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. 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 2016, Con Edison incurred $1.4 billion of property taxes in New York City (“NYC” or the “City”), $170.3 million in Westchester County and $12.8 million in other areas primarily located in upstate New York. Orange and Rockland’s 2016 liability to New York State (“NYS”) municipalities and schools amounted to $62.5 million. In total, the Company incurred over $1.6 billion in property taxes in 2016.

This report presents some general background information on property taxes for regulated utilities; summarizes the amount of property taxes incurred in 2016; 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 rate plans in Cases 15-E-0050 (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.
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 (the “Department”), 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. Commonly used valuation techniques, such as benchmarking properties based on recent sales of comparable properties, are inapplicable 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 different values, depending on whether the asset is valued by the ORPTS or by a local assessor. The Company is attempting to address the varied assessment practices through 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 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 feasible 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.

Challenges 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 increases in property tax rates, cause the Company’s property taxes to increase, despite its successful challenges to assessed values.

One of the biggest 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 sections 102.12 (e) and (f) specifically include 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.

Few 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, manufacturing businesses in NYS pay no property tax on their equipment. It makes no sense that machinery producing electricity or steam, or cable and/or pipes 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, and not on its equipment on its own property, in the right-of-way, or within its buildings.

This practice of taxing total infrastructure investment is the principal driver of the Company’s annual property tax increases. Without a change in state law on property taxes, the Company will remain among the largest, if not the largest tax payer in the state. And the burden will increase each year because of our need to invest in infrastructure.

Another major hurdle in managing our property tax cost is the classification system in NYC. There are four classes:
- 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 (Con Edison’s property accounts for more than 80% of all the property in Class 3). 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 Con Edison is most of that class. It ensures that the utility class pays a disproportionate share of the tax levy in relation to its 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. Such a phase in applies to property within Class 4.

Assuming the RPTL continues to tax utility equipment, we believe the true cost basis on which to tax utility property should be a valuation based on rate base. Such a valuation would produce a fairer value since it is transparent, independently verified, and is the basis upon which a utility is permitted to earn a specified rate of return. 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 municipal assessors and government officials, but without statewide valuation for all public utility property, which the Company is also pursuing, implementation of such a proposal has
little hope of success, as it would result in a significant assessment reduction for utility companies at the expense of other taxpayers.

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 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 they consider to be 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. Con Edison and the NYC Law Department have continued to meet to address generating station properties, as well as substations and other properties covered by the tax certiorari petitions that Con Edison has filed over the years.

Con Edison’s initial plan was to bring seven properties to trial. These properties include the three generating stations in Manhattan (59th Street, 74th Street and East River) along with four substation properties, one each in Manhattan, Bronx, Brooklyn and Queens. Appraisals were exchanged on the valuations of the 59th Street and 74th Street steam plants, and trial of the proceedings covering the 74th Street plant was scheduled for February 16, 17 and 18, 2016. Trial of the 59th Street plant was to be scheduled for a later date in 2016. At the urging of the court, the parties engaged in extensive settlement negotiations and eventually reached a compromise on 74th Street for the tax years 1994/95 through 2012/2013. A consent judgment was submitted and agreed to by the City and signed by the Judge. It is anticipated that 59th Street will be settled along the same terms and for the same years, and proposed revised assessments for 59th Street have been submitted to the City’s Law Department. The refunds related to these actions are expected to be approximately $48 million dollars.

In October 2016, Con Edison 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 Ed filed ICIP applications for projects involving the construction of new facilities, including substations, substation renovations, and substation upgrades. Con Ed 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 Ed to extend the ICIP program, the program expired as of June 30, 2008. Con Ed continues, however, to receive benefits for the projects that were eligible under ICIP. During the 2016/2017 fiscal year, Con Ed estimates that the tax savings related to ICIP will amount to $52 million.

Efforts to Reduce Property Taxes – NYC Special Franchise Taxes

Con Ed commenced proceedings in Supreme Court, Albany County, challenging the ORPTS’ special franchise full values for the City’s 2009/10 through 2016/17 assessment rolls. Con Ed has obtained a preliminary appraisal of the property for the earliest years under review. After an Albany court conference in August, the parties agreed to share the Company’s preliminary appraisal with NYS and NYC as an impetus to settlement. The parties continue to meet, including meetings with the Judge. Settlement talks related to gas pipe have commenced.

The Company’s 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 Con Edison has challenged the allowances in the special franchise tax legal actions, it 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. In the City, ORPTS staff has approved a reduction of 12% for economic obsolescence on gas plant which will be applied to the New York City special franchise values for the 2017 assessment roll. Con Edison also requested a reduction 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:

<table>
<thead>
<tr>
<th>Location</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Yonkers</td>
<td>9%</td>
</tr>
<tr>
<td>Borough of Bronx</td>
<td>11%</td>
</tr>
<tr>
<td>Borough of Manhattan</td>
<td>11%</td>
</tr>
<tr>
<td>Borough of Queens</td>
<td>3%</td>
</tr>
</tbody>
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**Efforts to Reduce Property Taxes – Outside of NYC**

Con Edison aggressively challenges property tax assessments outside of the City and, as a result, 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 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, Con Edison entered into tentative settlements in late 2015, phasing in reductions to Con Edison’s assessments on properties contested over a three-year period. In each of the five communities, assessments were reduced, commencing with the 2014 assessment roll, to equalized value based upon RCNLD of Con Edison’s property. For the City of Rye and for White Plains, the outstanding proceedings were settled in 2016 and have been fully implemented. In total, all seven settlements were approved by the court and implemented in 2016.

Late in 2014, O&R began settlement discussions with officials from the City of Middletown and the Towns of Ramapo\(^2\) and Clarkstown, as well as with the assessor from Orangetown, and reached settlements with all four municipalities during 2015. During 2015, Orange and Rockland reached settlements with the City of Middletown and the Towns of Blooming Grove, Clarkstown, Orangetown, and Ramapo.\(^3\)

A case was commenced against the Village of Elmsford in 2016. No settlement discussions have been held to date.

**Legislative Efforts**

The Company continues to pursue and/or support changes in law that could result in a reduction of its property tax liability.

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 its property in a larger pool of properties, and allow property tax assessment increases to be phased in over a five-year period, thereby limiting the volatility of property tax assessment changes and

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\(^2\) The majority of property in Ramapo is owned by Orange & Rockland, but the Ramapo and Ladentown substations owned by Con Edison were also included in the negotiations.

tempering the negative effects of tax rate increases on Con Edison. It would not reduce the City’s property tax revenue because the City would find other sources. Although Con Edison had tried for many years to have Classes 3 and 4 combined there has been little progress in this area 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. We will continue to discuss the issue with the City.

Representatives of Con Edison have met with representatives from the NYS Legislature to discuss a proposal concerning centralizing property tax assessments by the ORPTS for private utility property located in Westchester County. The Company also discussed its proposal with the Westchester County Assessor’s Association on March 7, 2017.

Under the pilot proposal, all of Con Edison’s Westchester properties that are valued locally would be valued by the ORPTS. Con Edison 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 Con Edison files, and would also provide a model for a uniform method of statewide assessment. In addition, the ORPTS property assessments are generally more current and transparent, as Con Edison is required to report all of its property additions to the ORPTS. Overall, the ORPTS property assessments may result in tax reductions on some of Con Edison’s properties, however, the main goal of the proposal is to create assessment uniformity, predictability and transparency. We have informed Westchester municipalities that central assessment could also provide some financial relief to local governments, who currently must secure outside expertise to value certain complex utility properties, and are frequently required to defend these assessments in court, the court proceedings result
in appraisal and legal fees, and also property tax refunds resulting from successful legal challenges brought by utility companies.

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 is seeking a legislative sponsor for this proposal.