any effects of the TCJA for which it was not able to either complete the required analysis or make a reasonable estimate.

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:

<i>(% of Pre-tax income)</i>	2017	2016	2015
<b>STATUTORY TAX RATE</b>			
Federal	35%	35%	35%
<b>Changes in computed taxes resulting from:</b>			
State income tax	4	4	5
Cost of removal	2	2	(3)
Corporate-owned life insurance policy	—	(3)	(2)
Other	(1)	—	1
<b>Effective tax rate</b>	<b>40%</b>	<b>38%</b>	<b>36%</b>

The Protecting Americans from Tax Hikes Act of 2015 extended bonus depreciation for property acquired and placed in service during 2015 through 2019. The bonus depreciation percentage is 50 percent for property placed in service during 2015, 2016 and 2017 and phases down to 40 percent in 2018, and 30 percent in 2019. As a result of the extension of bonus depreciation to 2015, Con Edison received a refund from the IRS in February 2016 of \$15 million in estimated federal tax payments for O&R. The TCJA does not allow bonus depreciation for property acquired and placed into service by regulated public utilities after September 27, 2017.



## Notes to the Financial Statements - Continued

### Uncertain Tax Positions

Under the accounting rules for income taxes, O&R is not permitted to recognize the tax benefit attributable to a tax position unless such position is more likely than not to be sustained upon examination by taxing authorities, including resolution of any related appeals and litigation processes, based solely on the technical merits of the position.

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

<i>(Millions of Dollars)</i>	2017	2016	2015
Balance at January 1,	\$3	\$3	\$3
Additions based on tax positions of prior years	—	—	—
Reductions for tax positions of prior years	—	—	—
Balance at December 31,	\$3	\$3	\$3

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 statements. In 2017, 2016 and 2015, O&R recognized an immaterial amount of interest and no penalties for uncertain tax positions in its consolidated income statements. At December 31, 2017 and 2016, O&R recognized an immaterial amount of accrued interest and no penalties in its consolidated balance sheets.

The Company does not expect the total amount of uncertain tax positions to significantly increase or decrease within the next twelve months. At December 31, 2017, the total amount of unrecognized tax benefits that, if recognized, would reduce O&R's effective tax rate is \$3 million.

Federal tax returns for 2012 through 2016 remain under examination, with tax refunds for tax years 2012 through 2015 waiting for approval by the Joint Committee on Taxation. State income tax returns remain open for examination in New York for tax years 2010 through 2016 and in New Jersey for tax years 2008 through 2016.

### Note J - Stock-Based Compensation

O&R may compensate employees under Con Edison's stock-based compensation plans with, among other things, stock options, restricted stock units and contributions to the stock purchase plan. The Long Term Incentive Plan, which was approved by Con Edison's shareholders in 2003 (2003 LTIP), and the Long Term Incentive Plan, which was approved by Con Edison's shareholders in 2013 (2013 LTIP), are collectively referred to herein as the LTIP. The LTIP provides for, among other things, awards to employees of restricted stock units and stock options. Existing awards under the 2003 LTIP continue in effect, however no new awards may be issued under the 2003 LTIP. The 2013 LTIP provides for awards for up to five million shares of common stock.

Shares of Con Edison common stock used to satisfy O&R's obligations with respect to stock-based compensation may be new (authorized, but unissued) shares, treasury shares or shares purchased in the open market. The shares used during the year ended December 31, 2017 were new shares. Con Edison intends to use new shares to fulfill its stock-based compensation obligations for 2018.

## Notes to the Financial Statements - Continued

The Company has recognized stock-based compensation expense using a fair value measurement method. The following table summarizes stock-based compensation expense recognized by the Company in the years ended December 31, 2017, 2016 and 2015:

<i>(Millions of Dollars)</i>	2017	2016	2015
Performance-based restricted stock	\$4.9	\$4.6	\$2.6
Time-based restricted stock	0.1	0.1	0.1
Stock purchase plan	0.3	0.3	0.3
Total	\$5.3	\$5.0	\$3.0
Income tax benefit	\$2.1	\$2.0	\$1.2

### Stock Options

Stock options were last granted in 2006. The stock options generally vested over a three-year period and had a term of ten years. Options were granted at an exercise price equal to the fair market value of a common share when the option was granted. The Company generally recognized compensation expense (based on the fair value of stock option awards) over the vesting period. At December 31, 2017 and 2016, there were no outstanding options.

The aggregate intrinsic value of options exercised in 2016 was \$0.3 million. Aggregate intrinsic value represents the changes in the fair value of all outstanding options from their grant dates to December 31, 2016. Cash received by Con Edison for payment of the exercise price for options in 2016 was \$0.4 million. No options were exercised in 2017.

### Restricted Stock Units

Restricted stock unit awards under the LTIP have been made as follows: (i) awards that provide for adjustment of the number of units (performance-restricted stock units or Performance RSUs) to certain officers and employees; and (ii) time-based awards to certain employees. Restricted stock units awarded represents the right to receive, upon vesting, shares of Con Edison common stock, or, the cash value of shares or a combination thereof.

The number of units in each annual Performance RSU award 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 200 percent, based on Con Edison's total shareholder return relative to a specified peer group during a specified performance period (the TSR portion); and (ii) 50 percent of the units awarded will be multiplied by factors that may range from 0 to 200 percent, based on determinations made in connection with O&R's annual incentive plans or, for certain executive officers, actual performance as compared to certain performance measures during a specified performance period (the non-TSR portion). Performance RSU awards generally vest upon completion of the performance period.

Performance against the established targets is recomputed each reporting period as of the earlier of the reporting date and the vesting date. The TSR portion applies a Monte Carlo simulation model, and the non-TSR

## Notes to the Financial Statements - Continued

portion is the product of the market price at the end of the period and the average non-TSR determination over the vesting period. Performance RSUs 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 assumptions used to calculate the fair value of the awards were as follows:

	2017	2016	2015
Risk-free interest rate (a)	1.76% - 1.89%	0.85% - 1.20%	0.64% - 3.28%
Expected term (b)	3 years	3 years	3 years
Expected share price volatility (c)	11.01% - 14.70%	17.72% - 18.22%	15.82%

(a) The risk-free rate is based on the U.S. Treasury zero-coupon yield curve.

(b) The expected term of the Performance RSUs equals the vesting period. The Company does not expect significant forfeitures to occur.

(c) Based on historical experience.

A summary of changes in the status of the Performance RSUs’ TSR and non-TSR portions during the year ended December 31, 2017 is as follows:

	Weighted Average Grant Date Fair Value (a)		
	Units	TSR Portion (b)	Non-TSR Portion (c)
Non-vested at December 31, 2016	109,811	\$54.84	\$62.68
Granted	32,102	73.39	74.39
Vested	(39,630)	25.41	53.65
Forfeited	(4,429)	75.08	71.39
Transferred (d)	(1,358)	63.12	52.41
Non-vested at December 31, 2017	96,496	\$72.05	\$70.03

(a) The TSR and non-TSR Portions each account for 50 percent of the awards’ value.

(b) Fair value is determined using the Monte Carlo simulation described above. Weighted average grant date fair value does not reflect any accrual or payment of dividends prior to vesting.

(c) Fair value is determined using the market price of one share of Con Edison common stock on the grant date. The market price has not been discounted to reflect that dividends do not accrue and are not payable on Performance RSUs until vesting.

(d) Represents allocation to another Con Edison subsidiary of a portion of the Performance RSUs that had been awarded to an O&R officer who transferred to the other subsidiary.

The total expense to be recognized by the Company in future periods for unvested Performance RSUs outstanding at December 31, 2017 is \$4 million and is expected to be recognized over a weighted average period of one year.

In accordance with the accounting rules for stock compensation, for time-based awards, the Company has accrued a liability based on the market value of a Con Edison common share on the grant date and is recognizing compensation expense over the vesting period. The vesting period for awards is three years and is based on the employee’s continuous service to O&R. Prior to vesting, the awards are subject to forfeiture in whole or in part under certain circumstances. The awards are “liability awards” because each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, prior to vesting, changes in the fair value of the units are reflected in net income. A summary of changes in the status of time-based awards during the year ended December 31, 2017 is as follows:

## Notes to the Financial Statements - Continued

	Units	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2016	3,400	\$64.36
Granted	1,200	77.66
Vested	(1,000)	53.65
Forfeited	(150)	66.21
Non-vested at December 31, 2017	3,450	\$72.01

The total expense to be recognized by the Company in future periods for unvested time-based awards outstanding at December 31, 2017 was immaterial and is expected to be recognized over a weighted average period of one year.

### Stock Purchase Plan

Under the Con Edison Stock Purchase Plan, which was approved by shareholders in 2004 and 2014, the Company contributes up to \$1 for each \$9 invested by its officers or employees to purchase Con Edison common stock under the plan. 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 percent 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 2017, 2016 and 2015, 719,125, 720,268 and 761,784 shares were purchased under the Stock Purchase Plan at a weighted average price of \$79.57, \$72.67 and \$62.75 per share, respectively.

### Note K – Financial Information by Business Segment

The business segments of the Company, which are its operating segments, were determined based on management's reporting and decision-making requirements in accordance with the accounting rules for segment reporting.

The Company's principal business segments are its regulated electric and gas utility activities.

All revenues of these business segments are from customers located in the United States of America. Also, all assets of the business segments are located in the United States of America. The accounting policies of the segments are the same as those described in Note A.

Common services shared by the business segments are assigned directly or allocated based on various cost factors, depending on the nature of the service provided.

The financial data for the business segments are as follows:

## Notes to the Financial Statements - Continued

As of and for the Year Ended December 31, 2017 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Other Income (deductions)	Interest charges	Income taxes on operating income (a)	Total assets	Construction expenditures
Electric	\$642	\$—	\$51	\$100	\$1	\$24	\$30	\$1,949	\$128
Gas	232	—	20	41	—	12	12	824	61
<b>Total</b>	<b>\$874</b>	<b>\$—</b>	<b>\$71</b>	<b>\$141</b>	<b>\$1</b>	<b>\$36</b>	<b>\$42</b>	<b>\$2,773</b>	<b>\$189</b>

As of and for the Year Ended December 31, 2016 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Other Income (deductions)	Interest charges	Income taxes on operating income (a)	Total assets	Construction expenditures
Electric	\$637	\$—	\$49	\$95	\$1	\$24	\$30	\$1,949	\$114
Gas	184	—	18	35	—	12	10	809	52
<b>Total</b>	<b>\$821</b>	<b>\$—</b>	<b>\$67</b>	<b>\$130</b>	<b>\$1</b>	<b>\$36</b>	<b>\$40</b>	<b>\$2,758</b>	<b>\$166</b>

As of and for the Year Ended December 31, 2015 (Millions of Dollars)	Operating revenues	Inter- segment revenues	Depreciation and amortization	Operating income	Other Income (deductions)	Interest charges	Income taxes on operating income (a)	Total assets	Construction expenditures
Electric	\$663	\$—	\$50	\$103	\$(2)	\$23	\$31	\$2,140	\$114
Gas	182	—	18	18	(2)	12	2	579	46
<b>Total</b>	<b>\$845</b>	<b>\$—</b>	<b>\$68</b>	<b>\$121</b>	<b>\$(4)</b>	<b>\$35</b>	<b>\$33</b>	<b>\$2,719</b>	<b>\$160</b>

(a) The income tax expense/(benefit) on non-operating income was \$- million, \$(3) million and \$1 million in 2017, 2016 and 2015, respectively.

### Note L – 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 consolidated balance sheet at fair value (see Note M), 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.

The fair values of the Company's commodity derivatives including the offsetting of assets and liabilities on the consolidated balance sheet at December 31, 2017 and 2016 were:

(Millions of Dollars)	2017			2016		
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	\$5	\$(2)	\$3	\$8	\$(8)	\$—
Noncurrent	1	—	1	7	(7)	—
Total fair value of derivative assets	\$6	\$(2)	\$4	\$15	\$(15)	\$—
Fair value of derivative liabilities						
Current	\$(4)	\$1	\$(3)	\$(9)	\$4	\$(5)
Noncurrent	(7)	—	(7)	(13)	7	(6)
Total fair value of derivative liabilities	\$(11)	\$1	\$(10)	\$(22)	\$11	\$(11)
Net fair value derivative assets/(liabilities)	\$(5)	\$(1)	\$(6)	\$(7)	\$(4)	\$(11)

(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

## Notes to the Financial Statements - Continued

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.

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. See "Recoverable Energy Costs" in Note A. In accordance with the accounting rules for regulated operations, the Company records a regulatory asset or liability to defer recognition of unrealized gains and losses on its 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 CECONY (CECONY together with O&R, the Utilities) have combined their gas requirements, and contracts to meet those requirements, into a single portfolio. The combined portfolio is administered by, and related management services (including hedging market price fluctuations associated with the physical purchase of gas) are provided by, CECONY (for itself and as agent for O&R) and costs (net of the effect of the related hedging transactions) are allocated between the Utilities in accordance with provisions approved by the NYSPPSC. See Note O.

The following table presents the realized and unrealized gains or losses on commodity derivatives that have been deferred for the years ended December 31, 2017 and 2016:

<i>(Millions of Dollars)</i>	<b>Balance Sheet Location</b>	<b>2017</b>	<b>2016</b>
Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations:			
Current	Deferred derivative gains	\$(1)	\$4
Noncurrent	Deferred derivative gains	1	(1)
Total deferred gains/(losses)		\$0	\$3
Current	Deferred derivative losses	\$3	\$5
Current	Recoverable energy costs	(11)	(18)
Noncurrent	Deferred derivative losses	(1)	(2)
Total deferred gains/(losses)		\$(9)	\$(15)
Net deferred gains/(losses)		\$(9)	\$(12)

The following table presents the hedged volume of the Company's derivative transactions at December 31, 2017:

<b>Electric Energy (MWh) (a)</b>	<b>Capacity (MW) (a)</b>	<b>Natural Gas (Dt) (a)</b>
2,155,550	5,760	8,310,000

(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

## Notes to the Financial Statements - Continued

replacement cost of open positions represents unrealized gains, net of any unrealized losses where the Company has a legally enforceable right of offset.

At December 31, 2017, the Company had \$2 million of credit exposure in connection with energy supply and hedging activities, net of collateral, primarily related to investment-grade counterparties.

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 December 31, 2017:

*(Millions of Dollars)*

Aggregate fair value – net liabilities (a)	\$7
Collateral posted	5
Additional collateral (b) (downgrade one level from current ratings)	—
Additional collateral (b) (downgrade to below investment grade from current ratings)	4 (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 required to post an immaterial amount of collateral at December 31, 2017. 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 December 31, 2017, if the Company had been downgraded to below investment grade, it would not have been required to post additional collateral.

### Note M – Fair Value Measurements

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

## Notes to the Financial Statements - Continued

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.
- 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, 2017 and 2016 are summarized below.

<i>(Millions of Dollars)</i>	2017					2016				
	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)	\$—	\$3	\$1	\$—	\$4	\$—	\$—	\$3	\$(3)	\$—
Other (a)(b)(d)	23	6	—	—	29	22	5	—	—	27
<b>Total assets</b>	<b>\$23</b>	<b>\$9</b>	<b>\$1</b>	<b>\$—</b>	<b>\$33</b>	<b>\$22</b>	<b>\$5</b>	<b>\$3</b>	<b>\$(3)</b>	<b>\$27</b>
Derivative liabilities:										
Commodity (a)(b)(c)	\$—	\$4	\$5	\$1	\$10	\$—	\$8	\$2	\$1	\$11



## Notes to the Financial Statements - Continued

- (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 \$1 million of commodity derivative liabilities transferred from level 3 to level 2 during the year ended December 31, 2017 because of availability of observable market data due to the decrease in the terms of certain contracts from beyond three years as of September 30, 2017 to less than three years as of December 31, 2017. There were no transfers between levels 1, 2 and 3 for the year ended December 31, 2016.
- (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 December 31, 2017 and 2016, 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 non-qualified retirement plan.
- (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 verifies 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.

Commodity	Fair Value of Level 3 at December 31, 2017 (Millions of Dollars)	Valuation Techniques	Unobservable Inputs	Range
Electricity	\$(4)	Discounted Cash Flow	Forward capacity prices (a)	\$1.50-\$9.40 per kW- month

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

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the years ended December 31, 2017 and 2016 and classified as Level 3 in the fair value hierarchy:

<i>(Millions of Dollars)</i>	2017	2016
Beginning balance as of January 1,	\$1	\$1
Included in earnings	4	—
Included in regulatory assets and liabilities	(6)	—
Purchases	—	—
Settlements	(4)	—
Transfer out of level 3	1	—
Ending balance as of December 31,	\$(4)	\$1

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

## Notes to the Financial Statements - Continued

### Note N - Asset Retirement Obligations

The Company recognizes a liability at fair value for legal obligations associated with the retirement of long-lived assets in the period in which they are incurred, or when sufficient information becomes available to reasonably estimate the fair value of such legal obligations. The Company evaluates these assumptions underlying the asset retirement obligation liability on an annual basis or as frequently as needed. Any such obligations identified by the Company were immaterial.

The Company includes in depreciation rates the estimated removal costs, less salvage, for utility plant assets. The amounts related to removal costs that are associated with asset retirement obligations are classified as an asset retirement liability. Pursuant to accounting rules for regulated operations, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities. Accretion and depreciation expenses related to removal costs that represent legal asset retirement obligations are applied against the Company's regulatory liabilities. Asset retirement costs that are recoverable from customers are recorded as regulatory liabilities to reflect the timing difference between costs recovered through the rate-making process and recognition of costs. The related net regulatory liabilities recorded for the Company were \$127 million and \$112 million at December 31, 2017 and 2016, respectively.

### Note O – Related Party Transactions

The Company provides and receives administrative and other services to and from Con Edison and its subsidiaries pursuant to cost allocation procedures developed in accordance with rules approved by the NYSPPSC 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 years ended December 31, 2017, 2016 and 2015 were as follows:

<i>(Millions of Dollars)</i>	2017	2016	2015
Cost of services provided	\$17	\$17	\$17
Cost of services received	\$52	\$47	\$43

At December 31, 2017 and 2016, O&R's payable to Con Edison and its other subsidiaries associated with these services was \$6 million and \$4 million, respectively.

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which O&R purchased from CECONY \$66 million and \$47 million of natural gas for the years ended December 31, 2017 and 2016, respectively. These amounts are net of the effect of related hedging transactions. At December 31, 2017 and 2016, O&R's net payable to CECONY associated with these gas purchases was \$10 million and \$11 million, respectively.

## Notes to the Financial Statements - Continued

At December 31, 2017 and 2016, the Company's net payable to Con Edison for income taxes was \$20 million and \$2 million, respectively.

FERC has authorized CECONY through 2019 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 December 31, 2017 and 2016, there were no loans outstanding for O&R.

### **Note P – New Financial Accounting Standards**

In January 2018, the Company adopted Accounting Standards Update (ASU) No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," including the amendments thereto, (the New Standard) using the modified retrospective approach the New Standard permitted. The New Standard supersedes the revenue recognition requirements within Accounting Standards Codification Topic 605, "Revenue Recognition," and most industry-specific guidance (the Superseded Standard)." The purpose of the New Standard is to create a consistent framework for revenue recognition. The New Standard clarifies how to measure and recognize revenue arising from customer contracts to depict the transfer of goods or services in an amount that reflects the consideration the entity expects to receive. The New Standard also clarifies key areas including principal/agent considerations, performance obligations, licensing, sales taxes, noncash consideration, and contracts.

The majority of the Company's revenues are derived from the provision of electric and gas service to customers pursuant to the terms of tariffs approved by the NYSPSC or NJBPU. For such service, the Company expects that the revenue from contracts with customers for a period that will be recorded under the New Standard will be equivalent to the revenue for the period that would have been recorded under the Superseded Standard.

Under the modified retrospective method of adoption, prior year reported results are not restated and a cumulative-effect adjustment, if applicable, is recorded to retained earnings at January 1, 2018. As of January 1, 2018, the cumulative-effect adjustment was not material to the Company. The Company also plans to use certain practical expedients including applying this guidance to open contracts at the date of adoption and recognizing revenues for certain contracts under the invoice practical expedient. Such expedients allow revenue recognition to be consistent with invoiced amounts (including estimated billings) provided certain criteria are met, including consideration of whether the invoiced amounts reasonably represent the value provided to customers.

The adoption of the New Standard will not have a material impact on the Company's financial statements, results of operations, and liquidity, including the presentation of revenues in its consolidated income statements. The adoption of the New Standard will not require a change in the Company's internal control over financial reporting that is reasonably likely to materially affect its internal control over financial reporting.

## Notes to the Financial Statements - Continued

In February 2016, the FASB issued amendments on financial reporting of leasing transactions through ASU No. 2016-02, "Leases (Topic 842)." The amendments require lessees to recognize assets and liabilities on the balance sheet and disclose key information about leasing arrangements. Lessees will need to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). Lessor accounting is similar to the current model, but updated to align with certain changes to the lessee model. For income statement purposes, the pattern of expense recognition will depend on whether transactions are designated as operating leases or finance leases. In January 2018, the FASB issued amendments on the lease standard's application to land easements through ASU No. 2018-01, "Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842." The amendments allow an entity to not evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously accounted for as leases under the current lease standard. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. The amendments must be adopted using a modified retrospective transition and provide for certain practical expedients. Based on the existing portfolio of leases at implementation, for leases currently classified as operating leases, the Company expects to recognize on the statements of financial position right-of-use assets and lease liabilities. The Company is in the process of evaluating the potential impact of the new guidance on the Company's financial position, results of operations and liquidity.

In January 2017, the FASB issued amendments to the guidance for business combinations through ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." The amendments in this update clarify the definition of a business and provide guidance on evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and liquidity.

In January 2017, the FASB issued amendments to the guidance for the subsequent measurement of goodwill through ASU 2017-04, "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this update simplify goodwill impairment testing by eliminating Step 2 of the goodwill impairment test wherein an entity has to compute the implied fair value of goodwill by performing procedures to determine the fair value of its assets and liabilities. Under the new guidance, an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value up to the total amount of goodwill allocated to that reporting unit. The amendments are effective for fiscal years beginning after December 15, 2021. Early adoption is permitted. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and liquidity.

In February 2017, the FASB issued amendments to the guidance for other income through ASU 2017-05, "Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying

## Notes to the Financial Statements - Continued

the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.” The amendments in this update clarify the scope of assets within Subtopic 610-20 and add guidance for partial sales of nonfinancial assets. The amendments are effective upon the adoption of ASU 2014-09, and therefore will be effective for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The application of this guidance is not expected to have a material impact on the Company’s financial position, results of operations and liquidity.

In March 2017, the FASB issued amendments to the guidance for the retirement benefits through ASU 2017-07, “Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” The amendments in this update modify the presentation of net benefit cost, where the service component must be disaggregated from the other components of net benefit cost and be presented in the same line item as current employee compensation costs. The remaining components of the net benefit cost should be presented outside of income from operations. Additionally, the update allows only the service cost component to be eligible for capitalization. The amendments are effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted. The guidance allows a practical expedient that permits the use of amounts disclosed in prior-period financial statements as appropriate estimates when applying the presentation requirements retrospectively. The Company has elected to use the practical expedient under ASU 2017-07. The application of this guidance is not expected to have a material impact on the Company’s financial position, results of operations and liquidity.

In March 2017, the FASB issued amendments to the guidance for debt securities through ASU 2017-08, “Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.” The amendments in this update shorten the amortization period for certain callable debt securities held at a premium. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments are effective for annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. Early adoption is permitted. The application of this guidance is not expected to have a material impact on the Company’s financial position, results of operations and liquidity.

In May 2017, the FASB issued amendments to the guidance for stock compensation through ASU 2017-09, “Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting.” The amendments in this update specify that changes to value, vesting conditions, or classification of an existing share-based payment award require application of modification accounting in Topic 718. The amendments are effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, beginning after December 15, 2017. 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 - Continued

In August 2017, the FASB issued amendments to the guidance for derivatives and hedging through ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The amendments in this update provide greater clarification on hedge accounting for risk components, presentation and disclosure of hedging instruments, and overall targeted improvements to simplify hedge accounting. The amendments are effective for annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. Early adoption is permitted. The Company is in the process of evaluating the potential impact of the new guidance on the Company's financial position, results of operations and liquidity.

In February 2018, the FASB issued amendments to the guidance for reporting comprehensive income through ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA. The amendments are effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. The Company is in the process of evaluating the potential impact of the new guidance on the Company's financial position, results of operations and liquidity.

### **Note Q – Dispositions**

#### **Pike**

In October 2015, O&R entered into an agreement to sell Pike to Corning Natural Gas Holding Corporation (Corning). In August 2016, the sale was completed. O&R received cash consideration of \$15 million for the sale. O&R has agreed to provide transition services to Corning for operations and customer support for a period of up to 18 months subsequent to the sale. In addition, O&R will continue to purchase and sell to Pike electric and gas commodity for three years. Pike has an option to extend the commodity procurement service for up to an additional three years. At September 30, 2015, O&R recorded an impairment charge of \$5 million (\$3 million, net of taxes), representing the difference between the carrying amount of Pike's assets and the estimated sales proceeds.