

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

**Annual Report on
Property Tax Reduction Efforts – 2010**

Introduction

This report documents the efforts taken during 2010 by Consolidated Edison Company of New York, Inc. (“Con Edison” or “CECONY”) and Orange and Rockland Utilities, Inc. (“Orange and Rockland” or “O&R”) to reduce their property tax obligations. Con Edison and Orange & Rockland (“the Companies”) are aware of the adverse impact that excessive property tax levies on the Companies create for its customers, as well as for the region’s economic competitiveness. The Companies continuously strive to ensure they pay no more than their fair share of property taxes through legislation, negotiation with municipalities, and other initiatives to reduce assessments. When negotiations fail, or when inequities continue despite the Companies’ continuing efforts to reach an accommodation with governmental authorities, litigation becomes necessary.

The New York State Real Property Tax Law subjects utility-owned land and equipment to taxation. The real property tax is an “ad valorem” tax, meaning it is based on the value of real property. All tangible utility property operating on, under, or above both privately-owned (real estate tax) and publicly-owned rights-of-way (special franchise tax), plus the value of the intangible right to operate in the public way for utilities holding special franchises, is assessable for property tax purposes, unless specifically excluded.

The difference between special franchise and real estate property is essentially that special franchise property consists of equipment owned by utilities situated on, over, or under land that is owned by the public, such as roads, highways, and bridges. Real estate includes land, structures, and equipment located on property owned by the Companies, or on other privately-owned property.

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The State Board of Real Property Tax Services (“SBRPTS”) is charged with valuing special franchise utility property. The Office of Real Property Tax Services (“ORPTS”) effectuates the policies of the SBRPTS. Local assessors, generally employees of the local municipality, are responsible for valuing utility property on privately-owned property.

In New York State, property may be valued in one of three ways:

- Market or comparable value,
- Income, or
- Cost.

Land and certain of the Companies’ structures are valued at market. For instance, the Companies’ headquarters buildings are treated the same as any other office building in the state for valuation purposes. The same is true for land. However, the Companies’ equipment cannot be valued that way since no ready market exists for that type of property. New York State law does not prescribe a valuation method for utility property, other than that the tangible property value must be measured.

New York court rulings have established that utility property is "specialty property," and the proper methodology for valuation of specialty property is Reproduction Cost New Less Depreciation (“RCNLD”). Using this methodology, the Companies’ historic asset costs are trended by using a construction cost index to arrive at reproduction cost, then reproduction cost is reduced to account for a depreciation allowance. The computed RCNLD is a specialty property’s market or full value. The ORPTS and some local assessors use RCNLD for valuing utility property.

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Certain of the Companies' properties are not subject to property tax since they are not assessable under the Real Property Tax Law. For instance, meters and portions of services crossing from the public right-of-way to the customer's property are not taxed. The theory is that placement of the utility equipment on the homeowners' property increases homeowners' property values, so they are assessed for the utility property located on their own property. The Companies' general equipment, such as personal computers, office furniture, and vehicles, is personal property, and is not taxed.

Merge Property Class 3 and Class 4 in New York City

CECONY's principal ongoing legislative initiative is our effort to merge New York City's utility class (Class 3) with the general business class (Class 4) to allow Con Edison and its customers to benefit from a reduced tax rate in the merged class. Assembly bill A03184 was reintroduced in early 2011 by Assemblyman Jonathan Bing, and co-sponsored by Assemblyman Guillermo Linares and three other Assembly members. The Senate bill, S150A, was reintroduced in 2011 by Senator George Maziarz. Con Edison's efforts to accomplish the merger have been extensive. Con Edison wrote the legislation, found the sponsors for the bills in both houses, sought and received the support of others including other utilities and the Real Estate Board of New York, organized several meetings with various parties, and through a letter to each member of the legislature in September 2009, explained Con Edison's position on the merger and its benefits to our customers in an attempt to seek their support.

The real property classification system is a major concern for Con Edison because New York City's classified property tax system divides the City's real property tax burden among four classes, including one specifically for utility real property (Class

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3). CECONY's property comprises approximately 79% of this class by assessed value.¹ Therefore, little protection from tax rate increases exists, since few other taxpayers share in the increases in this class. Additionally, Class 3 taxpayers do not receive the benefit of the transitional five-year phase-in of assessment increases that is available to Class 4 taxpayers. Transitional assessments will help to limit volatility.

OTHER PROPERTY TAX INITIATIVES

Additionally, the Companies are involved in a number of other initiatives to reduce or better forecast property taxes. The Companies note that, in recent years, the RCNLD methodology for certain of its asset accounts has been highly volatile, producing large, unexpected, and unpredictable changes in assessments. Accordingly, the Companies are in the process of addressing property tax reductions and volatility in the following manner:

- Challenge the utility assessment community's full reliance on the Handy-Whitman Index to escalate asset costs for property tax valuation purposes. The Handy-Whitman Index has recently been volatile for certain of Con Edison's largest asset accounts, which may be distorting the true trend in the value of our utility property. Therefore, the Companies are seeking to identify or develop an alternative, more viable, index.
- Review the Companies' asset base to determine whether certain types of costs currently capitalized for rate base purposes can be eliminated from the property tax base (e.g., paving costs and interference costs).

¹ Con Edison, National Grid, and Verizon New York comprise approximately 94 percent of the Class 3 special franchise property.

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- Challenge the 5% intangible value added to all special franchise assessments.
- Adjust Depreciation Service Lives, Net Salvage Values, and Floors and consider challenges that would alter the current curve to accelerate allowances. Additionally, consider a challenge to the floor limiting recoverability to 80% for non-special franchise property and a stepped 95% for special franchise property.

After an extensive vetting of several companies, we have contracted with AUS Consultants, a firm that focuses exclusively on the utility industry, to assist us in these efforts. The Companies believe AUS has the experience, both nationally and in New York, and the expertise to help us in each of the areas we had identified to challenge the Companies' property tax liability.

Real Estate Activities Outside of New York City

Because it is difficult to obtain cash refunds from municipalities and school districts, especially during difficult economic times, both CECONY and O&R often structure their settlements to secure a partial refund, as well as future assessment reductions, in lieu of a full cash refund.

Over the last decade, CECONY has reached property tax settlements with a substantial number of municipalities outside of New York City. In Westchester, agreements have been reached with the cities of Mt. Vernon, New Rochelle, Rye, White Plains, and Yonkers, and with the towns of Cortlandt, Greenburgh, Harrison, Mt. Kisco, Mt. Pleasant, New Castle, Ossining, Peekskill, and Yorktown. In the upstate counties of

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Orange, Rockland, Dutchess, and Putnam, Con Edison has reached settlements with the towns of Carmel, Chester, East Fishkill, LaGrange, Ramapo, Stony Point, Tuxedo, and the Village of Hillburn.

Orange & Rockland has reached settlements in Rockland County with the towns of Clarkstown, Haverstraw, Orangetown, Ramapo, and with the Village of Hillburn. In Orange County, agreements have been reached with the towns of Blooming Grove, Chester, and Wawayanda, and in Sullivan County with the towns of Lumberland and Forestburgh.

These settlements, which cover a significant amount of both Companies' real estate property, have substantially reduced the Companies' property tax liability on its real estate properties located outside of New York City. For properties where the tax amounts exceed a minimum dollar threshold, both Companies continue to monitor assessments to ensure that they do not, once again, fall outside of an acceptable tolerance around a RCNLD valuation. When they do, the Companies file additional challenges.

Currently, Con Edison has outstanding challenges against Pleasant Valley and LaGrange. As to Pleasant Valley, during 2010, the town appealed a decision in Con Edison's favor on a service issue with respect to years 2004 through 2008, thereby delaying the trial for those years. CECONY argued the appeal and ultimately prevailed in February 2011, paving the way for a trial of all open years. However, in March 2011 the trial judge recused himself from the matter for unknown reasons, resulting in the adjournment of a conference scheduled for April 7, as well as the trial date scheduled for November 7, 2011. The conference and trial dates will be set by the new justice assigned to this matter.

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Orange & Rockland has outstanding challenges against Monroe, Middletown, and Tuxedo. Discussions to settle Monroe and Middletown have taken place, and requests for judicial intervention and notes of issue have been filed for each of the back years. In Tuxedo, the town has served O&R with an extensive discovery demand.

During 2010, the Companies reached settlements with the Village of Hillburn (O&R), the Town of Forestburgh (O&R), and the City of Peekskill (Con Edison). The agreement reached with the City of Peekskill, although not yet formally approved, settled outstanding proceedings for 2008, 2009, and 2010. The settlement covers various distribution equipment throughout the city and results in a refund of nearly \$400,000, and provides forward-looking tax savings due to reduced assessments. The assessments will be computed under an RCNLD methodology resulting in a 43% drop, which will lower annual tax payments to the city by approximately \$195,000.

The Hillburn settlement covered O&R's Hillburn Substation. The agreement calls for a \$300,000 refund, and O&R has agreed to accept a schedule of payments through 2016 since the dollar amount, in conjunction with future tax reductions, could adversely impact the village. The substation will be valued on an RCNLD methodology that will drop the assessed value from \$4.2 million to \$938,000, an 82% reduction. The tax savings as a result of the lower assessments are estimated to be \$126,000 annually.

In connection with the Forestburgh agreement, which covers various electric distribution equipment located throughout the town, CECONY took the position that the existing total assessment for the facilities, totaling \$234,900, should be lowered to \$32,500. A compromise was reached at \$65,965, representing a decrease of 72%. The agreement results in annual tax savings of approximately \$52,000. At this time, all parties have signed the agreement but it is awaiting the Judge's signature.

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Real Estate Activities in New York City

Tax certiorari proceedings challenging assessments on valuation on certain of Con Edison's current or formerly-owned properties, dating back to fiscal year 1994/95, remain open in the supreme courts of various counties. Negotiations with the New York City Law Department have taken place during 2009 and 2010 concerning settlement proceedings challenging the assessments on certain of Con Edison's real estate properties for fiscal years 1994/95 through 2009/10. In the first phase of the discussions, CECONY received a settlement offer on the Astoria, Ravenswood, and Hudson Avenue properties covering all of the open fiscal years through 2009/10 that has been rejected by Con Edison. Absent a significant change in the City's offer, Con Edison anticipates that it will commence litigation on all of these outstanding cases.

Despite activities to bring the many years of outstanding litigation to a close, during 2010 Con Edison has once again filed property tax certiorari petitions against New York City challenging overvaluations on its properties located in the City. The petitions, one filed for each county covering each individual property CECONY considers to be over-assessed in that county for the 2010/11 fiscal year, assert that the properties are overvalued for assessment purposes by approximately \$800 million, which would result in a tax reduction of slightly more than \$100 million if CECONY were awarded the full claimed amount in a lawsuit.

Special Franchise Property

Con Edison currently has two tax certiorari cases filed against the State Board of Real Property Tax Services concerning special franchise property. These cases challenge the New York City tentative assessments of Con Edison's special franchise facilities for all of CECONY's services. The Supreme Court has set January 7, 2012 as

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the deadline for the filing of Con Edison's appraisal. Settlement negotiations are in their initial stages and have resulted in the receipt of an initial settlement offer from ORPTS. Con Edison is evaluating the offer and will respond once it has completed its review, but expects that a third year of tax petitions will be filed before any resolution of the two outstanding years.

Each year Con Edison applies to the Office of Real Property Tax Services for three benefits: economic obsolescence, functional obsolescence (applicable to gas plant only), and a modifier on facilities in the vicinity of the World Trade Center site. Con Edison has been approved for each of these benefits for several years.

Regarding economic obsolescence, the approval for steam dropped slightly from a 28% factor to a 26% factor for fiscal year 2011/12, however, this will be more than offset by an increase in electric obsolescence from 6% to 8% for fiscal year 2011/12. For the gas system, a first-time benefit was approved by ORPTS for both New York City of 10% and for Westchester of 8%. This form of obsolescence was granted because Con Edison's systems are considered economically obsolete since there is an insufficient return on investment from a property tax valuation standpoint. We estimate the benefits for economic obsolescence to be \$59.3 million, \$14.0 million, and \$10.7 million for electric, gas, and steam, respectively.

A functional obsolescence benefit for gas system excess capacity is received for obsolescence in certain areas of Manhattan, Bronx, and Queens. Con Edison's most recent filing also included a new initiative to expand the obsolescence study to include the Westchester low-pressure system. Our new initiative for Westchester resulted in an approval for adjustments ranging from 1% in Harrison to 17% in Sleepy Hollow. In all, Con Edison received benefits for six cities and 22 towns/villages in Westchester. We

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estimate the system-wide tax benefits for gas functional obsolescence to amount to \$11.0 million for the coming fiscal year.

Special franchise tax benefits also apply to facilities surrounding the World Trade Center and are expected to save Con Edison customers approximately \$2.9 million in taxes for the City's fiscal year 2011/12. The benefit results from an annual filing made to the Office of Real Property Tax Services related to the replacement facilities for the equipment destroyed in the attack. Since the market value of the new facilities has been higher than the market value of the facilities that were destroyed in the attack, Con Edison's taxes increased when the replacement equipment was installed because the new facilities do not have the benefit of a significant depreciation allowance.

Industrial & Commercial Incentive Program

The Industrial and Commercial Incentive Program ("ICIP") was created to encourage the development, expansion, and preservation of commercial and industrial real estate in the City of New York. The ICIP grants a property tax exemption of the additional real property taxes that would otherwise be payable as a result of eligible industrial and commercial construction work. Capital projects in Regular Exemption Areas are entitled to a 15-year exemption, while projects in Special Exemption Areas are entitled to a 25-year exemption, and projects in Renovation Exemption Areas are entitled to a 12-year exemption.

The ICIP laws expired in June 2008, despite Con Edison's efforts to have the legislation extended. Those efforts included a memo in opposition, meetings with City and State officials to persuade them not to repeal the law or, in the alternative, to include utility property in the new legislation being considered, and a letter to the Governor's Counsel requesting that the Governor not sign the replacement legislation.

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The ICIP has since been replaced by the Industrial and Commercial Abatement Program (“ICAP”), which deemed utility companies ineligible. However, Con Edison is eligible to continue to receive ICIP exemptions for all projects that have been grandfathered under the ICIP for the duration of their tax exemption benefit period. Projects with pending applications may also receive benefits if they are deemed eligible.

The chart below identifies the ICIP applications which have been filed and provides a breakdown of the potential property tax savings over the duration of the projects’ ICIP exemption periods, as well as the amount of the tax savings which are estimated to be realized in fiscal year 2011/12.

ICIP Capital Project	Estimated Total Tax Benefits	Estimated Tax Benefits in FY 2011/12
<u>Facilities</u>		
3rd Ave Yard-Garage & W/O Center	<u>\$37,100,000</u>	<u>\$1,469,000</u>
<u>New Substations</u>		
Mott Haven	\$249,700,000	\$13,609,000
Parkview	106,900,000	4,493,000
Academy	143,300,000	Note A
Newtown	<u>130,900,000</u>	<u>5,112,000</u>
Total New Substations	\$630,800,000	\$23,214,000
<u>Substation Upgrades</u>		
Woodrow	\$7,800,000	\$96,000

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Fresh Kills	20,900,000	Note A
Water Street	11,200,000	1,075,000
Water Street-Hudson Avenue East	2,200,000	99,000
Glendale	6,300,000	982,000
Goethals	12,400,000	1,079,000
Jamaica	11,300,000	1,075,000
Sherman Creek Yard East	2,900,000	Note B
Sherman Creek Yard West	2,400,000	Note B
Fox Hills	<u>2,200,000</u>	<u>171,000</u>
Total Substation Upgrades	\$79,600,000	\$4,577,000
 <u>Generation</u>		
East River Repowering Project	<u>\$286,500,000</u>	<u>\$32,279,000</u>
 Grand Total	 <u>\$1,034,000,000</u>	 <u>\$61,539,000</u>

(A) ICIP benefits projected to commence in fiscal year 2012/13.

(B) Application in progress.

The Fresh Kills substation project's approval was received during fiscal year 2010/11.