

Consolidated Edison Company of New York, Inc.
Orange & Rockland Utilities, Inc.

Annual Report on Property Tax Reduction Efforts
Year 2015

Background

This is the annual report of Consolidated Edison Company of New York, Inc. (“Con Edison”) and Orange and Rockland Utilities, Inc. (“Orange and Rockland” or “O&R”) on their ongoing efforts to reduce property tax obligations.¹ Con Edison and Orange and Rockland (collectively, the “Company”) have continuously sought to reduce property tax liabilities and the customer bill impacts that are caused by high property taxes.

The Company strives to pay no more than its fair share of property taxes through negotiation with municipalities and other initiatives to reduce tax liabilities associated with property assessments. Assessments increase when property is added to the Company’s utility systems or when property values increase. The Company has a long and successful record of aggressively undertaking efforts to reduce its overall property tax burden through assessment reductions. Nevertheless, the Company has an enormous tax burden. In calendar year 2015, Con Edison incurred \$1.2 billion of property taxes in New York City (“NYC” or the “City”), \$162.1 million in Westchester County and \$11.9 million in other areas primarily located in upstate New York. Orange and Rockland’s 2015 liability to New York State (“NYS”) municipalities amounted to \$61.1 million.

This report presents some general background information on property taxes for regulated utilities; summarizes the amount of property taxes incurred in 2015; explains the limitations on the Company’s ability to mitigate its property tax obligation; discusses certain legislative initiatives under consideration; and discusses the Company’s efforts to pay no more than its fair share of property taxes.

¹ This report is filed pursuant to Con Edison’s current rate plans in Cases 13-E-0030 (electric), 13-G-0031 (gas) & 13-S-0032 (steam). The Company is continuing its historic practice of also including in this report efforts to reduce O&R’s property taxes.

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Property taxes are levied based on the “value” of taxable property. The Company is subject to two types of property taxes: special franchise tax and real estate tax. Special franchise tax is paid on equipment owned by utilities situated on, over or under land that is owned by the public, such as roads, highways and bridges. Real estate tax is paid on land, structures, and equipment located on property owned by the Company or on other privately-owned property.

The real property tax is an “ad valorem” tax, meaning it is based on the value of real property. With few exceptions, all tangible utility properties, plus the value of the franchise right to operate in the public way, are assessable for property tax purposes.

The State Board of Real Property Tax Services (the “SBRPTS”) is charged with valuing special franchise utility property and the Office of Real Property Tax Services (the “ORPTS”), part of the New York State Department of Taxation and Finance, effectuates the policies of the SBRPTS. Local tax assessors are charged with valuing real estate property. NYS law provides no standard, formulaic methodology for assessing real property. Additionally, many local property assessors have little experience in determining the value of utility property. Commonly used valuation techniques, such as benchmarking properties based on recent sales of comparable properties, are ineffective in the utility industry because there are very few sales of utility properties. The Company owns properties in dozens of municipalities, and each municipality can develop its own approach or method in determining the taxable value of the Company’s properties. As a result of this property tax system, the Company often finds that the same or similar utility assets are assessed at markedly different values, depending on whether the asset is valued by the ORPTS or by a local assessor, and depending on the valuation method employed by the local assessor in each specific

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municipality. The Company is attempting to address varying assessment practices through proposed Central Assessment legislation, discussed later in this report.

Real estate taxes are paid on land and other real property (structures) but, unlike companies in other industries, the Company's real estate taxes are also paid on its facilities and equipment constructed on its land or within its structures and, with only a few exceptions, is paid on all utility equipment. However, as noted above, utility equipment cannot be valued like other real estate because there is not a ready resale market in order to derive a fair value. Therefore, the New York State Real Property Tax Law ("RPTL") requires only that the value of tangible utility property be measured, but does not prescribe a specific valuation method.

In NYS, property values may be ascertained using three different techniques: Market or Comparable Value; Income; or Cost.

NYS court decisions have determined that utility property is "specialty property" and is to be valued under a Cost methodology; the proper Cost methodology for valuation in NYS is Reproduction Cost New Less Depreciation ("RCNLD"). Under this approach, the Company's historic asset costs are trended using a construction cost index to arrive at an estimated reproduction cost, which is then reduced by a depreciation allowance. The computed RCNLD is considered a specialty property's market or full value. The ORPTS, NYC assessors, and some other local assessors use RCNLD for valuing utility property; however, RCNLD can be implemented in various ways.

RCNLD calculates what it would cost to reproduce property at current construction costs based on a trending index, subtracts an allowance for depreciation and obsolescence, if any, and adds the value of land to arrive at a "value" for the entire

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property. The RCNLD methodology is only used to value certain of the Company's structures and all of its taxable equipment. The value of land is determined by using comparable sales data.

Property taxes change because either the tax rate changes or the assessed value of the property changes. In NYS, the main revenue source to balance local municipal budgets is property taxes. Local budgets are strongly influenced by general economic conditions. Economic conditions are outside of the Company's control making it difficult for the Company to control its property tax costs. In addition, the Company has no control over tax rates, leaving assessment challenges, when warranted, as our only recourse to manage property tax liability within the framework of existing law.

Although the majority of the Company's plant assets are taxable, certain Company-owned property is not subject to property tax since it is not assessable under the RPTL. For instance, meters and portions of services crossing from the public right-of-way to a customer's property are not taxed. The theory is that the utility connection increases the private property value, capturing the assessment of the utility facilities located on the property in the assessment of that property. In addition, the Company's general equipment, such as computers, office furniture and vehicles, constitutes personal property, and is not subject to property tax.

Obstacles to Reducing Property Taxes

Each year the Company makes sizeable investments in infrastructure in order to maintain and improve service to customers. The Company's infrastructure additions far outweigh its asset retirements, and these investments increase the value of the Company's properties in taxing jurisdictions. These increased values, coupled with

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increases in property tax rates, cause the Company's property taxes to increase, despite its successful challenges to assessed values of plant in service.

One of the largest hurdles in managing the Company's tax burden is the property tax law itself. As noted, the RPTL subjects virtually all of our infrastructure investments to NYS property taxation. Although not unique in the United States, the RPTL section 102.12 (e) and (f) specifically includes public utility property in the definition of real property, below:

(e) Mains, pipes and tanks permitted or authorized to be made, laid or placed in, upon, above or under any public or private street or place for conducting steam, heat, water, oil, electricity or any property, substance or product capable of transportation or conveyance therein or that is protected thereby;

(f) Boilers, ventilating apparatus, elevators, plumbing, heating, lighting and power generating apparatus, shafting other than counter-shafting and equipment for the distribution of heat, light, power, gases and liquids, but shall not include movable machinery or equipment consisting of structures or erections to the operation of which machinery is essential, owned by a corporation taxable under article nine-a of the tax law, used for trade or manufacture and not essential for the support of the building, structure or superstructure, and removable without material injury thereto;

No other companies in the City's business class (Class 4) pay property tax on the equipment they own, as their tax is paid only on their real estate (land) and buildings. Likewise, other businesses in NYS are not required to pay tax on their equipment. If property tax was applied to the State's manufacturing industry it would likely drive the manufacturing industry out of the state – it makes no sense to collect property taxes on

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machinery used in the manufacture of goods. It makes no sense that an electric cable transporting energy under or over the streets of New York is subject to property tax.

In other states, property taxes are not normally applied to utility equipment. For instance, in New Jersey, the Company's affiliate, Rockland Electric Company, pays property taxes only on the land and structures it owns, not on its equipment in the public right-of-way and not on its equipment on its own property or within its buildings. The Company's Pennsylvania affiliate, Pike County Light & Power Company, is taxed in the same manner.

This practice of taxing total infrastructure investment is fully outside the control of the Company and is the principal driver of the Company's annual tax increases. Without a sea change in how taxes are levied in NYS, the Company will remain a principal tax payer, with the burden growing each year fueled by the need to invest in infrastructure which, in turn, leads to higher and higher energy costs.

For example, if \$2 billion of infrastructure investment were added in the City, Con Edison would pay an annual property tax of approximately \$100 million on that infrastructure investment. As the investment ages, the RCNLD methodology restates that investment to a value that would allow for an exact reproduction of the asset, reduced by a depreciation allowance that effectively results in a continuation of the original \$100 million tax burden for many years to come. Although not as dramatic outside of the City, the same holds true for Con Edison's infrastructure investments in Westchester and upstate New York, and the same is true for Orange and Rockland's investment in Orange, Rockland, Sullivan and Ulster counties.

Another major hurdle in managing our property tax cost is the classification system in NYC. There are four classes:

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- Classes 1 and 2 pertain to various forms of residential property.
- Class 3 contains most utility property. Special franchise property is included within this class.
- Class 4 contains all commercial and industrial properties, such as office, retail, factory buildings and all other properties not included in tax classes 1, 2 or 3.

With minor exceptions covering certain vacant land that is classified within the residential classes, the vast majority of the Company's property is included in Class 3, with the remainder included in Class 4. Each class is responsible for a specific share of the property tax levy, known as the "class share."

This classification system virtually ensures that Con Edison will pay an unfair tax burden compared to other businesses. It does so by singling out public utilities and keeping Con Edison as a big fish in a small pond. It ensures that the utility class pays a disproportionate share of the tax levy in relation to their market value, and it prevents the Company's assessment increases from being phased-in over a number of years to ease the impact of large market value changes.

Although Con Edison had tried for many years to have Classes 3 and 4 combined, no lasting progress has been made other than raising awareness of the issue. Although once endorsed by both NYC and the Real Estate Board of New York ("REBNY"), neither currently supports the class merger. Without the support of NYC, it is highly unlikely that the merger of Classes 3 and 4 will occur absent overall property tax reform in NYC.

Assuming the RPTL continues to tax utility equipment, notwithstanding court rulings to the contrary, the true cost basis on which to tax utility property should be a

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valuation based on rate base. Such a valuation would produce a fairer value since it is the basis upon which a utility is permitted to earn a specified rate of return. Generally, rate base represents the property that is “used and useful” in providing energy service. It is based on prudent original cost investment with a deduction for accumulated depreciation.

RCNLD is not appropriate because the Company’s energy system would not, for a variety of reasons, be reproduced in its existing state. The Company has advocated for valuation based on rate base in virtually all of its discussions with municipalities and government officials, but without statewide valuation for all public utility property, implementation of such a proposal has little hope of success, as it would result in a significant assessment reduction for utility companies.

Efforts to Reduce Property Taxes – Real Estate Taxes

The Company has aggressively challenged its property tax assessments in an effort to pay no more than its fair share of property taxes. The Company has been and remains very concerned with the level of property taxes in its service territory and the impact of these taxes on customer bills. Property tax amounts are a function of a tax rate multiplied by an assessed value. Since the Company has no influence or control over the tax rates that municipalities set, its focus is on the fairness of assessed values set by the municipalities.

Each year the Company reviews its property assessments to determine if they fall within a range of reasonableness under an RCNLD valuation. This approach to valuation begins with the original cost of property, which is then trended to the current year using Handy Whitman indices to arrive at an estimated current cost to reproduce

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the property. That valuation is then reduced by a depreciation allowance, which includes a net salvage value (removal costs). Net salvage represents the net cost, either positive or negative (although net salvage is usually negative for utility property), to remove a property at the end of its useful life and, as such, either increases or decreases the property's assessed value. The RCNLD methodology, used for valuation purposes by the ORPTS and the NYC assessors, develops what is considered the current market or full value of utility property. If the actual assessments vary substantially from the Company's RCNLD calculations, it files complaints with the applicable taxing authorities. The Company first attempts to settle these complaints through negotiation, as it believes that a settlement is a more cost efficient way of reducing our tax burden than more expensive prolonged litigation, which requires independent appraisals and the outcome of which is uncertain. The Company does, however, pursue litigation when efforts to reach a fair compromise fail.

Efforts to Reduce Property Taxes – NYC Real Estate Taxes

Con Edison has a history of property tax challenges against the City covering real estate property assessments for tax years 1994/95 through 2015/16. Following settlement with respect to production assets at Hudson Avenue, Ravenswood and Astoria Generating Stations,² Con Edison and the NYC Law Department have continued to meet to address the remaining generating station properties, as well as substations and other properties covered by ongoing tax controversy.

The Company's initial plan was to bring seven properties to trial. These properties include the three generating stations in Manhattan (59th Street, 74th Street

² The Astoria and Ravenswood Generating Stations were divested by the Company in 1999. The Hudson Avenue Generating Station remains the property of Con Edison but was retired in 2010.

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and East River) along with four substation properties, one each in Manhattan, Bronx, Brooklyn and Queens. Appraisals have been exchanged on the valuations of the 59th Street and 74th Street steam generating stations. The trial of the proceedings covering the 74th Street steam generating station was scheduled for February 16, 17, and 18, 2016, however, it was postponed in order for the Company and the City to continue settlement discussions. A trial covering the 59th Street steam generating station will be scheduled for a later date.

In October 2015, the Company again filed real property tax petitions with the NYC Tax Commission seeking assessment reductions for many of its properties, adding another year of litigation against the City.

Aside from litigation, and as reported in the past, Con Edison has for several years secured the tax benefits provided under the Industrial and Commercial Incentive Program (“ICIP”) in NYC. The ICIP was instituted to encourage the development, expansion and preservation of commercial and industrial real estate. The ICIP grants a property tax exemption for the additional real property taxes that would otherwise be payable as a result of eligible industrial and commercial construction work. Con Edison has filed ICIP applications for projects involving the construction of new facilities and substations, substation renovations, and substation upgrades. The Company filed for and received the exemption for 20 projects, some of which included multiple filings which, assuming current tax rates, will generate more than \$1 billion in tax savings over the course of their benefit periods, which range from 12 to 25 years. Despite efforts by Con Edison to extend the ICIP program, the program expired as of June 30, 2008. Con Edison continues, however, to receive benefits for the projects that were eligible under ICIP. During the 2015/2016 fiscal year, Con Edison estimates that the tax savings related to ICIP will amount to \$65 million.

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Efforts to Reduce Property Taxes – NYC Special Franchise Taxes

The Company commenced proceedings in Supreme Court, Albany County, challenging the ORPTS' special franchise full values for the City's 2009/10 through 2015/16 assessment rolls. The court has consolidated the proceedings for trial, and discovery has been largely completed. Con Edison has obtained a preliminary appraisal of the property, portions of which it intends to share with NYS and NYC as an impetus for settlement negotiations.

The special franchise complaints allege that the ORPTS's application of the RCNLD methodology produces anomalous results that significantly overstate the value of special franchise property. The complaints are based on the fact that the ORPTS does not properly taking into account the effects of:

- Changes in the cost of materials;
- Depreciation due to use of an artificial property age ceiling in relation to the property's average service life; and
- The proper level of Economic Obsolescence ("EO") and Functional Obsolescence ("FO").

Regarding obsolescence, although the Company has challenged the allowances in our special franchise tax legal actions, Con Edison continues to apply for and receive EO and FO benefits. A request for an EO benefit is filed on all services (electric, gas and steam), and a request for the FO benefit is filed on Con Edison's gas low pressure distribution mains. For 2016, Con Edison was approved for a reduction for economic obsolescence of 13% on its gas plant and 5% on its steam plant, which will be applied to the 2016 NYC special franchise full values. Con Edison also requested a reduction

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for obsolescence for excess capacity in the gas distribution low pressure system from ORPTS. The ORPTS will apply reductions for functional obsolescence on the gas distribution mains as follows:

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|----------------------|-----|
| City of Yonkers | 9% |
| Borough of Bronx | 11% |
| Borough of Manhattan | 10% |
| Borough of Queens | 8% |

Efforts to Reduce Property Taxes – Outside of NYC

The Company aggressively challenges property tax assessments outside of the City and, as a result, Con Edison has reached property tax settlements with many of the cities, towns, and villages in upstate New York. These settlements cover a significant amount of the Company's property outside of NYC, and assessments continue to be monitored in all of these areas to see if additional challenges are warranted.

For each of the following five Westchester communities: New Castle, North Castle, Mt. Pleasant, Eastchester, and Greenburgh, tentative settlements were entered into in late 2015, phasing in reductions to Con Edison's assessments on properties contested over a three year period. The Company estimates the tax savings in New Castle to be \$100,000 in the first year and \$300,000 over the term of the agreement. In North Castle, it estimates the tax savings to be \$92,000 in the first year and \$275,000 over the term of the agreement. The Company estimates the tax savings in Mt. Pleasant to be \$443,000 in the first year and \$1,330,000 over the term of the agreement. In Eastchester, it estimates the tax savings to be \$253,000 in the first year and \$759,000 over the term of the agreement. It estimates the tax savings in Greenburgh to be \$359,000 in the first year and \$1,076,000 over the term of the agreement. The

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Company expects that the five settlements will be approved by the Court in the next few months.

In Yorktown, discussions and meetings were held with the assessor in 2014, and a settlement was reached without the need to file a tax certiorari petition. The settlement includes assessment reductions that will be phased-in over three years. Those reductions resulted in an estimated tax savings of \$153,000 in 2015 and \$256,000 over the three-year term.

During 2015, Orange and Rockland reached settlements with the City of Middletown and the Towns of Blooming Grove, Clarkstown, Orangetown, and Ramapo.

Late in 2014, O&R began settlement discussions with officials from the Towns of Ramapo³ and Clarkstown, as well as with the assessor from Orangetown, and reached settlements with all three towns during 2015. To illustrate the value of some of these property tax settlements, in 2014, O&R paid \$58.1 million in property taxes, of which the aforementioned towns received \$27.4 million or 47% of the taxes paid. In addition, Con Edison paid an additional \$4.7 million dollars to Ramapo. The settlement principles we agreed to with Clarkstown, Orangetown, and Ramapo are unique in that the assessment methodology is locked in for ten years unless central assessment becomes the law in NYS. Additionally, the new methodology allows for the ORPTS depreciation lives and removal cost factors and, most significantly, an increased depreciation allowance. The tax savings for the Company's customers from these settlements are significant. In Clarkstown, O&R estimates the tax savings to be \$210,000 in the first year and \$3,530,000 over the term of the agreement. It estimates the tax savings for Orangetown to be \$110,000 in the first year and \$1,788,000 over the term of the agreement. In Ramapo, Con Edison estimates the tax savings to be \$274,000 in the

³ The majority of property in Ramapo is owned by Orange & Rockland, but the Ramapo and Ladentown substations owned by Con Edison are also included in the negotiations.

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first year and \$10,807,000 over the term of the agreement. O&R estimates the tax savings for Ramapo to be \$161,000 in the first year and \$6,347,000 over the term of the agreement. Actual savings will exceed these estimates, as the Company adds new plant in these municipalities. The Company negotiated these settlements in lieu of seeking refunds of prior years' taxes through litigation. Both sides agreed to prospective tax reductions, as neither side wanted to engage in costly litigation.

In the City of Middletown, proceedings were commenced by O&R challenging the assessments for years 2010 through 2014 on a parcel of property that used to contain a liquid propane tank farm. The tanks were removed from service in 2009, sold and removed from the property in 2011, however the assessment of the property was never reduced. O&R has negotiated a settlement with the City of Middletown, and the stipulation and order has been signed by the parties and the judge and is awaiting entry of the order by the clerk's office. O&R estimates the tax savings for the City of Middletown to be \$73,200 in the first year and \$555,300 over the term of the agreement.

Proceedings were commenced by against the Town of Blooming Grove challenging the 2013 and 2014 assessments on O&R's Blooming Grove office building. Subsequently, O&R and the Town of Blooming Grove entered into a settlement with respect to the 2015 assessment, resulting in an estimated tax savings of \$462,000 in the first year and \$1,849,000 over the three years of the agreement. The 2013 and 2014 cases are still pending in court.

Legislative Efforts

The Company pursues and/or supports changes in law that could result in a reduction of its property tax liability.

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Con Edison has long supported a change to merge the two non-residential property classes (Classes 3 and 4) in NYC. A merger would put the Company's property in a larger pool of properties, and allow property tax assessment increases to be phased over a five-year period, thereby limiting the volatility of property tax assessment changes and tempering the negative effects of tax rate increases on the Company without reducing the City's property tax revenue. However, there has been little progress in this area other than raising awareness of the issue. After several years of attempts, the Company no longer has the support of the City or the Real Estate Board of New York to merge these classes. Without the support of these major entities, it is highly unlikely that the merger of Classes 3 and 4 will occur absent overall property tax reform in NYC.

Representatives of the Company have met with representatives from the NYS Department of Taxation and Finance to discuss a proposal concerning centralizing property tax assessments by the ORPTS. The Company's proposal was also discussed with the Westchester County Assessor's Association. In addition, the Company has met with other utilities in New York to gauge their interest in pursuing this legislation, and has received generally positive feedback.

Under the Company's proposal, all properties that are valued locally would be valued by the ORPTS. The Company believes that the ORPTS's staff is in the best position to value utility properties due to their expertise and independence. Central assessment by the ORPTS would reduce the number of separate tax grievances that

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the Company files, and would also provide for a uniform method of assessment state-wide. In addition, the ORPTS property assessments are generally more current and transparent, as the Company is required to report all of its property additions to the ORPTS. Overall, the ORPTS property assessments may result in tax reductions on many of the Company's properties, however, the main goal of the proposal is to create assessment uniformity, predictability and transparency. In fact, central assessment could also provide some financial relief to local governments who must secure outside expertise to value certain complex utility properties, and are frequently required to defend these assessments in court, resulting in appraisal and legal fees and property tax refunds resulting from successful legal challenges brought by utility companies.

The Company has been involved in efforts to get central assessment legislation enacted for some time. In fact, the proposal became law in 2013 for telecom companies. However, a last minute change resulted in the exclusion of electric, gas and steam utilities from the legislation.

The Company strongly believes that the true market value of utility property for property tax purposes is rate base, as opposed to RCNLD. It has discussed this approach to valuation with local officials, whose primary concern is the loss of revenues. However, using rate base for valuation purposes has a number of advantages. A concern of local officials has always been transparency on assessments, and rate base offers that transparency. Moreover, the rate base standard is used in valuing utilities in merger and acquisition activities. Although the proposal is in its infancy, the Company plans to introduce it to the legislature in an up-coming session.