DANIELSON HOLDING CORP
Form 10-K/A
April 22, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A
Amendment No. 2

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 6732
DANIELSON HOLDING CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**95-6021257**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employee Identification No.)*
40 Lane Road, Fairfield, N.J.	**07004**
(Address of Principal Executive Offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(973) 882-9000
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.10 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
N/ A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined by Exchange Act Rule 12b-2). Yes þ No o

State the aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant computed by reference to the price at which the common equity was last sold, or the average bid and asked prices of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. $284,458,822

Outstanding Stock (all classes)

Class	March 9, 2005
Common Stock, $0.10 par value	73,214,836 shares

Documents Incorporated By Reference:
None.

EXPLANATORY NOTE

Danielson Holding Corporation (Danielson) is filing this Amendment No. 2 to its annual report on Form 10-K for the fiscal year ended December 31, 2004 (this Amendment No. 2) to amend its disclosures in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the sub-headings Executive Summary, Covanta s Capital Resources and Commitments and Material Weakness in Internal Controls and Procedures and Item 9A Controls and Procedures of its annual report on Form 10-K filed on March 16, 2005, as amended by Amendment No. 1 filed on Form 10-K/A on March 21, 2005 (Amendment No. 1), as well as to provide an amended report of its independent auditors, Sycip Gorres Velayo & Co., of its subsidiary Quezon Power, Inc. The purpose of this Amendment No. 2 is to provide (1) an expanded contractual obligations tabular presentation on page 78, (2) an expanded disclosure of management s conclusions regarding Danielson s disclosure controls and procedures and changes that had been made in Danielson s internal controls over financial reporting, and (3) a revised report of its independent auditors, Sycip Gorres Velayo & Co., which has been revised solely for the purpose of referring to standards of the Public Company Oversight Board (United States) in lieu of the previous reference to auditing standards generally accepted in the United States. The other items of the Annual Report as amended by Amendment No. 1 have not been changed by this Amendment No. 2. The complete text of the items amended is included in this Amendment No. 2 pursuant to Rule 12b-15 promulgated under the Securities Exchange Act of 1934. As a result, this Amendment amends and restates in its entirety only Part II, Items 7 and 9A of the Annual Report and Exhibit 23.2. Reference to Annual Report and Form 10-K in this Amendment No. 2 refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, as amended by both Amendment No. 1 and Amendment No. 2.

Except as otherwise expressly stated for the portions of the items amended in this Amendment No 2, this Amendment No. 2 continues to speak as of the date of the original Annual Report and Danielson has not updated the disclosure contained herein to reflect events that have occurred since the filing of the original Annual Report. Accordingly, this Form 10-K/A should be read in conjunction with Danielson s other filings made with the Securities and Exchange Commission subsequent to the filing of the original Annual Report, including any amendments to those filings.

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Certification of Chief Executive Officer
Certification of Chief Financial Officer
Certification of Chief Executive Officer
Certification of Chief Financial Officer

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PART I

Item 1. ***BUSINESS***

INTRODUCTION

Danielson Holding Corporation (Danielson) is a holding company incorporated in Delaware on April 16, 1992. Prior to entering the energy business through its acquisition of Covanta Energy Corporation (Covanta) in March 2004, substantially all of its operations were conducted in the insurance services industry. Danielson engages in insurance operations through its indirect subsidiaries, National American Insurance Company of California (NAICC) and related entities. Throughout 2004, Danielson also held an equity interest in companies engaged in the marine transportation and services industry through its investment in American Commercial Lines, LLC (ACL) and related entities.

Prior to its acquisition of Covanta, Danielson s strategy has been to grow by making strategic acquisitions. As part of this corporate strategy Danielson has sought acquisition opportunities, such as the acquisition of Covanta, which management believes will enable us to earn an attractive return on our investment.

As a result of the consummation of the Covanta acquisition on March 10, 2004, Danielson s future performance will predominantly reflect the performance of Covanta s operations which are significantly larger than Danielson s other operations. As a result, the nature of Danielson s business, the risks attendant to such business and the trends that it will face will be significantly altered by the acquisition of Covanta. Accordingly, Danielson s prior financial results will not be comparable to future results.

Danielson acquired its 100% ownership interest in ACL in May 2002. On January 31, 2003, ACL and many of its subsidiaries and its immediate direct parent entity, American Commercial Lines Holdings, LLC (ACL Holdings), filed a petition with the U.S. Bankruptcy Court to reorganize under Chapter 11 of the U.S. Bankruptcy Code. ACL Holdings and ACL confirmed a plan of reorganization on December 30, 2004, and emerged from bankruptcy on January 11, 2005. As a result, Danielson s equity interest in ACL was cancelled, and as a part of ACL s plan of reorganization it received in January 2005 warrants to purchase 3% of ACL s new common stock from certain creditors of ACL.

During 2004, Danielson owned a direct 5.4% interest in Global Materials Services, LLC (GMS) and a direct 50% interest in Vessel Leasing, LLC (Vessel Leasing). GMS was a joint venture among ACL, Danielson, and a third party, which owned and operated marine terminals and warehouse operations. Vessel Leasing was a joint venture between ACL and Danielson which leases barges to ACL s barge transportation operations. Neither GMS nor Vessel Leasing filed for Chapter 11 protection. Danielson, GMS and Vessel Leasing were not guarantors of ACL s debt nor were they liable for any of ACL s liabilities. On October 6, 2004, Danielson and ACL sold its interests in GMS to the third party joint venture member and on January 13, 2005, Danielson sold its interest in Vessel Leasing to ACL.

As a result of the ACL bankruptcy filing, while Danielson continued to exercise influence over the operating and financial policies of ACL, it no longer maintained control of ACL. Accordingly, beginning with the year ended December 31, 2003, Danielson accounted for its investments in ACL, GMS and Vessel Leasing using the equity method of accounting. Under the equity method of accounting, Danielson reported its share of the equity investees income or loss based on its ownership interest. In determining the proper equity method earnings to be recognized for ACL, Danielson did not recognize losses in excess of its investment s carrying value of zero at December 31, 2003, as Danielson was not liable either directly or as guarantor for such losses.

Danielson had cash and investments, including investments in subsidiaries, at the holding company level of $117.3 million at December 31, 2004. Danielson s cash amounted to $12.9 million. Danielson s investments consisted of publicly traded bonds of $3.3 million. Danielson had a $81.8 million investment in Covanta. Danielson also had a $16.8 million investment in insurance subsidiaries and a $2.5 million investment in Vessel Leasing. Danielson had liabilities at the holding company level of $5.2 million.

Danielson estimates as of the end of 2004, that it had aggregate consolidated net operating loss tax carryforwards for federal income tax purposes (NOLs) of approximately $516 million. See Note 25 of the Notes to Consolidated Financial Statements (hereinafter referred to as Notes to Consolidated Financial Statements) for more detailed information on Danielson s NOLs.

Acquisition of Covanta Energy Corporation

On December 2, 2003, Danielson executed a definitive investment and purchase agreement to acquire Covanta in connection with Covanta s emergence from Chapter 11 proceedings after the non-core and geothermal assets of Covanta were divested. The primary components of the transaction were: (1) the purchase by Danielson of 100% of the equity of Covanta in consideration for a cash purchase price of approximately $30 million, and (2) agreement as to new letter of credit and revolving credit facilities for Covanta s domestic and international operations, provided by some of the existing Covanta lenders and a group of additional lenders organized by Danielson.

This agreement was amended on February 23, 2004 which reduced the purchase price and released from an escrow account $0.2 million to purchase Danielson s equity interest in Covanta Lake, Inc. A limited liability company was formed by Danielson and one of Covanta s subsidiaries and this limited liability company acquired an equity interest in Covanta Lake II, Inc., an indirect subsidiary of Covanta, in a transaction separate and distinct from the acquisition of Covanta out of bankruptcy.

As required by the investment and purchase agreement, Covanta filed a proposed plan of reorganization, a proposed plan of liquidation for specified non-core businesses, and the related draft disclosure statement, each reflecting the transactions contemplated under the investment and purchase agreement, with the Bankruptcy Court. On March 5, 2004, the Bankruptcy Court confirmed the Reorganization Plan (as hereafter defined and more fully discussed under Description of Danielson s Business Energy Services Business. On March 10, 2004, Danielson acquired 100% of Covanta s equity in consideration for approximately $30 million.

With the purchase of Covanta, Danielson acquired a leading provider of waste-to-energy services and independent power production in the United States and abroad. Danielson s equity investment and ownership provided Covanta s businesses with improved liquidity and capital resources to finance its business activities and emerge from bankruptcy.

The aggregate purchase price was $47.5 million which included the cash purchase price of $29.8 million, approximately $6.4 million for professional fees and other estimated costs incurred in connection with the acquisition, and an estimated fair value of $11.3 million for Danielson s commitment to sell up to 3 million shares of its common stock at $1.53 per share to certain creditors of Covanta, subject to certain limitations.

Financing the Covanta Acquisition

Danielson obtained the financing necessary for the Covanta acquisition pursuant to a note purchase agreement dated December 2, 2003, with each of SZ Investments, LLC (SZ Investments), Third Avenue Trust, LLC on behalf of Third Avenue Value Fund Series (collectively, TAVF) and D.E. Shaw Laminar Portfolios, LLC (Laminar), referred to collectively as the Bridge Lenders . Pursuant to the note purchase agreement, the Bridge Lenders severally provided Danielson with an aggregate of $40 million of bridge financing in exchange for notes which were convertible under certain circumstances into shares of Danielson common stock at a price of $1.53 per share, subject to agreed upon limitations. Danielson used $30 million of the proceeds from the notes to post an escrow deposit prior to the closing of the transactions contemplated by the investment and purchase agreement with Covanta. At closing, the deposit was used to purchase Covanta. The remainder of the proceeds was made available to pay transaction expenses and for general corporate purposes. These notes were repaid on June 11, 2004 from the conversion of a portion of the notes held by Laminar and from the issuance of 8.75 million shares of Danielson Common Stock to Laminar upon such conversion and from the proceeds of a pro rata rights offering made to all stockholders on May 18, 2004.

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Danielson issued to the Bridge Lenders an aggregate of 5,120,853 shares of Danielson s common stock in consideration for the $40 million of bridge financing. At the time that Danielson entered into the note purchase agreement, agreed to issue the notes convertible into shares of Danielson common stock and issued the equity compensation to the Bridge Lenders, the trading price of the Danielson common stock was below the $1.53 per share conversion price of the notes. On December 1, 2003, the day prior to the announcement of the Covanta acquisition, the closing price of Danielson common stock on the American Stock Exchange was $1.40 per share.

In addition, under the note purchase agreement, Laminar agreed to convert an amount of notes to acquire up to an additional 8.75 million shares of Danielson common stock at $1.53 per share based upon the levels of public participation in the May 18, 2004 rights offering. Based upon the public participation in the rights offering, Danielson issued the maximum of 8.75 million shares to Laminar pursuant to the conversion of approximately $13.4 million in principal amount of notes. Consequently, the $20 million principal amount of notes held by Laminar plus accrued but unpaid interest was repaid in full on June 11, 2004 through the issuance of 8.75 million shares of Danielson common stock to Laminar and $7.9 million of the proceeds from the rights offering.

Danielson has agreed to commence an offering of shares to a class of creditors of Covanta that are entitled to participate in an offering of up to 3.0 million shares of Danielson common stock at a price of $1.53 per share pursuant to the Covanta Reorganization Plan. Danielson has filed a registration statement with the Securities and Exchange Commission (the SEC) to register the offering, which registration statement has not yet been declared effective by the SEC.

As part of Danielson s negotiations with Laminar and its becoming a five percent stockholder, pursuant to a letter agreement dated December 2, 2003, Laminar has agreed to additional restrictions on the transferability of the shares of Danielson common stock that Laminar holds or will acquire. Further, in accordance with the transfer restrictions contained in Article Fifth of Danielson s charter restricting the resale of Danielson common stock by five percent stockholders, Danielson has agreed with Laminar to provide it with limited rights to resell the Danielson common stock that it holds. Finally, pursuant to its agreement with the Bridge Lenders on July 28, 2004, Danielson has filed a registration statement with the SEC to register the shares of Danielson common stock issued to or acquired by them under the note purchase agreement. The registration statement was declared effective on August 24, 2004.

Samuel Zell, Danielson s former Chief Executive Officer and Chairman of the Board of Directors, and William Pate, current Chairman of Danielson, are affiliated with SZ Investments. David Barse, a Director of Danielson, is affiliated with Third Avenue. The note purchase agreement and other transactions involving the Bridge Lenders were negotiated, reviewed and approved by a special committee of Danielson s Board of Directors composed solely of disinterested directors and advised by independent legal and financial advisors.

DESCRIPTION OF DANIELSON S BUSINESSES

Set forth below is a description of Danielson s business operations as of December 31, 2004, as presented in the Consolidated Financial Statements included in this report. Danielson is engaged in two primary business segments: the Energy Services business of Covanta and the Insurance Services business. Each of these businesses, and the NOLs at the holding company level, are described below.

Additional information about Danielson s business segments is included in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 32 of the Notes to Consolidated Financial Statements.

This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results may differ materially from those contained in such forward-looking statements. See Forward Looking Statements below.

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(A) Holding Company Business

Prior to the Covanta acquisition, Danielson s strategy had been to grow by developing business partnerships and making strategic acquisitions. Following the Covanta acquisition, Danielson s strategy has been to concentrate on increasing value in Covanta s core waste-to-energy business, while ensuring the NOLs at the Danielson level are available to Covanta as contemplated by the Reorganization Plan.

As of December 31, 2004, Danielson had consolidated NOLs of approximately $516 million. This estimate was based upon federal consolidated income tax losses for the periods through December 31, 2003 and an estimate of the 2004 taxable results. Some or all of the carryforward may be available to offset, for federal income tax purposes, the future taxable income, if any, of Danielson, its wholly-owned subsidiaries and the Mission trusts described in more detail in Note 25 of the Notes to Consolidated Financial Statements. The Internal Revenue Service (IRS) has not audited any of Danielson s tax returns for any of the years during the carryforward period including those returns for the years in which the losses giving rise to the NOL carryforward were reported.

Danielson s NOLs will expire, if not used, in the following approximate amounts in the following years (in thousands of dollars):

Year	Amount of Carryforward Expiring
2005	$ 12,405
2006	92,355
2007	89,790
2008	31,688
2009	39,689
2010	23,600
2011	19,755
2012	38,255
2019	33,635
2022	26,931
2023	108,331
	$ 516,434

Danielson s ability to utilize its NOLs would be substantially reduced if Danielson were to undergo an ownership change within the meaning of Section 382(g)(1) of the Internal Revenue Code. Danielson will be treated as having had an ownership change if there is more than a 50% increase in stock ownership during a three year testing period by 5% stockholders . In an effort to reduce the risk of an ownership change, Danielson has imposed restrictions on the ability of holders of five percent or more of the Common Stock, as well as the ability of others to become five percent stockholders as a result of transfers of Common Stock. The transfer restrictions were implemented in 1992, and Danielson expects that they will remain in force as long as the NOLs are available to Danielson. Notwithstanding such transfer restrictions, there could be circumstances under which an issuance by Danielson of a significant number of new shares of Common Stock or other new class of equity security having certain characteristics (for example, the right to vote or convert into Common Stock) might result in an ownership change under the Internal Revenue Code.

(B) Energy Services Business

See Note 33 to the Notes to Consolidated Financial Statements for financial information about segments and geographic areas.

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(i) Domestic Energy Business

Covanta s domestic business is the design, construction and long-term operation of key infrastructure for municipalities and others in waste-to-energy and independent power production. Covanta s largest operations are in waste-to-energy projects, and it currently operates 25 waste-to-energy projects, the majority of which were developed and structured contractually as part of competitive procurements conducted by municipal entities. The waste-to-energy plants combust municipal solid waste as a means of environmentally sound disposal and produce energy that is typically sold as electricity to utilities and other electricity purchasers. Covanta processes approximately four percent of the municipal solid waste produced in the United States and therefore represents a vital part of the nation s solid waste disposal industry.

Waste-to-Energy Projects

The essential purpose of Covanta s waste-to-energy projects is to provide waste disposal services, typically to municipal clients who sponsor the projects (Client Communities). Generally, Covanta provides these services pursuant to long-term service contracts (Service Agreements). The electricity or steam is sold pursuant to long-term power purchase agreements (Energy Contracts) with local utilities or industrial customers, with one exception, and most of the resulting revenues reduce the overall cost of waste disposal services to the Client Communities. Each Service Agreement is different to reflect the specific needs and concerns of the Client Community, applicable regulatory requirements and other factors. The original terms of the Service Agreements are each 20 or more years, with the majority now in the second half of the applicable term. Most of Covanta s Service Agreements may be renewed for varying periods of time, at the option of the client community.

Covanta currently operates the waste-to-energy projects identified below under Domestic Project Summaries. Most of Covanta s operating waste-to-energy projects were developed and structured contractually as part of competitive procurement conducted by municipal entities. As a result, these projects have many common features, which are described in Structurally Similar Waste-to-Energy Projects below. Certain projects which do not follow this model, or have been or may be restructured, are described in Other Waste-to-Energy Project Structures and Project Restructurings during 2004 below.

Covanta receives its revenue in the form of fees pursuant to Service Agreements, and in some cases Energy Contracts, at facilities it owns. Covanta s Service Agreements begin to expire in 2007, and Energy Contracts at Company-owned projects generally expire at or after the date on which that project s Service Agreement expires. As Covanta s contracts expire it will become subject to greater market risk in maintaining and enhancing its revenues. As its Service Agreements at municipally-owned facilities expire, Covanta intends to seek to enter into renewal or replacement contracts to operate several such facilities. Covanta also will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. As Covanta s Service Agreements at facilities it owns begin to expire, it intends to seek replacement or additional contracts, and because project debt on these facilities will be paid off at such time Covanta expects to be able to offer rates that will attract sufficient quantities of waste while providing acceptable revenues to Covanta. At Company-owned facilities, the expiration of existing Energy Contracts will require Covanta to sell its output either into the local electricity grid at prevailing rates or pursuant to new contracts. There can be no assurance that Covanta will be able to enter into such renewals, replacement or additional contracts, or that the terms available in the market at the time will be favorable to Covanta.

Covanta s opportunities for growth by investing in new projects will be limited by existing non-project debt covenants, as well as by competition from other companies in the waste disposal business. For a discussion of such debt covenants see Note 19 to the Notes to Consolidated Financial Statements.

Structurally Similar Waste-to-Energy Projects

Each Service Agreement is different to reflect the specific needs and concerns of the Client Community, applicable regulatory requirements and other factors. However, the following description sets forth terms that are generally common to these agreements:

Covanta designs the facility, helps to arrange for financing and then constructs and equips the facility on a fixed price and schedule basis.

Covanta operates the facility and generally guarantees it will meet minimum waste processing capacity and efficiency standards, energy production levels and environmental standards. Covanta s failure to meet these guarantees or to otherwise observe the material terms of the Service Agreement (unless caused by the Client Community or by events beyond its control (Unforeseen Circumstances)) may result in liquidated damages charged to Covanta or, if the breach is substantial, continuing and unremedied, the termination of the Service Agreement. In the case of such Service Agreement termination, Covanta may be obligated to pay material damages, including payments to discharge project indebtedness. Covanta or an intermediate holding company typically guarantees performance of the Service Agreement.

The Client Community is generally required to deliver minimum quantities of municipal solid waste to the facility on a put-or-pay basis and is obligated to pay a service fee for its disposal (the Service Fee). A put-or-pay commitment means that the Client Community promises to deliver a stated quantity of waste and pay an agreed amount for its disposal. This payment is due even if the counterparty delivers less than the full amount of waste promised. Portions of the Service Fee escalate to reflect indices of inflation. In many cases the Client Community must also pay for other costs, such as insurance, taxes and transportation and disposal of the residue to the disposal site. If the facility is owned by Covanta, the Client Community also pays as part of the Service Fee an amount equal to the debt service due to be paid on the bonds issued to finance the facility. Generally, expenses resulting from the delivery of unacceptable and hazardous waste on the site are also borne by the Client Community. In addition, the contracts generally require that the Client Community pay increased expenses and capital costs resulting from Unforeseen Circumstances, subject to limits which may be specified in the Service Agreement.

The Client Community usually retains a portion of the energy revenues (generally 90%) generated by the facility, and pays the balance to Covanta.

Financing for Covanta s domestic waste-to-energy projects is generally accomplished through tax-exempt and taxable revenue bonds issued by or on behalf of the Client Community. If the facility is owned by a Covanta subsidiary, the Client Community loans the bond proceeds to the subsidiary to pay for facility construction and pays to the subsidiary amounts necessary to pay debt service. For such facilities, project-related debt is included as project debt (short-and long-term) in Covanta s consolidated financial statements. Generally, such debt is secured by the revenues pledged under the respective indentures and is collateralized by the assets of Covanta s subsidiary with the only recourse to Covanta being related to construction and operating performance defaults.

Covanta has issued instruments to its Client Communities and other parties which guarantee that Covanta s operating subsidiaries will perform in accordance with contractual terms including, where required, the payment of damages. Such contractual damages could be material, and in circumstances where one or more subsidiary s contract has been terminated for its default, such damages could include amounts sufficient to repay project debt. For facilities owned by Client Communities and operated by Covanta subsidiaries, Covanta s potential maximum liability as of December 31, 2004 associated with the repayment of project debt on such facilities was in excess of $1 billion. If Covanta is asked to perform under one or more of such guarantees, its liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt which is presently not estimable. To date, Covanta has not incurred material liabilities under such guarantees.

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Other Waste-to-Energy Project Structures

Haverhill, Massachusetts

Covanta s Haverhill, Massachusetts waste-to-energy facility is not operated pursuant to a Service Agreement with a Client Community. In this project, Covanta assumed the project debt and risks relating to waste availability and pricing, risks relating to the continued performance of the electricity purchaser, as well as risks associated with Unforeseen Circumstances. Covanta retains all of the energy revenues from sales of power and disposal fees for waste accepted at this facility. Accordingly, Covanta believes that this project carries both greater risks and greater potential rewards than projects in which there is a Client Community.

During 2003, US Gen New England, Inc. (USGenNE), the power purchaser for the Haverhill project, filed a petition under Chapter 11 of the United States Bankruptcy Code. During the pendency of its bankruptcy, on October 8, 2004, the United States Bankruptcy Court for the District of Maryland entered an order approving the sale by USGenNE of certain of its assets, including its contract to purchase power from the Haverhill project, to Dominion Energy New England, Inc. (Dominion). As a result of USGenNE s sale to Dominion, USGenNE assigned and Dominion assumed such contract and Covanta was paid all outstanding prepetition cure amounts plus interest.

Union, New Jersey

In Union County, New Jersey, a municipally-owned facility has been leased to Covanta, and the Client Community has agreed to deliver approximately 50% of the facility s capacity on a put-or-pay basis. The balance of facility capacity is marketed by Covanta at its risk. Covanta guarantees its subsidiary s contractual obligations to operate and maintain the facility, and on one series of subordinated bonds, its obligations to make lease payments which are the sole source for payment of principal and interest on that series of bonds. As of December 31, 2004, the current outstanding principal amount of the subordinated bonds, sold to refinance a portion of the original bonds used to finance the facility, was $17.7 million. As a part of restructuring of this project, the Client Community assigned to Covanta the long-term power contract with the local utility. As part of this assignment, the power contract was amended to give Covanta the right to sell all or a portion of the plant s output to other purchasers. Since April 2002, Covanta has sold the majority of its output directly into the regional electricity grid at market pricing with the remainder of the electricity sold under short-term contract when Covanta may enter into contracts with other purchasers if it believes doing so would enhance this project s revenues.

Alexandria, Virginia

Covanta s Alexandria, Virginia waste-to-energy facility is operated pursuant to a Service Agreement with the City of Alexandria, Virginia and Arlington County, Virginia and authorities established by those communities (the Virginia Communities). The Virginia Communities pay a fixed tip fee, subject to certain adjustments, for each ton of waste they are required to deliver on a put-or-pay basis (about 65% of the facility s capacity). The balance of the waste is obtained by Covanta from private haulers pursuant to short-term contracts or on a spot basis. Covanta s operating subsidiary receives all of the electricity revenues received under the facility s power sales agreement and pays the debt service on the bonds issued to finance the facility. The Service Agreement provides that if income available for debt service, as calculated in accordance with the Service Agreement, does not cover debt service, the Virginia Communities will loan Covanta s operating subsidiary the amount of the shortfall. Any such loan is required to be repaid from the project s positive cash flow in succeeding years and would have an ultimate maturity in 2023. The interest rate on any such loan is six percent. Since the Alexandria facility began operating in 1988, the Virginia Communities have been required to extend such loans on four occasions, the last of which was with respect to the operating year ending June 1, 2001. All such loans have been fully repaid within six months, and as of December 31, 2004 there were currently no outstanding loans to Covanta s operating subsidiary.

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Project Restructurings during 2004

Babylon, New York

The Town of Babylon, New York (Babylon) filed a proof of claim against Covanta Babylon, Inc. (Covanta Babylon) in its bankruptcy proceeding for approximately $13.4 million in prepetition damages and $5.5 million in postpetition damages, alleging that Covanta Babylon has accepting less waste than required under the Service Agreement between Babylon and Covanta Babylon at the waste-to-energy facility in Babylon and that Covanta Babylon s Chapter 11 Cases imposed on Babylon additional costs for which Covanta Babylon should be responsible. Covanta filed an objection to Babylon s claim, asserting that it was in full compliance with the express requirements of the Service Agreement and was entitled to adjust the amount of waste it is required to accept to reflect the energy content of the waste delivered. Covanta Babylon also asserted that the costs arising from its Chapter 11 proceedings are not recoverable by Babylon. After lengthy discussions, Babylon and Covanta Babylon reached a settlement pursuant to which, in part, (i) the parties amended the Service Agreement to adjust Covanta Babylon s operational procedures for accepting waste, reduce Covanta Babylon s waste processing obligations, increase Babylon s additional waste service fee to Covanta Babylon and reduce Babylon s annual operating and maintenance fee to Covanta Babylon; (ii) Covanta Babylon paid a specified amount to Babylon in consideration for a release of any and all claims (other than its rights under the settlement documents) that Babylon may hold against the Covanta and in satisfaction of Babylon s administrative expense claims against Covanta Babylon; and (iii) the parties allocated additional costs relating to the project s swap financing as a result of Covanta Babylon s Chapter 11 proceedings until such costs are eliminated. Covanta Babylon subsequently emerged from Chapter 11 pursuant to the Reorganization Plan as described below on March 10, 2004, and the restructuring became effective on March 12, 2004.

Lake County, Florida

In late 2000, Lake County, Florida (Lake County) commenced a lawsuit in Florida state court against Covanta Lake, Inc. (Covanta Lake,) relating to the waste-to-energy facility operated by Covanta in Lake County, Florida (the Lake Facility). In the lawsuit, Lake County sought to have its Service Agreement with Covanta Lake declared void and in violation of the Florida Constitution. That lawsuit was stayed by the commencement of the Chapter 11 Cases. Lake County subsequently filed a proof of claim seeking in excess of $70 million from Covanta Lake and Covanta.

After months of negotiations that failed to produce a settlement between Covanta Lake and Lake County, on June 20, 2003, Covanta Lake filed a motion with the Bankruptcy Court seeking entry of an order (i) authorizing Covanta Lake to assume, effective upon confirmation of a plan of reorganization for Covanta Lake, its Service Agreement with Lake County, (ii) finding no cure amounts due under the Service Agreement, and (iii) seeking a declaration that the Service Agreement is valid, enforceable and constitutional and remains in full force and effect. Contemporaneously with the filing of the assumption motion, Covanta Lake filed an adversary complaint asserting that Lake County is in arrears to Covanta Lake in the amount of more than $8.5 million. Shortly before trial commenced in these matters, Covanta and Lake County reached a tentative settlement calling for a new agreement specifying the parties obligations and restructuring of the project. That tentative settlement and the proposed restructuring involved, among other things, termination of the existing Service Agreement and the execution of a new waste disposal agreement which provides for a put-or-pay obligation on Lake County s part to deliver 163,000 tons per year of acceptable waste to the Lake Facility and a different fee structure; a replacement guarantee from Covanta in a reduced amount; the payment by Lake County of all amounts due as pass through costs with respect to Covanta Lake s payment of property taxes; the payment by Lake County of a specified amount in 2004, 2005 and 2006 in reimbursement of certain capital costs; the settlement of all pending litigation; and a refinancing of the existing bonds.

The Lake settlement was contingent upon, among other things, receipt of all necessary approvals, as well as a favorable outcome to the Debtors separate objection to the proof of claims filed by F. Browne Gregg, a third-party claiming an interest in the existing Service Agreement that would be terminated under the

proposed settlement. In August 2004, the Bankruptcy Court ruled on the Debtors claims objections, finding in favor of the Debtors. Based on the foregoing, the Debtors determined to propose a plan of reorganization for Covanta Lake.

The Debtors subsequently reached a final settlement with Mr. Gregg, entered into a new long-term waste disposal agreement with Lake County on terms substantially similar to the tentative settlement, refinanced the project debt and confirmed the Covanta Lake plan of reorganization in December 2004. Covanta Lake emerged from bankruptcy on December 12, 2004.

Warren County, New Jersey

The Covanta subsidiary (Covanta Warren) which operates Covanta s waste-to-energy facility in Warren County, New Jersey (the Warren Facility) and the Pollution Control Financing Authority of Warren County (Warren Authority) have been engaged in negotiations for an extended time concerning a potential restructuring of the parties rights and obligations under various agreements related to Covanta Warren s operation of the Warren Facility. Those negotiations were in part precipitated by a 1997 federal court of appeals decision invalidating certain of the State of New Jersey s waste-flow laws, which resulted in significantly reduced revenues for the Warren Facility. Since 1999, the State of New Jersey has been voluntarily making all debt service payments with respect to the project bonds issued to finance construction of the Warren Facility, and Covanta Warren has been operating the Warren Facility pursuant to an agreement with the Warren Authority which modifies the existing Service Agreement for the Warren Facility.

Although discussions continue, to date Covanta Warren and the Warren Authority have been unable to reach an agreement to restructure the contractual arrangements governing Covanta Warren s operation of the Warren Facility. Based upon the foregoing, Covanta has not yet determined to propose a plan of reorganization or plan of liquidation for Covanta Warren at this time, and instead has determined that Covanta Warren should remain a debtor-in-possession.

In order to emerge from bankruptcy without uncertainty concerning potential claims against Covanta related to the Warren Facility, Covanta rejected its guarantees of Covanta Warren s obligations relating to the operation and maintenance of the Warren Facility. Covanta anticipates that if a restructuring is consummated, Covanta may at that time issue a new parent guarantee in connection with that restructuring and emergence from bankruptcy.

In the event the parties are unable to timely reach agreement upon and consummate a restructuring of the contractual arrangements governing Covanta Warren s operation of the Warren Facility, Covanta may, among other things, elect to litigate with counterparties to certain agreements with Covanta Warren, assume or reject one or more executory contracts related to the Warren Facility, attempt to file a plan of reorganization on a non-consensual basis, or liquidate Covanta Warren. In such an event, creditors of Covanta Warren may not receive any recovery on account of their claims.

Covanta expects that the outcome of this restructuring will not negatively affect its ability to implement its business plan or have a material impact on its operating results and financial position.

Projects under Development

Hillsborough County, Florida

Covanta designed, constructed and now operates and maintains this 1,200 ton per day mass burn waste-to-energy facility located in and owned by Hillsborough County. Due to the growth in the amount of solid waste generated in Hillsborough County, Hillsborough County has informed Covanta of its desire to expand the facility s waste processing and electricity generation capacities, a possibility contemplated by the existing contract between Covanta and Hillsborough County. As part of the proposed agreement to implement this expansion Covanta would receive a long-term operating contract extension. Negotiations are ongoing and contracts for construction of the expansion and operation and maintenance of the expanded facility are still to be finalized and approved by the parties. In addition, environmental and other project related permits will need to be secured and financing completed. At this time, there can be no assurance that any definitive agreements

will be finalized or approved by the parties, the relevant permits will be received or that Hillsborough County will, in fact, expand the facility.

Lee County, Florida

Covanta designed, constructed and now operates and maintains this 1,200 ton per day mass burn waste-to-energy facility located in and owned by Lee County. Due to the growth in the amount of solid waste generated in Lee County, Lee County has informed Covanta of its desire to enlist Covanta to manage the expansion of the facility s waste processing and electricity generation capacities, a possibility contemplated by the existing contract between Covanta and Lee County. As part of the proposed agreement to implement this expansion Covanta would receive a long term operating contract extension. Negotiations are ongoing and contracts for construction of the expansion and operation and maintenance of the expanded facility are still to be finalized and approved by the parties. In addition, financing for the expansion project must be completed. Lee County has received the principal environmental permit for the expansion. At this time, there can be no assurance that any definitive agreements will be finalized or approved by the parties or that Lee County will, in fact, expand the facility.

Honolulu, Hawaii

This 2,160 ton per day refuse derived fuel facility was designed and constructed by an entity not related to Covanta. Subsequently, Covanta purchased the rights to operate and maintain the facility on behalf of the City and County of Honolulu. The City and County of Honolulu have informed Covanta of their desire to expand the facility s waste processing capacity, a possibility contemplated by the existing contract between Covanta and the City and the County of Honolulu. As part of the proposed agreement to implement the expansion Covanta would receive a long-term operating contract extension. Negotiations are ongoing and contracts for construction of the expansion and operation and maintenance of the expanded facility are still to be finalized and approved by the parties. In addition, environmental and other project related permits will need to be secured and financing completed. At this time, there can be no assurance that any definitive agreements will be finalized or approved by the parties, the relevant permits will be received or that the City and the County of Honolulu will, in fact, expand the facility

Independent Power Projects

Since 1989, Covanta has been engaged in developing, owning and/or operating independent power production facilities utilizing a variety of energy sources including water (hydroelectric), natural gas, coal, waste wood (biomass), landfill gas, heavy fuel oil and diesel fuel. Covanta currently owns, has ownership in and operates 13 such facilities. The electrical output from each facility, with one exception, is sold to local utilities. Covanta s revenue from the independent power production facilities is derived primarily from the sale of energy and capacity under energy contracts. During 2003, Covanta sold its interests in its Geothermal Energy Project Business.

The regulatory framework for selling power to utilities from independent power facilities (including waste-to-energy facilities) after current contracts expire is in flux, given the energy crisis in California in 2000 and 2001, the over-capacity of generation at the present time in many markets and the uncertainty as to the adoption of new federal energy legislation. Various states and Congress are considering a wide variety of changes to regulatory frameworks, but none has been established definitively at present.

Hydroelectric

Covanta owns a 50% equity interest in two run-of-river hydroelectric facilities, Koma Kulshan and Weeks Falls, which have a combined gross capacity of 17 MW. Both Koma Kulshan and Weeks Falls are located in Washington State and both sell energy and capacity to Puget Sound Power & Light Company under long-term energy contracts. A subsidiary of Covanta provides operation and maintenance services to the Koma Kulshan partnership under a cost plus fixed fee agreement.

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During the first quarter of 2004, Covanta operated the New Martinsville facility in West Virginia, a 40 MW run-of-river project pursuant to a short-term Interim Operations and Maintenance Agreement which expired March 31, 2004. Covanta chose not to renew the lease on the project, the term of which expired in October 2003.

Waste Wood

Covanta owns 100% interests in Burney Mountain Power, Mt. Lassen Power, and Pacific Oroville Power, three wood-fired generation facilities in northern California. A fourth facility, Pacific Ultrapower Chinese Station, is owned by a partnership in which the Company holds a 50% interest. Fuel for the facilities is procured from local sources primarily through short-term supply agreements. The price of the fuel varies depending on time of year, supply and price of energy. These projects have a gross generating capacity of 67 MW and sell energy and capacity to Pacific Gas & Electric under energy contracts. Until July 2001 these facilities were receiving Pacific Gas & Electric s short run avoided cost for energy delivered. However, beginning in July 2001 these facilities entered into five-year fixed-price periods pursuant to energy contract amendments.

Landfill Gas

Covanta has interests in and/or operates seven landfill gas projects which produce electricity by burning methane gas produced in landfills. The Otay, Oxnard, Salinas, Stockton, Toyon and Santa Clara projects are located in California, and the Gude project is located in Maryland. The seven projects have a total gross capacity of 19.9 MW. The Gude facility energy contract has expired and the facility is currently selling its output into the regional utility grid. The remaining six projects sell energy and contracted capacity to various California utilities. The Salinas, Stockton and Santa Clara energy contracts expire in 2007. The Otay and Oxnard energy contracts expire in 2011. Upon the expiration of the energy contracts, it is expected that these projects will enter into new power off take arrangements or the projects will be shut down. During the fourth quarter of 2004, Covanta sold its interests in the Penrose and Toyon landfill gas projects, located in California and a subsidiary of Covanta will continue to operate the Toyon project under an agreement which expires in 2007.

Water Operations

Covanta designed, built and now continues to operate and maintain a 24 million gallon per day (mgd) potable water treatment facility and associated transmission and pumping equipment that supplies water to residents and businesses in Bessemer, Alabama, a suburb of Birmingham. Under a long-term contract with the Governmental Services Corporation of Bessemer, Covanta received a fixed price for design and construction of the facility, and it is paid a fixed fee plus pass-through costs for delivering processed water to Bessemer s water distribution system.

Between 2000 and 2002, Covanta was awarded contracts to supply its patented DualSand microfiltration system (DSS) to twelve municipalities in upstate New York as the primary technological improvement necessary to upgrade their existing water and wastewater treatment systems. Five of these upgrades were made in connection with the United States Environmental Protection Agency and New York City Department of Environmental Protection (NYCDEP), a $1.4 billion program to protect and enhance the drinking water supply, or watershed, for New York City. These DSS contracts for upgrades have been completed and non-material payment issues are currently being discussed by, and may be litigated between, Covanta and NYCDEP in order to close out these contracts. Covanta does not expect to enter into further contracts for such projects in the New York City watershed.

Domestic Project Dispositions in 2004

Tampa Bay, Florida

During 2003, Covanta Tampa Construction, Inc. (CTC) completed construction of a 25 mgd desalination-to-drinking water facility under a contract with Tampa Bay Water (TBW) near Tampa,

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Florida. Covanta Energy Group, Inc. guaranteed CTC s performance under its construction contract with TBW. A separate subsidiary, Covanta Tampa Bay, Inc. (CTB), entered into a contract with TBW to operate the Tampa Water Facility after construction and testing is completed by CTC. As construction of the Tampa Water Facility neared completion, the parties had material disputes between them. These disputes led to TBW issuing a default notice to CTC and shortly thereafter CTC filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.

In February 2004, Covanta and TBW reached a tentative compromise of their disputes which was approved by the Bankruptcy Court. On July 14, 2004, the Bankruptcy Court confirmed a plan of reorganization for CTC and CTB, which incorporated the terms of the settlement between Covanta and TBW. That plan became effective on August 6, 2004 when CTC and CTB emerged from bankruptcy. After payment of certain creditor claims under the CTC and CTB plan, Covanta realized approximately $4 million of the proceeds from the settlement with TBW. Under the terms of The Plan CTB will not operate the Tampa Water Facility, and the Company will have no continuing obligations with respect to this project.

Transfers of Waste Water Project Contracts

Covanta formerly operated and maintained wastewater treatment facilities on behalf of seven small municipal and industrial customers in upstate New York. During 2004, Covanta disposed of these assets through assignment, transfer or contract expiration. In addition, some of these contracts are short-term agreements which were by their terms terminated by the counterparty on notice that the counterparty no longer desired to continue receiving service from Covanta.

Sales of Certain Landfill Gas Assets

During the fourth quarter of 2004, Covanta sold its ownership interests in two small landfill gas projects, the Penrose project and the Toyon project, located in southern California. These sales occurred following a determination by Covanta that it would either cease operating these projects or sell them to third parties who would upgrade them to meet new regulatory requirements and run them to generate renewable energy. Covanta received a total of approximately $0.5 million for the two projects.

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Domestic Project Summaries

Summary information with respect to Covanta s domestic projects(1) that are currently operating, is provided in the following table:

		Location	Waste Processing Capacity (TON/DAY)	Gross Electric Output (MW)	Nature of Interest(1)	Date of Acquisition/ Commencement of Operations
A.	**MUNICIPAL SOLID WASTE**					
1.	Marion County	Oregon	550	13.1	Owner/Operator	1987
2.	Hillsborough County	Florida	1,200	29.0	Operator	1987
3.	Hartford(5)(6)	Connecticut	2,000	68.5	Operator	1987
4.	Bristol	Connecticut	650	16.3	Owner/Operator	1988
5.	Alexandria/ Arlington	Virginia	975	22.0	Owner/Operator	1988
6.	Indianapolis(2)	Indiana	2,362	6.5	Owner/Operator	1988
7.	Warren County(5)	New Jersey	400	11.8	Owner/Operator	1988
8.	Hennepin County(5)	Minnesota	1,212	38.7	Operator	1989
9.	Stanislaus County	California	800	22.4	Owner/Operator	1989
10.	Babylon	New York	750	16.8	Owner/Operator	1989
11.	Haverhill	Massachusetts	1,650	44.6	Owner/Operator	1989
12.	Wallingford(5)	Connecticut	420	11.0	Owner/Operator	1989
13.	Kent County	Michigan	625	16.8	Operator	1990
14.	Honolulu(4)(5)	Hawaii	1,851	57.0	Lessee/Operator	1990
15.	Fairfax County	Virginia	3,000	93.0	Owner/Operator	1990
16.	Huntsville(2)	Alabama	690		Operator	1990
17.	Lake County	Florida	528	14.5	Owner/Operator	1991
18.	Lancaster County	Pennsylvania	1,200	33.1	Operator	1991
19.	Pasco County	Florida	1,050	29.7	Operator	1991
20.	Huntington(3)	New York	750	24.3	Owner/Operator	1991
21.	Detroit(2)(4)(5)	Michigan	2,832	68.0	Lessee/Operator	1991
22.	Union County(7)	New Jersey	1,440	42.1	Lessee/Operator	1994
23	Lee County	Florida	1,200	36.9	Operator	1994
24	Onondaga County(3)	New York	990	36.8	Owner/Operator	1995
25.	Montgomery County	Maryland	1,800	63.4	Operator	1995
		SUBTOTAL	30,925	816.3		
B.	**HYDROELECTRIC**					
26.	Koma Kulshan(8)	Washington		12.0	Part Owner/Operator	1997
27.	Weeks Falls(8)	Washington		5.0	Part Owner	1997
		SUBTOTAL		17.0		
C.	**WOOD**					
28.	Burney Mountain	California		11.4	Owner/Operator	1997
29	Pacific Ultrapower Chinese Station(8)	California		25.6	Part Owner	1997
30.	Mount Lassen	California		11.4	Owner/Operator	1997
31.	Pacific Oroville	California		18.7	Owner/Operator	1997

		SUBTOTAL	67.1		
D.	**LANDFILL GAS**				
32.	Gude	Maryland	3.0	Owner/Operator	1997
33.	Otay	California	3.7	Owner/Operator	1997
34.	Oxnard	California	5.6	Owner/Operator	1997
35.	Salinas	California	1.5	Owner/Operator	1997
36.	Santa Clara	California	1.5	Owner/Operator	1997
37.	Stockton	California	0.8	Owner/Operator	1997
38.	Toyon(9)	California	3.8	Operator	1977
		SUBTOTAL	19.9		
TOTAL DOMESTIC GROSS MW IN OPERATION			920.3		
E.	**WATER**				
39.	Bessemer	Alabama	24 mgd	Design/ Build/Operate	2000
			24 mgd		

NOTES:

(1) Covanta s ownership and/or operation interest in each facility listed below extends at least into calendar year 2007.

(2) Facility has been designed to export steam for sale.

(3) Owned by a limited partnership in which the limited partners are not affiliated with Covanta.

(4) Operating contracts were acquired after completion. Facility uses a refuse-derived fuel technology and does not employ the Martin technology described below.

(5) Covanta subsidiaries were purchased after construction completion.

(6) Under contracts with the Connecticut Resource Recovery Authority, Covanta operates only the boilers and turbines for this facility.

(7) The facility is leased to a Covanta subsidiary.

(8) Covanta has a 50% ownership interest in the project.

(9) Covanta owned this project from 1997 until its sale in the fourth quarter of 2004. Covanta continues to operate the project under an contract expiring in 2006.

(ii) International Energy Business

Covanta conducts its international energy businesses through Covanta Power International Holdings, Inc. (CPIH) and its subsidiaries. Internationally, the largest element of Covanta s energy business is its 26.2% ownership in and operation of the 460 MW (net) pulverized coal-fired electrical generating facility in Quezon Province, the Philippines. Covanta has interests in other fossil-fuel generating projects in Asia, a waste-to-energy project in Italy and two small hydroelectric projects in Costa Rica. In general, these projects provide returns primarily from equity distributions and, to a lesser extent, operating fees. The projects sell the electricity and steam they generate under long-term contracts or market concessions to utilities, governmental agencies providing power distribution, creditworthy industrial users, or local governmental units. In select cases, such sales of electricity and steam may be provided under short-term arrangements as well. Similarly, Covanta seeks to obtain long-term contracts for fuel supply from reliable sources.

Covanta presently has interests in international power projects with an aggregate generating capacity of approximately 1061 MW (gross). Covanta s ownership in these facilities is approximately 461 MW. In addition to its headquarters in Fairfield, New Jersey, Covanta s business is facilitated through field offices in Shanghai, China; Chennai, India; Manila, the Philippines; and Bangkok, Thailand.

In August 2004, Covanta sold its 50% equity interest in a 15 MW natural gas-fired cogeneration project in the province of Murcia, Spain and terminated its operations and maintenance agreement for the facility.

In September 2004, Covanta solicited bids for the possible sale of its ownership and operating interests in its operating power projects in Bangladesh, China and India. Indicative bids were received in October 2004 and following due diligence final bids were received in February 2005. In light of Danielson s proposed acquisition of American Ref-Fuel Holdings Corp., and the related repayment in full of the CPIH corporate debt obligations, Covanta has determined not to proceed with negotiating definitive agreements for the sale of these projects at this time. See additional information below under Recent Developments regarding such refinancing.

General Approach to International Projects

In developing its international businesses, Covanta has employed the same general approach to projects as is described above with respect to domestic projects. Given its plan to refocus its business in domestic markets, no new international project development is anticipated at this time.

The ownership and operation of facilities in foreign countries in connection with Covanta s international business entails significant political and financial uncertainties that typically are not encountered in such activities in the United States. Key international risk factors include governmentally-sponsored efforts to renegotiate long-term contracts, non-payment of fees and other monies owed to Covanta, unexpected changes in electricity tariffs, conditions in financial markets, changes in the markets for fuel, currency exchange rates, currency repatriation restrictions, currency convertibility, changes in laws and regulations and political, economic or military instability, civil unrest and expropriation. Such risks have the potential to cause material impairment to the value of Covanta s international

businesses.

Many of the countries in which Covanta operates are lesser developed countries or developing countries. The political, social and economic conditions in some of these countries are typically less stable than those in the United States. The financial condition and creditworthiness of the potential purchasers of power and services provided by Covanta (which may be a governmental or private utility or industrial consumer) or of the suppliers of fuel for projects in these countries may not be as strong as those of similar entities in developed countries. The obligations of the purchaser under the energy contract, the service recipient under the related service agreement and the supplier under the fuel supply agreement generally are not guaranteed by any host country or other creditworthy governmental agency. At the time it develops a project, Covanta undertakes a credit analysis of the proposed power purchaser or fuel supplier. It also has sought, to the extent appropriate and achievable within the commercial parameters of a project, to require such entities to provide financial instruments such as letters of credit or arrangements regarding the escrowing of the receivables of such parties in the case of power purchasers.

Covanta s power projects in particular depend on reliable and predictable delivery of fuel meeting the quantity and quality requirements of the project facilities. Covanta has typically sought to negotiate long-term contracts for the supply of fuel with creditworthy and reliable suppliers. However, the reliability of fuel deliveries may be compromised by one or more of several factors that may be more acute or may occur more frequently in developing countries than in developed countries, including a lack of sufficient infrastructure to support deliveries under all circumstances; bureaucratic delays in the import, transportation and storage of fuel in the host country; customs and tariff disputes; and local or regional unrest or political instability. In most of the foreign projects in which Covanta participates, it has sought, to the extent practicable, to shift the consequences of interruptions in the delivery of fuel (whether due to the fault of the fuel supplier or due to reasons beyond the fuel supplier s control) to the electricity purchaser or service recipient by securing a suspension of its operating responsibilities under the applicable agreements and an extension of its operating concession under such agreements. In some instances, Covanta requires the energy purchaser or service recipient to continue to make payments in respect of fixed costs if such interruptions occur. In order to mitigate the effect of short-term interruptions in the supply of fuel, Covanta has also endeavored to provide on-site storage of fuel in sufficient quantities to address such interruptions.

Payment for services that Covanta provides will often be made in whole or part in the domestic currencies of the host countries. Conversion of such currencies into U.S. dollars generally is not assured by a governmental or other creditworthy country agency and may be subject to limitations in the currency markets, as well as restrictions of the host country. In addition, fluctuations in the value of such currencies against the value of the U.S. dollar may cause Covanta s participation in such projects to yield less return than expected. Transfer of earnings and profits in any form beyond the borders of the host country may be subject to special taxes or limitations imposed by host country laws. Covanta has sought to participate in projects in jurisdictions where limitations on the convertibility and expatriation of currency have been lifted by the host country and where such local currency is freely exchangeable on the international markets. In most cases, components of project costs incurred or funded in the currency of the United States are recovered without risk of currency fluctuation through negotiated contractual adjustments to the price charged for electricity or service provided. This contractual structure may cause the cost in local currency to the project s power purchaser or service recipient to rise from time to time in excess of local inflation, and consequently there is risk in such situations that such power purchaser or service recipient will, at least in the near term, be less able or willing to pay for the project s power or service.

Covanta has sought to manage and mitigate these risks through all means that it deems appropriate, including: political and financial analysis of the host countries and the key participants in each project; guarantees of relevant agreements with creditworthy entities; political risk and other forms of insurance; participation by United States and/or international development finance institutions in the financing of projects in which Covanta participates; and joint ventures with other companies to pursue the development, financing and construction of these projects. Covanta determines which mitigation measurers to apply based on its balancing of the risk presented, the availability of such measures and their cost.

In addition, Covanta has generally participated in projects which provide services that are treated as a matter of national or key economic importance by the laws and politics of the host country. There is therefore

a risk that the assets constituting the facilities of these projects could be temporarily or permanently expropriated or nationalized by a host country, made subject to local or national control or be subject to unfavorable legislative action, regulatory decisions or changes in taxation.

In certain cases, Covanta has issued guarantees of its operating subsidiaries contractual obligations to operate certain international power projects. The potential damages owed under such arrangements for international projects may be material if called. Depending upon the circumstances giving rise to such domestic and international damages, the contractual terms of the applicable contracts, and the contract counterparty s choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than Covanta s then-available sources of funds. To date, Covanta has not incurred any material liabilities under its guarantees on international projects.

The following is a description of Covanta s international power projects by fuel type:

Waste-to-Energy

During 2000, Covanta acquired a 13% equity interest in an 18 MW mass-burn waste-to-energy project at Trezzo sull Adda in the Lombardy Region of Italy which burns up to 500 metric tons per day of municipal solid waste. The remainder of the equity in the project is held by Actelios S.p.A., a subsidiary of Falck S.p.A. and the municipality of Trezzo sull Adda. The Trezzo project is operated by Ambiente 2000 S.r.l. (A2000) an Italian special purpose limited liability company of which Covanta owns 40%. The solid waste supply for the project comes from municipalities and privately owned waste management organizations under long-term contracts. The electrical output from the Trezzo project is sold at governmentally established preferential rates under a long-term purchase contract to Italy s state-owned grid operator, Gestore della Rete di Trasmissione Nazionale S.p.A. (GRTN). The project started accepting waste in September 2002, successfully passed its performance tests in early 2003 and reached full commercial operation in August 2003. The late completion of the plant by the engineering, procurement and construction contractor, Protecma, represents a non-compliance with the terms of the contract with Protecma, and arbitration proceedings are currently underway with regard to amounts withheld by the project company, Prima Srl, in respect of penalties for late delivery of the plant. The project debt facility was refinanced in September 2004 with a new limited recourse project term loan and working capital facility from a banking consortium led by Banca Nazionale del Lavoro S.p.A.

In January 2001, A2000 also entered into a 15-year operations and maintenance agreement with E.A.L.L (Energia Ambiente Litorale Laziale S.r.l.), an Italian limited liability company owned by Ener TAD, to operate and maintain a 10 MW waste-to-energy facility capable of processing up to 300 metric tons per day of refuse-derived fuel in the Municipality of San Vittore del Lazio (Frosinone), Italy. The San Vittore project has a 15-year waste supply agreement with Reclas S.p.A. (mostly owned by regional municipalities) and a long-term power off-take contract with GRTN. The project is now in its third year of operation. There was a significant delay in starting up the plant after construction was complete due to a legal action by an environmental group that has subsequently been overturned. Operation and maintenance of the plant by A2000 was scheduled to commence in the third quarter of 2004 but has been delayed due to a dispute between the owner and operator as to the validity of the operations and maintenance agreement. Arbitration proceedings have commenced to settle the dispute.

Hydroelectric

Covanta operates the Don Pedro and the Río Volcán facilities in Costa Rica through an operating subsidiary pursuant to long-term contracts. Covanta also has a nominal equity investment in each project. The electric output from both of these facilities is sold to Instituto Costarricense de Electricidad, a Costa Rica national electric utility.

Coal

A consortium, of which Covanta is a 26% member, owns a 510 MW (gross) coal-fired electric generating facility in the Philippines (the Quezon Project). The project first generated electricity in October 1999 and full commercial operation occurred during the second quarter of 2000. The other members of the consortium

are an affiliate of International Generating Company, an affiliate of General Electric Capital Corporation, and PMR Limited Co., a Philippines partnership. The consortium sells electricity to Manila Electric Company (Meralco), the largest electric distribution company in the Philippines, which serves the area surrounding and including metropolitan Manila. Under an energy contract expiring in 2025, Meralco is obligated to take or pay for stated minimum annual quantities of electricity produced by the facility at an all-in tariff which consists of capacity, operating, energy, transmission and other fees adjusted to inflation, fuel cost and foreign exchange fluctuations. The consortium has entered into two coal supply contracts expiring in 2015 and 2022. Under these supply contracts, cost of coal is determined using a base energy price adjusted to fluctuations of specified international benchmark prices. Covanta is operating the project through a local subsidiary under a long-term agreement with the consortium. The financial condition of Meralco has been recently stressed by the failure of regulators to grant tariff increases to allow Meralco to achieve rates of return permitted by law. For further discussion, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Covanta has obtained political risk insurance for its equity investment in this project.

Covanta has majority equity interests in three coal-fired cogeneration facilities in three provinces in the People s Republic of China. Two of these projects are operated by the project entity, in which Covanta has a majority interest. The third project is operated by an affiliate of the minority equity shareholder. Parties holding minority positions in the projects include a private company, a local government enterprise and affiliates of the local municipal government. In connection with one of these projects, the local People s Congress has enacted a non-binding resolution calling for the relocation of the cogeneration facility from the city center to an industrial zone. The project company is currently reviewing its options in this matter. While the steam produced at each of the three projects is intended to be sold under long-term contracts to the industrial hosts, in practice, steam has been sold on either a short-term basis to local industries or the industrial hosts, in each case at varying rates and quantities. For two of these projects, the electric power is sold at average grid rate to a subsidiary of the Provincial Power Bureau. At one project, the electric power is sold directly to an industrial customer at a similar rate. In 2004, Covanta discontinued political risk insurance for its equity investment in these projects.

Natural Gas

In 1998, Covanta acquired an equity interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired facility located near Haripur, Republic of Bangladesh. This project began commercial operation in June 1999 and is operated by a subsidiary of Covanta. Covanta owns approximately 45% of the project company equity. An affiliate of El Paso Energy Corporation owns 50% of such equity, and the remaining interest is held by Wartsila North America, Inc. The electrical output of the project is sold to the Bangladesh Power Development Board (the BPDB) pursuant to an energy contract with minimum energy off-take provisions at a tariff divided into a fuel component and an other component. The fuel component reimburses the fuel cost incurred by the project up to a specified heat rate. The other component consists of a pre-determined base rate adjusted to actual load factor and foreign exchange fluctuations. The energy contract also obligates the BPDB to supply all the natural gas requirements of the project at a pre-determined base cost adjusted to fluctuations on actual landed cost of the fuel in Bangladesh. The BPDB s obligations under the agreement are guaranteed by the Government of Bangladesh. In 1999, the project received $87 million in financing and political risk insurance from the Overseas Private Investment Corporation (OPIC). Covanta obtained separate political risk coverage for its equity interest in this project. In 2004, the project obtained from OPIC the extension of an existing waiver permitting it to continue to forego obtaining certain project insurance coverage levels that are not presently commercially available.

Diesel/ Heavy Fuel Oil

In 1999, Covanta acquired an equity interest in a 106 MW (gross) heavy fuel oil-fired generating facility located near Samalpatti, Tamil Nadu, India. This project achieved commercial operation during the first quarter of 2001. The project is operated by a subsidiary of Covanta. Covanta owns a 60% interest in the project company. Shapoorji Pallonji Infrastructure Capital Co. Ltd. and its affiliates own 29% of such equity with the remainder of 11% being held by Wartsila India Power Investment, LLC. The electrical output of the project is

sold to the Tamil Nadu Electricity Board (the TNEB) pursuant to a long-term agreement with full pass-through tariff at a specified heat rate, operation and maintenance cost, and return on equity. The TNEB s obligations are guaranteed by the government of the State of Tamil Nadu. Bharat Petroleum Corporation, Ltd. supplies the oil requirements of the project through a fifteen-year fuel supply agreement based on market prices.

In 2000, Covanta acquired a controlling interest in a second project in India, the 106 MW Madurai project located at Samayanallur in the State of Tamil Nadu, India. The project began commercial operation in the fourth quarter of 2001. Covanta owns approximately 76.6% of the project equity and operates the project through a subsidiary. The balance of the project ownership interest is held by an Indian company controlled by the original project developer. The electrical output of the project is sold to the TNEB pursuant to a long-term agreement with full pass-through tariff at a specified heat rate, operation and maintenance cost, and return on equity. The TNEB s obligations are guaranteed by the government of the state of Tamil Nadu. Indian Oil Corporation, Ltd. supplies the oil requirements of the project through 15 year fuel supply agreement based on market prices.

Disputing several tariff provisions, the TNEB has failed to pay the full amount due under the energy contracts for both the Samalpatti and Madurai projects. Similar to many Indian state electricity boards, the TNEB has also failed to fund the escrow account or post letter of credit required under the project energy contracts, which failure constitutes a default under the project finance documents. The project lenders for both projects have not declared an event of default due to this matter and have permitted continued distributions of project dividends. To date, the TNEB has paid the undisputed portion of its payment obligations (approximately 93%) representing each project s operating costs, fuel costs, debt service and some equity return. Project lenders for both projects have either granted periodic waivers of such default or potential default and/or otherwise approved scheduled equity distributions. Neither such default nor potential default in the project financing arrangements constitutes a default under CPIH s recourse debt. Further, during 2004 CPIH was able to refinance a significant portion of the original project debt for both projects. While the tenor and the covenants remain the same, each project has been able to lower its interest costs substantially, resulting in reduced tariffs to the TNEB. The TNEB has indicated a desire to renegotiate tariffs for both project energy contracts, and it is possible that the issue of the escrow account or letter of credit requirement will be resolved as part of any such process.

Covanta owns interests in three diesel fuel facilities in the Philippines.

The Bataan Cogeneration project is an inactive moth-balled 58 MW facility that is owned by Covanta. Due to the inability to obtain a profitable power off-take agreement for this project following the June 2004 expiration of its principal off-take agreement, the project company in August 2004 exercised its option to pre-terminate its remaining loss-producing off-take agreement and ceased operations. Covanta has determined to auction off the physical assets. Such auction is anticipated to occur upon receipt of governmental approvals. Covanta previously wrote off its investment in this project in 2002.

Covanta owns a minority interest in the Island Power project, a 7 MW facility that has a long-term power contract with the National Power Corporation. Covanta does not believe its equity interest in this project has any value and in 1998 wrote off its investment. This project is not operated by Covanta. Covanta is exploring means of divesting its interest in this facility to the holders of the majority interest. It is uncertain at this time whether Covanta would realize any value from such a sale.

A subsidiary of Covanta owns and operates the Magellan cogeneration project, a 63 MW diesel fired electric generating facility in the province of Cavite, the Philippines. This project sells a portion of its energy and capacity to the National Power Corporation and a portion to the Philippine Economic Zone Authority (the Authority) pursuant to long-term energy contracts. On January 3, 2002, the Authority, the main power off-taker for this project, served the project with notice of termination of the energy contract for alleged non-performance by the project. Covanta disagrees with this assertion and has sought a court injunction against termination of the energy contract and to require arbitration of the dispute which involves alleged non-reliable operations and alleged improper substitution of National Power Corporation power for Magellan production. On February 6, 2002, The Regional Trial Court, National Capital Judicial Region, Branch 115, Pasay City

issued a temporary restraining order barring the Authority from terminating the energy contract. On April 5, 2002 after a series of hearings, such Court replaced such temporary restraining order with a preliminary injunction. Such preliminary injunction restrains the Authority from terminating the energy contract until such time as the merits of the case are resolved. If such case were ultimately to be decided in favor of the Authority, the project would lose not only the energy contract but also that portion of the plant site under lease from the Authority as such lease is tied to the energy contract. Due to high fuel pricing and low tariff conditions, project revenues were insufficient to cover both operating costs and debt service beyond the second quarter of 2004. As a result, on May 31, 2004, the Magellan project company filed a petition for corporate rehabilitation under Philippine law. On June 3, 2004, the Regional Trial Court, Fourth Judicial Region, Branch 21, Imus, Cavite issued a stay order enjoining creditors from pursuing collection of pre-petition debts and ordering suppliers to continue supplying goods and services in exchange for prompt payment. In addition, a Rehabilitation Receiver was appointed. On August 31, 2004, the same Regional Trial Court issued a due course order finding the rehabilitation petition to have sufficient merit to proceed. The Rehabilitation Receiver submitted his comments to the proposed rehabilitation plan and an alternative rehabilitation plan in January 2005. The final rehabilitation plan may provide for debt forgiveness, a debt equity swap, a reduction in interest rate and/or an extension of the debt tenor. Covanta wrote off its investment in this project in 2002.

International Project Dispositions 2004

On August 12, 2004, the Company sold its 50% ownership interest in an approximately 14 MW industrial cogeneration facility located in Murcia, Spain. Covanta received a total of approximately $1.8 million for its interest in the facility.

International Project Summaries

Summary information with respect to Covanta s projects(1) that are currently operating is provided in the following table:

		Location	Gross Electric Output (MW)	Nature of Interest(1)	Date of Acquisition/ Commencement of Operations
A.	**WASTE TO ENERGY**				
1.	Trezzo(2)	Italy	18	Part Owner/Operator	2003
2.	San Vittore(3)	Italy	10	Operator	2005(est.)
		SUBTOTAL	28		
B.	**HYDROELECTRIC**				
3.	Rio Volcán(4)	Costa Rica	17	Part Owner/Operator	1997
4.	Don Pedro(4)	Costa Rica	14	Part Owner/Operator	1996
		SUBTOTAL	31		
C.	**COAL**				
5.	Quezon(5)	the Philippines	510	Part Owner/Operator	2000
6.	Lin an(7)	China	24	Part Owner/Operator	1997
7.	Huantai(6)	China	36	Part Owner	1997
8.	Yanjiang(8)	China	24	Part Owner/Operator	1997
		SUBTOTAL	594		
D.	**NATURAL GAS**				
9.	Haripur(9)	Bangladesh	126	Part Owner/Operator	1999

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		Location	Gross Electric Output (MW)	Nature of Interest(1)	Date of Acquisition/ Commencement of Operations
E.	**DIESEL/ HEAVY FUEL OIL**				
10.	Island Power Corporation(10)	the Philippines	7	Part Owner	1996
11.	Magellan Cogeneration	the Philippines	63	Owner/Operator	1999
12.	Samalpatti(6)	India	106	Part Owner/Operator	2001
13.	Madurai(11)	India	106	Part Owner/Operator	2001
		SUBTOTAL	282		
TOTAL INTERNATIONAL MW IN OPERATION			1,061		

NOTES

(1) Covanta s ownership and/or operation interest in each facility listed below extends at least into calendar year 2007.

(2) Covanta has a 13% interest in this project and a 40% interest in the operator Ambiente 2000 S.r.l. A2000 .

(3) Operation by A2000 begins one year after the project begins commercial operation provided certain criteria are satisfied.

(4) Covanta has a nominal interest in this project.

(5) Covanta has an approximate 26% ownership interest in this project.

(6) Covanta has a 60% ownership interest in these projects.

(7) Covanta has an approximate 64% interest in this project.

(8) Covanta has an approximate 96% ownership interest in this project.

(9) Covanta has an approximate 45% interest in this project. This project is capable of operating through combustion of diesel oil in addition to natural gas.

(10) Covanta has an approximate 19.6% ownership interest in this project.

(11) Covanta has an approximate 77% interest in this project.

(iii) Description of Covanta Reorganization and Related Dispositions of Assets

Covanta s domestic and international businesses were reorganized when they emerged from bankruptcy on March 10, 2004 and Covanta became a wholly-owned subsidiary of Danielson.

Covanta s Chapter 11 proceedings commenced on April 1, 2002 (the First Petition Date), when Covanta and most of its domestic subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the Bankruptcy Court). All of the bankruptcy cases (the Chapter 11 Cases) were jointly administered under the caption In re Ogden New York Services, Inc., et al., Case Nos. 02-40826 (CB), et al. As debtors-in-possession, Covanta and its subsidiaries that were part of the Chapter 11 Cases (the Debtors) were authorized to continue to operate as an ongoing business.

In order to obtain post-petition financing, with the approval of the Bankruptcy Court, the Debtors entered into a Debtor-in-Possession Credit Agreement dated as of April 1, 2002 with several financial institutions (as amended, the DIP Financing Facility) with the Debtors prepetition bank lenders (the DIP Lenders).

Over the course of the Chapter 11 Cases, the Debtors disposed of all remaining interests in their entertainment and aviation businesses. The Debtors also held discussions with the Official Committee of Unsecured Creditors (the Creditors Committee), representatives of the Debtors prepetition bank lenders and other lenders (the DIP Lenders and together with the Company s pre-petition bank lenders, the

Secured Bank Lenders) under the DIP Financing Facility, as discussed below, and the holders of Covanta s 9.25% Debentures with respect to possible capital and debt structures for the Debtors and the formulation of a plan of reorganization. In connection with such discussion, it was determined to be in the best interests of the Debtors estates to dispose of Covanta s geothermal project businesses, which was effected in December 2003.

On December 2, 2003, Covanta and Danielson entered into an Investment and Purchase Agreement dated December 2, 2003 (as amended, the Danielson Agreement). The Danielson Agreement provided for:

- Danielson to purchase 100% of the shares of reorganized Covanta (New Common) for $30 million as part of a plan of reorganization (the Danielson Transaction);

- agreement as to new revolving credit and letter of credit facilities for Covanta s domestic and international operations, provided by certain of the Secured Bank Lenders and a group of additional lenders organized by Danielson; and

- execution and consummation of a Tax Sharing Agreement between Danielson and reorganized Covanta (the Tax Sharing Agreement), pursuant to which Covanta s share of Danielson s consolidated group tax liability for taxable years ending after consummation of the Danielson Transaction will be computed taking into account Danielson s net operating losses (NOLs) generated before January 1, 2003 to the extent not utilized by any other existing member of the consolidated group, and Danielson will have an obligation to indemnify and hold harmless Covanta for certain excess tax liability.

The Debtors determined that the Danielson Transaction was in the best interests of their estates and their creditors and was preferable to other alternatives under consideration because it provided:

- a more favorable capital structure for the Debtors upon emergence from Chapter 11;

- the injection of $30 million in equity from Danielson;

- enhanced access to capital markets through Danielson;

- diminished syndication risk in connection with the reorganized Debtors financing under the exit financing agreements; and

- reduced exposure of the Secured Bank Lenders as a result of financing arranged by new lenders.

On March 5, 2004, the Bankruptcy Court entered an order confirming the Debtors plans of reorganization premised on the Danielson Transaction and liquidation for certain of those Debtors involved in non-core businesses (the Liquidation Plan collectively with the plan of reorganization, the Reorganization Plan.), and on March 10, 2004 both Plans were effected upon the consummation of the Danielson Transaction (the plans of reorganization and liquidation collectively, the Reorganization Plan). The Debtors owning or operating Covanta s Warren County, New Jersey, Lake County, Florida and Tampa Bay, Florida projects initially remained debtors-in-possession (the Remaining Debtors), and were not the subject of the Reorganization Plan. During 2004, Covanta s subsidiaries involved with the Tampa Bay project and the Lake County project emerged from bankruptcy under separate reorganization plans. Covanta s subsidiaries involved with the Warren County project remain in bankruptcy.

The Reorganization Plan provided for, among other things, the following distributions:

(i) Secured Bank Lender and 9.25% Debenture Holder Claims

On account of their allowed secured claims, the Secured Bank Lenders and the 9.25% Debenture holders received, in the aggregate, a distribution consisting of:

- the cash available for distribution after payment by the Debtors of exit costs necessary to confirm the Reorganization Plan and establishment of required reserves pursuant to the Reorganization Plan,

new high-yield secured notes issued by Covanta and guaranteed by its subsidiaries (other than CPIH and its subsidiaries) which are not contractually prohibited from incurring or guaranteeing additional

debt (Covanta and such subsidiaries, the Domestic Borrowers) with a stated maturity of seven years (the High Yield Notes), and

a term loan of CPIH with a stated maturity of three years.

Additionally, the Reorganization Plan incorporates the terms of a settlement of litigation that had commenced during the Chapter 11 Cases by the Creditors Committee challenging the validity of the lien asserted on behalf of the holders of the 9.25% Debentures (the 9.25% Debenture Adversary Proceeding). Pursuant to the settlement, holders of general unsecured claims against Covanta are entitled to receive 12.5% of the value that would otherwise be distributable to the holders of 9.25% Debenture claims that participate in the settlement.

(ii) Unsecured Claims against Operating Company Subsidiaries

The holders of allowed unsecured claims against any of Covanta s operating subsidiaries will receive new unsecured notes in a principal amount equal to the amount of their allowed unsecured claims with a stated maturity of eight years (the Unsecured Notes).

(iii) Unsecured Claims against Covanta and Holding Company Subsidiaries

The holders of allowed unsecured claims against Covanta or certain of its holding company subsidiaries will receive, in the aggregate, a distribution consisting of (i) $4 million in principal amount of Unsecured Notes, (ii) a participation interest equal to five percent of the first $80 million in net proceeds received in connection with the sale or other disposition of CPIH and its subsidiaries used to pay down CPIH debt, if it were to effect asset sales, and (iii) the recoveries, if any, from avoidance actions not waived under the plan that might be brought on behalf of Covanta and its subsidiaries. As described above, pursuant to the Reorganization Plan, each holder of an allowed unsecured claim against Covanta or certain of its holding company subsidiaries is entitled to receive its pro-rata share of 12.5% of the value that would otherwise be distributable to the holders of 9.25% debenture claims that participate in the settlement of the 9.25% Debenture Adversary Proceeding pursuant to the Reorganization Plan.

(iv) Subordinated Claims of holders of Convertible Subordinated Debentures

The holders of Covanta s 6% Convertible Subordinated Debentures and its 5.75% Subordinated Debentures (together, the Convertible Subordinated Debentures) neither received distributions nor retained any property pursuant to the Reorganization Plan. The Convertible Subordinated Debentures were cancelled as of March 10, 2004.

(v) Equity interests of Old Common and Old Preferred stockholders

The holders of equity interests of Covanta s Old Preferred and Old Common shares outstanding immediately before consummation of the Danielson Transaction received no distribution and retained no property pursuant to the Reorganization Plan. The Old Preferred and Old Common shares were cancelled as of March 10, 2004.

The Liquidation Plan provided for the complete liquidation of those of Covanta s subsidiaries that have been designated as liquidating entities. Substantially all of the assets of these liquidating entities have already been sold. Under the Liquidation Plan the creditors of the liquidating entities will not receive any distribution other than those administrative creditors with respect to claims against the liquidating entities that have been incurred in the implementation of the Liquidation Plan and priority claims required to be paid under the Bankruptcy Code.

As further set forth in this Part 1, Item Business and Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, there are risks that might affect Covanta s ability to implement its business plan and pay the various debt instruments that were issued pursuant to the Reorganization Plan.

As a result of the consummation of the Danielson Transaction, Covanta emerged from bankruptcy with a new debt structure. Domestic Borrowers have two credit facilities:

- a letter of credit facility (the First Lien Facility), for the issuance of letters of credit required in connection with one waste-to-energy facility, the current aggregate amount of which was approximately $120 million at December 31, 2004, and

- a letter of credit and liquidity facility (the Second Lien Facility), in the aggregate amount of $118 million of which approximately $71 million was outstanding at December 31, 2004, up to $10 million of which shall also be available for cash borrowings on a revolving basis and the balance for letters of credit. Through December 31, 2004, CPIH had not sought to make draws on this facility and the outstanding commitment amount has been reduced to $9.1 million.

Both facilities expire on March 10, 2009 and are secured by the assets of the Domestic Borrowers not otherwise pledged. The lien of the Second Lien Facility is junior to that of the First Lien Facility.

The Domestic Borrowers also issued the High Yield Notes and issued or will issue the Unsecured Notes. The High Yield Notes are secured by a third priority lien in the same collateral securing the First Lien Facility and the Second Lien Facility. The High Yield Notes were issued in the initial principal amount of $205 million, which will accrete to $230 million at maturity in 7 years. The current accreted amount of the High Yield Notes was approximately $207.7 million at December 31, 2004.

Unsecured Notes in a principal amount of $4 million were issued on the effective date of the Reorganization Plan. Covanta issued additional Unsecured Notes in a principal amount of $20 million after emergence and recorded additional Unsecured Notes in a principal amount of $4 million in 2004 which it expects to issue in 2005. The final principal amount of all Unsecured Notes will be equal to the amount of allowed unsecured claims against Covanta s operating subsidiaries which were Reorganizing Debtors, and such amount will be determined at such time as the allowance of all such claims are resolved through settlement or further proceedings in the Bankruptcy Court. Notwithstanding the date on which Unsecured Notes are issued, interest on the Unsecured Notes accrues from March 10, 2004.

Also, CPIH and each of its domestic subsidiaries, which hold all of the assets and operations of Covanta s international businesses (the CPIH Borrowers) entered into two secured credit facilities:

- a revolving credit facility, secured by a first priority lien on substantially all of the CPIH Borrowers assets not otherwise pledged, consisting of commitments for cash borrowings in the initial amount of up to $10 million, which remained undrawn at December 31, 2004, for purposes of supporting the international businesses, and

- a term loan facility of up to $95 million, the outstanding amount of which approximately $77 million was outstanding at December 31, 2004, secured by a second priority lien on the same collateral.

Both facilities will mature in March 2007. The debt of the CPIH Borrowers is non-recourse to Covanta and its other domestic subsidiaries. For further discussion, see Part II, Item 7, Management s Discussion and Analysis of Financial Conditions and Results of Operations.

In addition, in the Chapter 11 cases, the Debtors had the right, subject to Bankruptcy Court approval and certain other limitations, to assume or reject executory contracts and unexpired leases. As a condition to assuming a contract, each Debtor was required to cure all existing defaults (including payment defaults). Covanta paid approximately $9 million in cure amounts in connection with assumed executory contracts and unexpired leases

(C) Insurance Services Business

Following the acquisition of Covanta, the relative contribution of Danielson s insurance services business to Danielson s cash flow and its relative percentage of Danielson s financial obligations were significantly reduced. Consequently, unlike prior years, Danielson s insurance services business neither contributes materially to Danielson s cash flow nor imposes material financial obligations on Danielson.

The insurance services business, however, continues to represent an important element of Danielson s structure in that Danielson s NOLs were in part generated through the operations of former subsidiaries of Danielson Indemnity Company (DIND). Danielson s ability to utilize that portion of the NOLs will depend upon the continued inclusion of its insurance services business in Danielson s consolidated federal tax return. See Note 25 in Notes to Consolidated Financial Statements for more information on Danielson s NOLs.

As discussed more fully below, Danielson s insurance services businesses have succeeded in reducing losses by tightening underwriting criteria, exiting unprofitable lines of business and focusing on writing more profitable lines of business through its expanded arrangement with SCJ Insurance Services (SCJ).

Discussion of Business

Danielson s insurance operations are conducted through wholly-owned subsidiaries. National American Insurance Company of California (NAICC), an indirect, wholly-owned subsidiary of Danielson through DIND, is Danielson s principal operating insurance subsidiary. NAICC, in turn, is the sole stockholder of Valor Insurance Company, Incorporated, a Montana domiciled specialty insurance company (Valor), Danielson Insurance Company (DICO) and Danielson National Insurance Company (DNIC). Unless otherwise specified or the context requires otherwise, references to NAICC include NAICC and its subsidiaries.

NAICC has historically managed its business across four principal lines of business: (1) non-standard private passenger automobile; (2) commercial automobile; (3) workers compensation; and (4) property and casualty. However, as of December 31, 2004, NAICC was engaged in writing exclusively non-standard private passenger automobile primarily in California.

Insurers admitted in California are required to obtain approval from the California Department of Insurance (CDOI) of rates and/or forms prior to being used. Many of the other states, in which NAICC does business, have similar requirements. Rates and policy forms are developed by NAICC and filed with the regulators in each of the relevant states, depending upon each state s requirements. NAICC relies upon its own as well as industry experience in establishing rates.

NAICC began writing non-standard private passenger automobile insurance in California in July 1993 through SCJ and endeavored to write additional personal automobile programs beginning in 1998 in other territories, but due to underwriting losses, ceased writing such additional policies in March 2002.

Non-standard risks are those segments of the driving public which generally are not considered preferred business, such as drivers with a record of prior accidents or driving violations, drivers involved in particular occupations or driving certain types of vehicles, or those who drivers whose policies have not been renewed or declined by another insurance company. Generally, in order to address the associated higher risk or non-standard private automobile insurance, their premium rates are higher than standard premium rates while policy limits are lower than typical policy limits. Policyholder selection is governed by underwriting guidelines established by NAICC. Management believes that it is able to achieve underwriting success through refinement of various risk profiles, thereby dividing the non-standard market into more defined segments which can be adequately priced. Additionally, traditional lower policy limits lend themselves to quicker claims processing allowing management to respond more quickly to changing loss trends, by revising revised underlying underwriting guidelines and class and rate filings accordingly.

Private passenger automobile policy limits vary by state. In California non-standard policies primarily provide maximum coverage up to the statutory minimum of $15,000 per person, $30,000 per accident for liability and bodily injury and $10,000 per accident for property damage.

Net written premiums were $15.2 million, $18.1 million and $25.4 million in 2004, 2003 and 2002, respectively, for the non-standard private passenger automobile program. The primary reason for the continued decrease in private passenger automobile premiums in 2003 and 2004 were internally-imposed underwriting restrictions placed on the California non-standard automobile program in February 2002.

However, in November 2004, NAICC lifted its moratorium on the non-standard personal automobile program after receiving approval from CDOI for a new rate and class plan filing that is offered by DNIC through SCJ.

As a result of the favorable underwriting results in the non-standard personal automobile market, coupled with low premium leverage on its surplus, NAICC has retained 100% of the underlying risk of this program since 2001. Commencing in January 2005, NAICC and DNIC began to reinsure, on a quota share basis, 28% and 40%, respectively of its underlying risk with an AM Best A rated reinsurer. The new reinsurance program was sought to address premium growth ratio guidelines established by the Insurance Regulation Information System (IRIS) and the relative uncertainty of the underwriting results of the new program.

NAICC does not write any business through managing general agents. SCJ is responsible for all of the marketing, underwriting and policy administration for the non-standard personal automobile policies in California. SCJ does not have rate making authority nor can it bind reinsurance on behalf of NAICC and DNIC. In return SCJ receives a flat commission on new and renewal policies written and participates in an incentive compensation arrangement dictated solely by underwriting results.

Commercial Automobile

NAICC began writing non-standard commercial automobile insurance in 1995 through independent agents and ceased writing new policies in July 2003. In September 2003, NAICC began providing 60-day statutory notification to non-renew all in-force policies. As a result, as of September 2004, there was no further loss exposure on this line. The majority of automobiles owned or used by businesses are insured under policies that provide other coverage for the business, such as commercial multi-peril insurance. The policies issued by NAICC were generally to businesses that were unable to insure a specific driver and businesses having vehicles not qualifying for commercial multi-peril insurance. The typical NAICC commercial automobile policy covered fleets of four or fewer vehicles. NAICC did not insure interstate trucking, trucks hauling logs, gasoline or similar higher hazard operations.

The maximum non-standard commercial automobile policy limit provided by NAICC was $1 million for bodily injury and property damage combined as a single limit of liability for each occurrence. NAICC retained the first $0.25 million of bodily injury and property damage combined as a single limit of liability for each occurrence.

Net written premiums for commercial automobile insurance were $(0.1) million, $11.9 million and $19.5 million in 2004, 2003 and 2002, respectively. The decrease in commercial automobile premiums in 2003 and 2004 was attributable to NAICC s decision to exit this line of business. The decision to exit the market was primarily driven by the unprofitable historical underwriting results, lack of surplus capacity and relatively high net retentions for this line of business.

Workers Compensation

NAICC began writing workers compensation insurance in 1987 and ceased writing policies in January 2002 in response to adverse market developments and loss experience. Through January 2002, NAICC and its subsidiary Valor wrote workers compensation insurance primarily in California and Montana. NAICC previously wrote workers compensation insurance in California and four other western states. Workers compensation insurance policies provide coverage for statutory benefits which employers are required to pay to employees who are injured in the course of employment including, among other things, temporary or permanent disability benefits, death benefits, medical and hospital expenses and expenses for vocational rehabilitation. Policies were issued having a term of no more than one year. The last California workers compensation policy was issued in July 2001 and the last policy issued outside of California was issued in January 2002. Valor began non-renewing all policies in December 2001 and was placed into run-off effective January 2002.

Prior to April 2000, NAICC retained the first $0.5 million of each workers compensation loss and purchased reinsurance for up to $49.5 million in excess of its retention, the first $9.5 million of which has been placed with three major reinsurance companies with the remaining $40 million provided by 16 other

companies. In April 2000, NAICC entered into a workers compensation excess of loss reinsurance agreement with SCOR Re Insurance Company that provided coverage commencing at losses of $0.2 million. In May 2001, the $0.3 million excess of $200,000 layer was placed with PMA Re Insurance Company on a 50% participation basis through run-off.

Prior to January 1996, NAICC retained the first $0.4 million of each workers compensation loss and $0.5 million through March 2000. In April 2000, NAICC entered into a workers compensation excess of loss reinsurance agreement with SCOR Re Insurance Company that provided coverage commencing at losses of $0.2 million. In May 2001, the $0.3 million excess of $0.2 million layer was placed with PMA Re Insurance Company on a 50% participation basis through run-off. NAICC has purchased reinsurance up to a $50.0 million limit, net of its own retention. The first $10.0 million limit was placed with three major reinsurance companies with the remaining $40.0 million limit provided by 16 other companies.

Net written premiums for workers compensation were nil, $0.3 million and $7.6 million in 2004, 2003 and 2002, respectively. These decreases reflected NAICC s and Valor s exit from the market.

Property and Casualty

As of December 31, 1985, NAICC through a series of assumption agreements assumed the assets and liabilities of the Stuyvesant Insurance Company (Stuyvesant) for policies issued prior to 1978, along with then other affiliated H.F. Ahmanson insurance subsidiaries (collectively referred as H.F. Ahmanson). NAICC was subsequently acquired by KCP Holding Company (KCP) on September 19, 1986. On July 29, 1988, Mission American Insurance Company (MAIC) pursuant to an assumption agreement transferred all of its assets and liabilities (accident years 1985 through 1988) to NAICC in exchange for 62.76% of KCP s total common stock. MAIC was part of the Mission Insurance Group, Inc., which subsequently emerged from bankruptcy on August 16, 1990 as a predecessor of Danielson. On December 31, 1991, Danielson s predecessor acquired the remaining outstanding shares of KCP, not then indirectly owned by Danielson, through its ownership of MAIC. NAICC for the years 1987 to 1995 wrote a commercial multi peril program for artisan contractors, and separately, a homeowners program from 1998 to 2001. NAICC continues to discharge claims arising under its own insurance policies and contracts and those issued by MAIC, Stuyvesant and other H.F. Ahmanson former insurance affiliates.

The property and casualty claims are categorized as follows: (1) direct excess and primary policies; (2) workers compensation; (3) reinsurance assumed on an excess of loss basis; and (4) reinsurance assumed on pool business primarily from the London marketplace. Substantially all remaining claims on policies, issued by companies other than by NAICC, are of an asbestos and environmental (A&E) nature.

As of December 31, 2004, there remained 63 direct excess and primary claims, of which 17 were related to policies issued by Stuyvesant, 23 by H.F. Ahmanson entities, 9 by MAIC and 12 by NAICC. These claims generally had policy limits up to $1 million with reinsurance generally above $50,000. NAICC issued-policies are approaching the 10-year statute of limitations baring future claims acceptance. As of December 31, 2004, there were 51 open workers compensation claims, the majority of which were issued by MAIC with no reinsurance coverage. The assumed reinsurance contracts had relatively low participation, generally less than $25,000, and estimates of unpaid losses have been based on information provided by the primary insurance companies. At December 31, 2004, there were 395 open claims related to excess of loss assumed reinsurance. As of December 31, 2004 and 2003, NAICC s net unpaid losses and loss adjustment expenses relating to A&E claims were approximately $8.2 million and $8.3 million, respectively. In the most current three years of development there has been an influx of newly reported A&E cases on an excess of loss basis related to the Stuyvesant issued policies that are beginning to pierce the limits in which NAICC participates. New cases reported in 2004, 2003 and 2002 on the assumed excess of loss of business increased 2%, 19% and 15%, respectively; however, the incurred losses, related to assumed excess of loss of business, were less than $0.4 million for the last three years. Approximately 40% of the aggregate assumed pool business has been reinsured, all with AM Best rated A or better carriers. Management has been successful in commuting with several cedants and pools with respect to the assumed liabilities and will continue to look for such opportunities in the future.

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Marketing

NAICC currently markets its non-standard private passenger automobile insurance in California through SCJ who in turn uses over 600 sub-agents or retail brokers to obtain applications for policies. SCJ processed 16,641, 16,002 and 43,013 applications in 2004, 2003 and 2002, binding 95.6%, 96.1% and 96.3% as policies, respectively.

Claims

All automobile claims are handled by employees of NAICC at its home office in Long Beach, California. Claims are reported by agents, insureds and claimants directly to NAICC. Claims involving suspected fraud are referred to an in-house special investigation unit (SIU) which manages a detailed investigation of these claims using outside investigative firms. When evidence of fraudulent activity is identified, the SIU works with the various state departments of insurance, the National Insurance Crime Bureau and local law enforcement agencies in handling the claims.

Workers compensation claims have been consolidated and outsourced to a regional third party administrator, TRISTAR Risk Management (Tristar) effective July 2004. NAICC transferred all of its files, to leverage Tristar s medical fee discounts, including medical provider networks, operational size, supervision, and SIU and quality assurance program on the remaining outstanding claims liability.

Property and casualty claims are received, reviewed and processed by NAICC employees located in Long Beach, California. Additionally, NAICC uses external consultants and attorneys to aid in determining the extent, obligation and accuracy of claims originating from Stuyvesant policies issued prior to 1978.

Losses and Loss Adjustment Expenses

NAICC s net unpaid losses and loss adjustment expenses (LAE) represent the estimated indemnity cost and expense necessary to cover the ultimate net cost of investigating and settling claims.

Such estimates are based upon estimates for reported losses, historical company experience of losses reported by reinsured companies for insurance assumed and actuarial estimates based upon historical company and industry experience for development of reported and unreported claims (incurred but not reported). Any changes in estimates of ultimate liability are reflected in current operating results. Inflation is assumed, along with other factors, in estimating future claim costs and related liabilities. NAICC does not discount any of its loss reserves.

The California legislature in response to rising workers compensation costs and a lack of available market, passed Assembly Bill No. 227 (AB 227), Senate Bill No. 228 (SB 228) both signed on September 12, 2003, and Senate Bill No. 899 (SB 899), effective April 19, 2004, all of which were signed by the Governor. These bills contain many reforms designed to reduce the cost of workers compensation claims. Several of the provisions apply to medical services provided after the effective dates, including services on injuries that occurred prior to the effective dates. As a result, the reforms are expected to have a retroactive impact and therefore affect pre-established reserve levels. The six major provisions that could have a retroactive impact on NAICC s reserves are:

Changes to the Official Medical Fee Schedule Values for Physician Services

Changes to the Official Medical Fee Schedule for Inpatient Services

Pharmaceutical Fee Schedule

Outpatient Surgery Center Fee Schedule

Repeal of the Primary Treating Physician Presumption for Pre-2003 Injuries

Other Medical Treatment Utilization

Soon after the legislative changes became effective, NAICC observed an increase in attempts to settle claims. The ultimate loss and allocated LAE (ALAE) estimates for NAICC (non Valor) workers

compensation was reduced by $2.6 million between 2003 and 2004 or approximately 19% of the prior year reserves. Although the actuarial estimates did not explicitly factor the effect of the reforms, NAICC believes that the favorable development were, in part, related to the new legislation.

The ultimate cost of claims is difficult to predict for several reasons. Claims may not be reported until many years after they are incurred. Changes in the rate of inflation and uncertainty in the legal environment may also create forecasting complications. Court decisions may dramatically increase liability in the time between the dates on which a claim is reported and its resolution. For example, punitive damages awards have grown in frequency and magnitude. Courts have imposed increasing obligations on insurance companies to defend policyholders. As a result, the frequency and severity of claims have grown rapidly and unpredictably.

The unpaid losses and LAE, related to environmental cleanup, were established considering facts then currently known and the then current state of the law and coverage litigation. Liabilities are estimated for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific contract of insurance or reinsurance and management can reasonably estimate its liability. Estimates for unknown claims and development on reported claims are included in NAICC s unpaid losses and LAE. The liability for development of reported claims has been based on the estimates of the range of potential losses for reported claims in the aggregate. Estimates of liabilities are reviewed and updated continually and there is the potential that NAICC s ultimate liabilities could be materially in excess of amounts that are currently recorded.

Management believes, taking into account the opinions of independent actuarial professionals, that that the provisions for unpaid losses and LAE are adequate to cover the net cost of losses and loss expenses incurred to date; however, such liability is necessarily based on estimates and there can be no assurance that the ultimate liability will not exceed such estimates.

The following table provides a reconciliation of NAICC s net unpaid losses and LAE (in thousands of dollars):

	Years Ended December 31,		
	2004	**2003**	**2002**
Net unpaid losses and LAE at beginning of year	$ 65,142	$ 79,192	$ 88,012
Incurred losses, net, related to:			
Current year	10,343	23,199	49,474
Prior years	2,518	13,485	10,407
Total net incurred	12,861	36,684	59,881
Paid losses, net, related to:			
Current year	(5,427)	(10,133)	(22,871)
Prior years	(26,348)	(40,601)	(45,830)
Total net paid	(31,775)	(50,734)	(68,701)
Net unpaid losses and LAE at December 31	46,228	65,142	79,192
Plus: Reinsurance recoverable on unpaid losses, net	18,042	18,238	22,057
Gross unpaid losses and LAE at December 31	$ 64,270	$ 83,380	$ 101,249

The net losses and LAE incurred during 2004 related to prior years is attributable to recognition of unfavorable development in commercial auto of $2.4 million primarily for accident years 2001 through 2002, property and

casualty of $1.6 million and unallocated LAE for all lines of $1.0 million. Favorable development on prior periods was recognized in workers compensation and private passenger automobile of $0.7 million and $1.8 million, respectively. The net losses and LAE incurred during 2003 related to prior years and were attributable to recognition of unfavorable development in the following: commercial automobile of $5.5 million for accident years 2000 through 2002; workers compensation of $5.5 million of which $3.9 million was attributable to Valor; and property and casualty of $1.5 million, most of which was attributable to unallocated

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LAE reserves. All of the commercial automobile programs were placed in run-off during 2003. The net losses and LAE incurred during 2002 related to prior years and were attributable to adverse development on both the California workers compensation line totaling $3.5 million, certain private passenger automobile programs totaling $4.7 million, and commercial automobile totaling $2.0 million.

The following table indicates the manner in which unpaid losses and LAE at the end of a particular year change as time passes. The first line reflects the liability as originally reported, net of reinsurance, at the end of the stated year. Each calendar year-end liability includes the estimated liability for that accident year and all prior accident years comprising that liability. The second section shows the original recorded net liability as of the end of successive years adjusted to reflect facts and circumstance that are later discovered. The next line, cumulative (deficiency) or redundancy, compares the adjusted net liability amount to the net liability amount as originally established and reflects whether the net liability as originally recorded was adequate to cover the estimated cost of claims or redundant. The third section reflects the cumulative amounts related to that liability that was paid, net of reinsurance, as of the end of successive years.

Analysis of Net Losses and LAE Development (in thousands of dollars):

	Years Ended December 31,										
	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Originally reported gross											
Unpaid Losses and LAE	$ 146,330	$ 137,406	$ 120,651	$ 105,947	$ 95,653	$ 94,934	$ 100,030	$ 105,745	$ 101,249	$ 83,381	$ 64,270
Originally reported ceded recoverable	17,705	21,112	23,546	20,185	18,187	15,628	20,641	17,733	22,057	18,239	18,042
Originally reported net Unpaid Losses and LAE	128,625	116,294	97,105	85,762	77,466	79,306	79,389	88,012	79,192	65,142	46,228
Net Unpaid Losses and LAE re-estimated as of:											
One Year Later	131,748	126,413	98,045	85,762	79,957	84,560	87,035	98,419	92,677	67,660	
Two Years	141,602	126,796	97,683	85,684	82,778	88,001	94,570	109,795	97,331		

Later										
Three Years Later	141,787	127,621	98,545	87,613	83,778	92,213	100,640	112,770		
Four Years Later	144,491	129,792	102,053	88,238	87,160	94,895	101,486			
Five Years Later	146,827	133,985	102,949	89,802	89,476	95,803				
Six Years Later	151,784	134,992	103,645	91,892	90,345					
Seven Years Later	152,764	135,629	105,767	92,301						
Eight Years Later	153,459	137,886	106,108							
Nine Years Later	155,591	138,245								
Ten Years Later	156,044									
Cumulative (deficiency) redundancy	(27,419)	(21,951)	(9,003)	(6,539)	(12,879)	(16,497)	(22,097)	(24,758)	(18,139)	(2,518)

	Years Ended December 31,										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
umulative et paid osses and AE:											
nception Year	$ 15,849	$ 14,464	$ 10,559	$ 13,801	$ 16,170	$ 16,527	$ 25,360	$ 28,631	$ 22,870	$ 10,263	$ 5,42
One Year Later	46,582	46,132	35,696	31,317	43,090	51,608	64,599	74,460	63,343	36,611	
Two Years Later	80,515	74,543	54,815	43,855	62,577	71,151	86,722	98,827	83,710		
Three Years Later	101,726	90,818	63,290	56,968	74,267	83,225	97,694	111,535			
Four Years Later	114,424	97,900	74,306	66,015	82,524	88,524	103,944				
Five Years Later	119,310	108,061	82,568	72,531	86,278	92,795					
Six Years Later	128,117	115,721	88,424	75,231	89,696						
Seven Years Later	135,013	121,344	90,776	91,574							
Eight Years Later	140,146	123,477	103,563								
Nine Years Later	141,899	125,575									
Ten Years Later	143,828										
econciliation gross re-timated serves:											
Net reserves e-estimated	156,044	138,245	106,108	92,301	90,345	95,803	101,486	112,770	97,331	67,560	46,22
Re-estimated eded ecoverable	27,473	29,463	28,441	28,838	23,659	18,506	25,232	33,750	29,798	21,323	18,04
Total gross e-estimated eserves	$ 183,517	$ 167,708	$ 134,549	$ 121,139	$ 114,004	$ 114,309	$ 126,718	$ 146,520	$ 127,129	$ 88,983	$ 64,27

A discussion regarding adverse development by line recorded in 2004, 2003 and 2002 is set forth above in the prior table and narrative. The adverse development for the years ended 1996 through 2001 was related to both commercial auto and workers compensation. The commercial auto was most significantly impacted by case

strengthening related to a change in claims administration, coupled with the recognition that development factors of prior years were not as indicative of the business written for those respective years due to changes in risk profile and limits. Workers compensation was most affected by changes in legislation that occurred in 1995 that took several years to develop, with such development being different than the experience prior to 1995.

The development for the years ended 1994 and 1995 was due in part to the strengthening of the unpaid losses and LAE of property and casualty businesses assumed by NAICC in 1985 and workers compensation written prior to 1991. NAICC has continued to post additional incurred but not reported losses (IBNR) despite negotiations on several commutations of assumed excess of loss reinsurance contracts that indicated previous estimates of IBNR.

Conditions and trends that have affected the development of these liabilities in the past may not necessarily recur in the future especially considering that those ongoing lines that have experienced the greatest adverse development have been placed in run-off in 2001 and 2003. Reliance on this cumulative history may not be indicative of future performance.

Reinsurance

In its normal course of business, NAICC reinsures a portion of its exposure with other insurance companies so as to effectively limit its maximum loss arising out of any one occurrence. Contracts of reinsurance do not legally discharge the original insurer from its primary liability. Estimated reinsurance receivables arising from these contracts of reinsurance are reported separately as assets in accordance with generally accepted accounting principles in the United States.

As of December 31, 2004 General Reinsurance Corporation (GenRe) was the only reinsurer that comprised more than 10% of NAICC s reinsurance recoverable on paid and unpaid balances. NAICC monitors all reinsurers, by reviewing A.M. Best reports and ratings, information obtained from reinsurance intermediaries and analyzing financial statements. At December 31, 2004, NAICC had reinsurance recover-

able on paid and unpaid balances from GenRe of $12.4 million. GenRe has an A.M. Best rating of A++. See Note 10 of the Notes to Consolidated Financial Statements for further information on reinsurance.

NAICC and two of its subsidiaries participate in an inter-company pooling and reinsurance agreement. Under this agreement DICO and DNIC cede 100% of their net liability, defined to include premiums, losses and LAE, to NAICC to be combined with the net liability for policies of NAICC in formation of the pool . NAICC simultaneously cedes to DICO and DNIC 10% of the net liability of the pool. DNIC commenced participation in July 1993 and DICO commenced in January 1994. Additionally, DICO, DNIC and Valor reimburse NAICC for executive services, professional services, and administrative expenses based primarily on designated percentages of net written premiums and other cost determiners for each line of business.

MARKETS, COMPETITION AND BUSINESS CONDITIONS

General Business Conditions

Covanta s business can be adversely affected by general economic conditions, war, inflation, adverse competitive conditions, governmental restrictions and controls, change in law, natural disasters, energy shortages, fuel cost and availability, weather, the adverse financial condition of customers and suppliers, various technological changes and other factors over which Covanta has no control.

Covanta expects in the foreseeable future that competition for new contracts and projects will be intense in all domestic markets in which Covanta conducts or intends to conduct its businesses, and its businesses will be subject to a variety of competitive and market influences.

With respect to its waste-to-energy business, Covanta competes in two principal markets, both of which are highly competitive. The first market in which it competes is the market for waste disposal. While Covanta currently processes for disposal approximately four percent of the municipal solid waste in the United States, the market for waste disposal is almost entirely price-driven and is greatly influenced by economic factors within regional waste sheds. These factors include:

- regional population and overall waste production rates;
- the number of other waste disposal sites (including principally landfills and transfer stations) in existence or in the planning or permitting process;
- the available disposal capacity (in terms of tons of waste per day) that can be offered by other regional disposal sites; and
- the availability and cost of transportation options (rail, intermodal, trucking) to provide access to more distant disposal sites, thereby affecting the size of the waste shed itself.

In this market, Covanta competes on disposal price (usually on a per-ton basis) with other disposal service providers seeking to obtain waste supplies to their facilities. At most of its facilities, Covanta is unable to compete in this market because it does not have the contractual right to solicit waste; at these facilities it is the Client Community which is responsible for obtaining the waste, if necessary by competing on price to obtain the tons of waste it has contractually promised to deliver to Covanta s facility. At all but three of its facilities, Covanta is unable to offer material levels of disposal capacity to the market because of existing long-term contractual commitments. At these projects plant capacity is contractually committed and therefore unable to be offered to the market. At three of its facilities, in Haverhill, Massachusetts, Union County, New Jersey, and Alexandria, Virginia Covanta is responsible for obtaining material amounts of waste supply and so is actively competing in these markets to enter into spot medium- and long-term contracts. All of these projects are in densely populated areas, with high waste generation rates and numerous large and small participants in the regional market.

Once a long-term contract expires and is not renewed or extended by a Client Community, Covanta s percentage of contracted disposal capacity will decrease, and it will need to compete in the regional market for waste disposal. At that point, it will compete on price with landfills, transfer stations, other waste-to-energy facilities, and other waste disposal technologies that are then offering disposal service in the region. See

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discussion below under Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, for additional information concerning the expiration of existing contracts.

The second market in which Covanta competes related to its waste-to-energy projects is the market for obtaining new contracts to operate waste-to-energy facilities, either through greenfield development or through competing to be selected by project owners soliciting bids for new operators. In this market, there are fewer competitors than in the broader waste disposal market. This market for new waste-to-energy facilities is anticipated to be very limited with few opportunities for the foreseeable future.

Since before its bankruptcy filing in 2002, Covanta has not engaged in material development activity with respect to its independent power business. Covanta may consider developing additional renewable energy projects in the future, and if it were to do so would face competition from a large number of independent energy companies.

With respect to its sales of electricity from its waste-to-energy projects and independent power projects Covanta primarily sells its output pursuant to long-term contract. Accordingly, it generally does not sell its output into markets where it must compete on price. As these contracts expire, Covanta will participate in such markets if it is unable to enter into new or renewed long-term contracts. See discussion below under Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, for additional information concerning the expiration of existing contracts.

Once a contract is awarded or a project is financed and constructed, Covanta s business can be impacted by a variety of risk factors which can affect profitability over the life of a project. Some of these risks are at least partially within Covanta s control, such as successful operation in compliance with law and the presence or absence of labor difficulties or disturbances. Other risk factors, described above, are largely out of Covanta s control and may have an adverse impact on a project over a long-term operation.

Technology

Covanta has the exclusive right to market in the United States the proprietary mass-burn technology of Martin GmbH für Umwelt und Energietechnik (Martin). All of the waste-to-energy projects that Covanta has constructed use the Martin technology, although Covanta does own and/or operate some projects using other technologies. The principal feature of the Martin technology is the reverse-reciprocating stoker grate upon which the waste is burned. The patent for the basic stoker grate technology used in the Martin technology expired in 1989, and there are various other expired and unexpired patents relating to the Martin technology. Covanta believes that it is Martin s know-how and worldwide reputation in the waste-to-energy field, and Covanta s know-how in designing, constructing and operating waste-to-energy facilities, rather than the use of patented technology, that is important to Covanta s competitive position in the waste-to-energy industry in the United States. Covanta does not believe that the expiration of the patent covering the basic stoker grate technology or patents on other portions of the Martin technology will have a material adverse effect on Covanta s financial condition or competitive position.

Covanta believes that mass-burn technology is now the predominant technology used for the combustion of solid waste. Covanta believes that the Martin technology is a proven and reliable mass-burn technology, and that its association with Martin has created significant name recognition and value for Covanta s domestic waste-to-energy business.

Since 1984, Covanta s rights to the Martin technology have been provided pursuant to a cooperation agreement with Martin which gives Covanta exclusive rights to market, and distribute parts and equipment for the Martin technology in the United States, Canada, Mexico, Bermuda and certain Caribbean countries. Martin is obligated to assist Covanta in installing, operating and maintaining facilities incorporating the Martin technology. The cooperation agreement renews automatically each year unless notice of termination is given, in which case the cooperation agreement would terminate 10 years after such notice. Any termination would not affect the rights of Covanta to design, construct, operate, maintain or repair waste-to-energy facilities for which contracts have been entered into or proposals made prior to the date of termination.

Insurance Services

The property and casualty insurance industry is highly competitive. The insurance industry consists of a large number of companies, many of which operate in more than one state, offering automobile, homeowners and commercial property insurance, as well as insurance coverage in other lines. Many of NAICC s competitors have larger volumes of business, greater financial resources and higher financial strength ratings. NAICC s competitors having greater shares of the California market sell automobile insurance either directly to consumers, through independent agents and brokers or through exclusive agency arrangements similar to SCJ.

The principal means by which Insurance Service s competes with other automobile insurers is by its focus on meeting the needs of the non-standard private passenger automobile market in California where it believes it has competitive pricing, underwriting and service capabilities. Insurance Services also competes by using niche marketing efforts of its products through SCJ.

The operating results of a property and casualty insurer are influenced by a variety of factors including general economic conditions, competition, regulation of insurance rates, weather, frequency and severity of losses. The California non-standard personal auto market in which NAICC operates has experienced a recovery of rate adequacy coupled with stable competition. Frequency of claims improved from 2002 to 2003 and remained stable in 2004, while the average cost of settling claims has steadily improved from 2002 to 2004.

REGULATION OF DANIELSON S BUSINESSES

Danielson s Energy and Insurance Service Businesses are highly regulated.

Environmental Regulatory Laws Affecting Covanta s Businesses

Domestic

Covanta s business activities in the United States are pervasively regulated pursuant to federal, state and local environmental laws. Federal laws, such as the Clean Air Act and Clean Water Act, and their state counterparts, govern discharges of pollutants to air and water. Other federal, state and local laws comprehensively govern the generation, transportation, storage, treatment and disposal of solid and hazardous waste and also regulate the storage and handling of chemicals and petroleum products (such laws and the regulations thereunder, Environmental Regulatory Laws).

Other federal, state and local laws, such as the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) (collectively, Environmental Remediation Laws) make Covanta potentially liable on a joint and several basis for any onsite or offsite environmental contamination which may be associated with Covanta s activities and the activities at sites, including but not limited to landfills that Covanta s subsidiaries have owned, operated or leased or, at which there has been disposal of residue or other waste generated, handled or processed by such subsidiaries. Some state and local laws also impose liabilities for injury to persons or property caused by site contamination. Some Service Agreements provide for indemnification of operating subsidiaries from some such liabilities. In addition, other subsidiaries involved in landfill gas projects have access rights to landfill sites pursuant to certain leases that permit the installation, operation and maintenance of landfill gas collection systems. A portion of these landfill sites is and has been a federally-designated Superfund site. Each of these leases provide for indemnification of Covanta subsidiary from some liabilities associated with these sites.

The Environmental Regulatory Laws require that many permits be obtained before the commencement of construction and operation of any waste-to-energy, independent power project or water facility, and further requires that permits be maintained throughout the operating life of the facility. There can be no assurance that all required permits will be issued or re-issued, and the process of obtaining such permits can often cause lengthy delays, including delays caused by third-party appeals challenging permit issuance. Failure to meet conditions of these permits or of the Environmental Regulatory Laws can subject an operating subsidiary to regulatory enforcement actions by the appropriate governmental unit, which could include fines, penalties,

damages or other sanctions, such as orders requiring certain remedial actions or limiting or prohibiting operation. To date, Covanta has not incurred material penalties, been required to incur material capital costs or additional expenses, nor been subjected to material restrictions on its operations as a result of violations of Environmental Regulatory Laws or permit requirements.

Although Covanta s operations are occasionally subject to proceedings and orders pertaining to emissions into the environment and other environmental violations, which may result in fines, penalties, damages or other sanctions, Covanta believes that it is in substantial compliance with existing environmental laws and regulations. Covanta may be identified, along with other entities, as being among parties potentially responsible for contribution to costs associated with the correction and remediation of environmental conditions at disposal sites subject to CERCLA and/or analogous state laws. In certain instances Covanta may be exposed to joint and several liabilities for remedial action or damages. Covanta s ultimate liability in connection with such environmental claims will depend on many factors, including its volumetric share of waste, the total cost of remediation, and the financial viability of other companies that also sent waste to a given site and, in the case of divested operations, its contractual arrangement with the purchaser of such operations.

The Environmental Regulatory Laws are subject to revision. New technology may be required or stricter standards may be established for the control of discharges of air or water pollutants for storage and handling of petroleum products or chemicals or for solid or hazardous waste or ash handling and disposal. Thus, as new technology is developed and proven, it may be required to be incorporated into new facilities or major modifications to existing facilities. This new technology may often be more expensive than that used previously.

The Environmental Remediation Laws prohibit disposal of regulated hazardous waste at Covanta s municipal solid waste facilities. The Service Agreements recognize the potential for improper deliveries of hazardous wastes and specify procedures for dealing with hazardous waste that is delivered to a facility. Although certain Service Agreements require Covanta s subsidiary to be responsible for some costs related to hazardous waste deliveries, to date no operating subsidiary has incurred material hazardous waste disposal costs.

Domestic drinking water facilities are subject to regulation of water quality by the state and federal agencies under the federal Safe Drinking Water Act and by similar state laws. These laws provide for the establishment of uniform minimum national water quality standards, as well as governmental authority to specify the type of treatment processes to be used for public drinking water. Under the federal Clean Water Act, Covanta may be required to obtain and comply with National Pollutant Discharge Elimination System permits for discharges from its treatment stations. Generally, under its current contracts, Covanta is not responsible for fines and penalties resulting from the delivery to Covanta s treatment facility of water not meeting standards set forth in those contracts.

International

Covanta aims to provide energy generating and other infrastructure through environmentally protective project designs, regardless of the location of a particular project. This approach is consistent with the stringent environmental requirements of multilateral financing institutions, such as the World Bank, and also with Covanta s experience in domestic waste-to-energy projects, where environmentally protective facility design and performance is required. Compliance with environmental standards comparable to those of the United States may be conditions to the provision of credit by multilateral banking agencies as well as other lenders or credit providers. The laws of other countries also may require regulation of emissions into the environment, and provide governmental entities with the authority to impose sanctions for violations, although these requirements are generally not as rigorous as those applicable in the United States. As with domestic project development, there can be no assurance that all required permits will be issued, and the process can often cause lengthy delays.

Energy and Water Regulations Affecting Covanta s Businesses

Covanta s businesses are subject to the provisions of federal, state and local energy laws applicable to the development, ownership and operation of their domestic facilities and to similar laws applicable to their foreign operations. Federal laws and regulations applicable to many of Covanta s domestic energy businesses impose limitations on the types of fuel used, prescribe the degree to which these businesses are subject to federal and state utility-type regulation and restrict the extent to which these businesses may be owned by one or more electric utilities. State regulatory regimes govern rate approval and the other terms and conditions pursuant to which utilities purchase electricity from independent power producers, except to the extent such regulation is governed by federal law.

Pursuant to the federal Public Utility Regulatory Policies Act (PURPA), the Federal Energy Regulatory Commission (the FERC) has promulgated regulations that exempt qualifying facilities (QFs) (facilities meeting certain size, fuel and ownership requirements) from compliance with certain provisions of the Federal Power Act (the FPA), the Public Utility Holding Company Act of 1935 (PUHCA), and certain state laws regulating the rates charged by, or the financial and organizational activities of, electric utilities. PURPA was enacted in 1978 to encourage the development of cogeneration facilities and other facilities making use of non-fossil fuel power sources, including waste-to-energy facilities. The exemptions afforded by PURPA to QFs from regulation under the FPA and PUHCA and most aspects of state electric utility regulation are of great importance to Covanta and its competitors in the waste-to-energy and independent power industries.

Except with respect to waste-to-energy facilities with a net power production capacity in excess of 30 MW (where rates are set by the FERC), state public utility commissions must approve the rates, and in some instances other contract terms, by which public utilities purchase electric power from QFs. PURPA requires that electric utilities purchase electric energy produced by QFs at negotiated rates or at a price equal to the incremental or avoided cost that would have been incurred by the utility if it were to generate the power itself or purchase it from another source. PURPA does not expressly require public utilities to enter into long-term contracts to purchase the output supplied by QFs. Many state public utility commissions have approved longer-term energy contracts as part of their implementation of PURPA.

Under PUHCA, any entity owning or controlling 10% or more of the voting securities of a public utility company or company which is a holding company of a public utility company is subject to registration with the SEC and regulation by the SEC unless exempt from registration. Under PURPA, most projects that satisfy the definition of a qualifying facility are exempt from regulation under PUHCA. Under the Energy Policy Act of 1992, projects that are not QFs under PURPA but satisfy the definition of an exempt wholesale generator are not deemed to be public utility companies under PUHCA. Finally, projects that satisfy the definition of foreign utility companies are exempt from regulation under PUHCA. Covanta believes that all of its operating projects involved in the generation, transmission and/or distribution of electricity, both domestically and internationally, qualify for an exemption from PUHCA and that it is not and will not be required to register with the SEC under PUHCA.

Congress continues from time to time to consider energy legislation to repeal both PURPA and PUHCA. Repeal of PUHCA would allow both independent power producers and vertically integrated utilities to acquire electric assets throughout the United States that are geographically widespread, eliminating the current requirement that the utility s electric assets be capable of physical integration. Also, registered holding companies would be free to acquire non-utility businesses, which they may not do now, with certain limited exceptions. With the repeal of PURPA or PUHCA, competition for independent power generators from utilities would likely increase. This is likely to have little or no impact on Covanta s existing projects, but may mean additional competition from highly capitalized companies seeking to develop projects in the U.S.

Covanta presently has ownership and operating interests in electric generating projects outside the United States. Most countries have expansive systems for the regulation of the power business. These generally include provisions relating to ownership, licensing, rate setting and financing of generating and transmission facilities.

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Insurance Services Business

Insurance companies are subject to insurance laws and regulations established by the states in which they transact business. The agencies established pursuant to these state laws have broad administrative and supervisory powers relating to the granting and revocation of licenses to transact business, regulation of trade practices, establishment of guaranty associations, licensing of agents, approval of policy forms, premium rate filing requirements, reserve requirements, the form and content of required regulatory financial statements, capital and surplus requirements and the maximum concentrations of certain classes of investments. Most states also have enacted legislation regulating insurance holding company systems, including acquisitions, extraordinary dividends, the terms of affiliate transactions and other related matters. Danielson and its insurance subsidiaries have registered as holding company systems pursuant to such legislation in California and Montana, and routinely report to other jurisdictions. The National Association of Insurance Commissioners (the Association) has formed committees and appointed advisory groups to study and formulate regulatory proposals on such diverse issues as the use of surplus debentures, accounting for reinsurance transactions and the adoption of risk based capital requirements. It is not possible to predict the impact of future state and federal regulation on the operations of Danielson or its Insurance Services business.

Effective January 1, 2001, the Association s codified statutory accounting principles (SAP) had been adopted by all U.S. insurance companies. The purpose of such codification is to provide a comprehensive basis of accounting and reporting to insurance departments. Although codification is expected to be the foundation of a state s statutory accounting practice, it may be subject to modification by practices prescribed or permitted by a state s insurance commissioner. Therefore, statutory financial statements will continue to be prepared on the basis of accounting practice prescribed or permitted by the insurance department of the state of domicile.

Dividends

NAICC is an insurance company domiciled in the State of California and is regulated by the California Department of Insurance for the benefit of policyholders. The California Insurance Code does not permit the payment of an extraordinary shareholder dividend without prior approval from the California Insurance Commissioner. Dividends are considered extraordinary if they exceed the greater of net income or 10% of statutory surplus as of the preceding December 31st. At this time and into the foreseeable future NAICC does not have sufficient accumulated earned surplus to pay further ordinary dividends.

Capital Adequacy and Risk-Based Capital

A model for determining the risk-based capital (RBC) requirements for property and casualty insurance companies was adopted in December 1993. The model generally assesses Danielson s assets at risk and underwriting operations and determines policyholders surplus levels necessary to support such activity. NAICC has calculated its RBC requirement under the most recent RBC model and, as of December 31, 2004, it had capital in excess of any regulatory action level.

The RBC model sets forth four levels of increasing regulatory intervention: (1) Company Action Level (200% of an insurer s Authorized Control Level) at which the insurer must submit to the regulator a plan for increasing such insurer s capital; (2) Regulatory Action Level (150% of an insurer s Authorized Control Level), at which the insurer must submit a plan for increasing its capital to the regulator and the regulator may issue corrective orders; (3) Authorized Control Level, a multi-step calculation based upon information derived from an insurer s most recent filed statutory annual statement, at which the regulator may take action to rehabilitate or liquidate the insurer; and (4) Mandatory Control Level (70% of an insurer s Authorized Control Level), at which the regulator must rehabilitate or liquidate the insurer. At December 31, 2004, the RBC of NAICC improved to 361% compared to 252% in 2003.

As discussed further in this Report at Part 1, Item 1, Business Introduction , ACL filed for protection under Chapter 11 of the Bankruptcy Code. As a result, it was determined that NAICC s investment in ACL was fully impaired for statutory accounting purposes. At December 31, 2002, NAICC recognized a statutory charge to its surplus of $7.4 million. This charge, when combined with NAICC s

underwriting results and investment losses, reduced its statutory surplus level below the Company Action Level of NAICC s RBC calculation. In response, Danielson repaid a $4.0 million note due May 2004 to NAICC, and further contributed $4.0 million to NAICC to increase its statutory capital during February 2003. With permission from the California Department of Insurance, these amounts were recorded as admitted assets for statutory accounting purposes at December 31, 2002. After consideration for the $8.0 million noted above, NAICC s reported capital and surplus as of December 31, 2002 was above the Company Action Level of NAICC s RBC calculation.

In December 2003, Danielson contributed $2.0 million to NAICC to increase its statutory capital. No contributions were made by Danielson to its insurance operations in 2004.

RECENT DEVELOPMENTS

Acquisition of American Ref-Fuel Holdings Corp.

On January 31, 2005, Danielson entered into a stock purchase agreement (the Purchase Agreement) with American Ref-Fuel Holdings Corp. (Ref-Fuel), an owner and operator of waste-to-energy facilities in the northeast United States, and Ref-Fuel s stockholders to purchase 100% of the issued and outstanding shares of American Ref-Fuel capital stock. Under the terms of the Purchase Agreement, Danielson will pay $740 million in cash for the stock of Ref-Fuel and will assume the consolidated net debt of Ref-Fuel, which as of December 31, 2004, was approximately $1.2 billion. After the transaction is completed, Ref-Fuel will be a wholly-owned subsidiary of Covanta.

The acquisition is expected to close when all of the closing conditions to the Purchase Agreement have been satisfied or waived. These closing conditions include the receipt of approvals, clearances and the satisfaction of all waiting periods as required under the Hart-Scott-Rodino Antitrust Act of 1976 and as required by certain governmental authorities such as the Federal Energy Regulatory Commission and other applicable regulatory authorities. Other closing conditions of the transaction include the following: Danielson s completion of debt financing and an equity Ref-Fuel Rights Offering, as further described below; Danielson arranging letters of credit or other financial accommodations in the aggregate amount of $100 million to replace two currently outstanding letters of credit that have been entered into by two respective subsidiaries of Ref-Fuel and issued in favor of a third subsidiary of Ref-Fuel; and other customary closing conditions. While it is anticipated that all of the applicable conditions will be satisfied, there can be no assurance as to whether or when all of those conditions will be satisfied or, where permissible, waived.

Either Danielson or the selling stockholders of Ref-Fuel may terminate the Purchase Agreement if the acquisition does not occur on or before June 30, 2005. If a required governmental or regulatory approval has not been received by such date, however, then either party may extend the closing to a date that is no later than the later of August 31, 2005 or the date 25 days after which Ref-Fuel has provided to Danielson certain financial statements described in the Purchase Agreement.

If the Purchase Agreement is terminated because of Danielson s failure to complete the rights offering and financing as described below, and all other closing conditions are capable of being satisfied, Danielson must pay to the selling stockholders of Ref-Fuel a termination fee of $25 million, of which no less than $10 million shall be paid in cash and of which up to $15 million may be paid in shares of Danielson s common stock, at its election, calculated based on $8.13 per share. As of the date of the Purchase Agreement, Danielson entered into a registration rights agreement granting registration rights to the selling stockholders of Ref-Fuel with respect to such termination fee stock and Danielson has deposited $10 million in cash in an escrow account pursuant to the terms of an escrow agreement.

Financing the Ref-Fuel Acquisition

Danielson intends to finance this transaction through a combination of debt and equity financing. The equity component of the financing is expected to consist of an approximately $400 million offering of warrants or other rights to purchase Danielson s common stock to all of Danielson s existing stockholders at $6.00 per share (the Ref-Fuel Rights Offering). In the Ref-Fuel Rights Offering Danielson s existing stockholders

will be issued rights to Danielson s stock on a pro rata basis, with each holder entitled to purchase approximately 0.9 shares of Danielson s common stock at an exercise price of $6.00 per full share for each share of Danielson s common stock then held. Danielson will file a registration statement with the SEC with respect to such rights offering and the statements contained herein shall not constitute an offer to sell or solicitation of an offer to buy shares of Danielson s common stock. Any such offer or solicitation will be made in compliance with all applicable securities laws.

Three of Danielson s largest stockholders, SZ Investments (together with its affiliate, EGI-Fund (05-07) Investors, L.L.C. to which it transferred a portion of it shares), TAVF and Laminar, representing ownership of approximately 40% of Danielson s outstanding common stock, have committed to participate in the Ref-Fuel Rights Offering and acquire their pro rata portion of the shares. As consideration for their commitments, Danielson will pay each of these four stockholders an amount equal to 1.5% to 2.25% of their respective equity commitments, depending on the timing of the transaction. Danielson agreed to amend an existing registration rights agreement to provide these stockholders with the right to demand that Danielson undertake an underwritten offering within twelve months of the closing of the acquisition of Ref-Fuel in order to provide such stockholders with liquidity.

Danielson also expects to complete its previously announced rights offering for up to 3.0 million shares of its common stock to certain holders of 9.25% debentures issued by Covanta at a purchase price of $1.53 per share (the 9.25% Offering). Danielson has executed a letter agreement with Laminar pursuant to which Danielson agreed to restructure the 9.25% Offering if that offering has not closed prior to the record date for the Ref-Fuel Rights Offering so that the holders that participate in the 9.25% Offering are offered additional shares of Danielson common stock at the same purchase price as in the Ref-Fuel Rights Offering and in an amount equal to the number of shares of common stock that such holders would have been entitled to purchase in the Ref-Fuel Rights Offering if the 9.25% Offering was consummated on or prior to the record date for the Ref-Fuel Rights Offering.

Assuming exercise of all rights in the Ref-Fuel Rights Offering and the purchase of three million shares in the 9.25% Offering, the Company estimates that it will have approximately 144 million shares outstanding following the consummation of both rights offerings.

Danielson has received a commitment from Goldman Sachs Credit Partners, L.P. and Credit Suisse First Boston for a debt financing package for Covanta necessary to finance the acquisition, as well as to refinance the existing recourse debt of Covanta and provide additional liquidity. It is currently expected that this financing shall consist of two tranches, each of which is secured by pledges of the stock of Covanta s subsidiaries that has not otherwise been pledged, guarantees from certain of Covanta s subsidiaries and all other available assets of Covanta s subsidiaries. The first tranche, a first priority senior secured bank facility, shall be made up of a $250 million term loan facility, a $100 million revolving credit facility and a $340 million letter of credit facility. The second tranche, a second priority senior secured term loan facility, shall consist of a $450 million term loan facility.

Danielson estimates that there will be approximately $45 million in aggregate transaction expenses (including customary underwriting and commitment fees relating to the financing).

Immediately upon closing of the acquisition, Ref-Fuel will become a wholly-owned subsidiary of Covanta, and Covanta will control the management and operations of the Ref-Fuel facilities. The current project and other debt of Ref-Fuel subsidiaries will be unaffected by the acquisition, except that the revolving credit and letter of credit facility of American Ref-Fuel Company LLC (the direct parent of each Ref-Fuel project company) will be cancelled and replaced with new facilities at the Covanta level. For additional information concerning the combined capital structure of Covanta and Ref-Fuel following the acquisition, see Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

There can be no assurance that Danielson will be able to complete the Ref-Fuel Rights Offering, obtain the credit facilities or complete the acquisition of Ref-Fuel. See Risks Related to the Ref-Fuel Acquisition in Part I.

RISK FACTORS

The following risk factors could have a material adverse effect on Danielson s business, financial condition and results of operations.

Danielson-Specific Risks

The market for our common stock has been historically illiquid which may affect your ability to sell your shares.

The volume of trading in our stock has historically been low. In the last six months, the daily trading volume for our stock has been approximately 270,352 shares. Having a market for shares without substantial liquidity can adversely affect the price of the stock at a time an investor might want to sell his, her or its shares.

Reduced liquidity and price volatility could result in a loss to investors.

Although our common stock is listed on the AMEX, there can be no assurance as to the liquidity of an investment in our common stock or as to the price an investor may realize upon the sale of our common stock. These prices are determined in the marketplace and may be influenced by many factors, including the liquidity of the market for our common stock, the market price of our common stock, investor perception and general economic and market conditions.

Concentrated stock ownership and charter provision may discourage unsolicited acquisition proposals.

Assuming the issuance of 3.0 million shares of our common stock in the 9.25% Offering SZ Investments (together with its affiliate EGI Fund (05-07) Investors), TAVF and Laminar separately own or will have the right to acquire approximately 15.5%, 6.0% and 18.4%, respectively, or when aggregated, 39.9% of our outstanding common stock. These stockholders have each separately committed to participate in the Ref-Fuel Rights Offering to finance the Company s acquisition of Ref-Fuel and acquire their pro rata portion of shares in the Ref-Fuel Rights Offering. Although there are no agreements among SZ Investments, TAVF and Laminar regarding their voting or disposition of shares of our common stock, the level of their combined ownership of shares of common stock could have the effect of discouraging or impeding an unsolicited acquisition proposal. In addition, the change in ownership limitations contained in Article Fifth of our charter could have the effect of discouraging or impeding an unsolicited takeover proposal.

Future sales of our common stock may depress our stock price.

No prediction can be made as to the effect, if any, that future sales of our common stock, or the availability of our common stock for future sales, will have on the market price of our common stock. Sales in the public market of substantial amounts of our common stock, or the perception that such sales could occur, could adversely affect prevailing market prices for our common stock. In addition, in connection with the Covanta acquisition financing, we have filed a registration statement on Form S-3 to register the resale of 17,711,491 shares of our common stock held by Laminar, TAVF and SZ Investments and in connection with our proposed acquisition of Ref-Fuel we intend to register additional shares to be offered in a pro rata rights offering and have agreed to register the resale of certain shares held or acquired by Laminar, TAVF and SZ Investments in an underwritten public offering. We have also agreed to register any shares issuable to current shareholders of Ref-Fuel in the event the purchase agreement we entered into with Ref-Fuel stockholders is terminated due to our failure to complete the equity and debt financing for such acquisition. The potential effect of these shares being sold may be to depress the price at which our common stock trades.

Our disclosure controls and procedures may not prevent or detect all acts of fraud.

Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Securities Exchange Act is accumulated and

communicated to management recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within our companies have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by an unauthorized override of the controls. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Failure to maintain an effective system of internal control over financial reporting may have an adverse effect on our stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, (Section 404) and the rules and regulations promulgated by the SEC to implement Section 404, we are required to furnish a report to include in our Form 10-K an annual report by our management regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

We have in the past, and in the future may discover, areas of our internal control over financial reporting which may require improvement. For example, during the course of its audit of our 2004 financial statements, our independent auditors, Ernst & Young LLP identified errors, principally related to complex manual fresh start accounting calculations, predominantly effecting Covanta s investments in its international businesses. These errors, the net effect of which was immaterial (less than $2 million, pretax), have been corrected in our 2004 consolidated financial statements. Management determined that errors in complex fresh start and other technical accounting areas originally went undetected due to insufficient technical in-house expertise necessary to provide sufficiently rigorous review. As a result, management has concluded that Danielson s internal control over financial reporting was not effective as of December 31, 2004. The Company has identified and undertaken steps necessary in order to address this material weakness, but the effectiveness of our internal control over financial reporting in the future will depend on our effectiveness in fulfilling these steps to address this material weakness. If we are unable to assert that our internal control over financial reporting is effective now or in any future period, or if our auditors are unable to express an opinion on the effectiveness of our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect in our stock price.

We cannot be certain that the net operating loss tax carryforwards will continue to be available to offset our tax liability.

As of December 31, 2004, we had approximately $516 million of NOLs. In order to utilize the NOLs, we must generate taxable income which can offset such carryforwards. The NOLs are also utilized by income from certain grantor trusts that were established as part of the Mission Insurance reorganization. The NOLs will expire if not used. The availability of NOLs to offset taxable income would be substantially reduced if we were to undergo an ownership change within the meaning of Section 382(g)(1) of the Internal Revenue Code. We will be treated as having had an ownership change if there is more than a 50% increase in stock ownership during a three year testing period by 5% stockholders .

In order to help us preserve the NOLs, our certificate of incorporation contains stock transfer restrictions designed to reduce the risk of an ownership change for purposes of Section 382 of the Internal Revenue Code. The transfer restrictions were implemented in 1990, and we expect that the restrictions will remain in force as long as the NOLs are available. We cannot assure you, however, that these restrictions will prevent an ownership change.

The NOLs will expire in various amounts, if not used, between 2005 and 2023. The Internal Revenue Service has not audited any of our tax returns for any of the years during the carryforward period including those returns for the years in which the losses giving rise to the NOLs were reported. We cannot assure you that we would prevail if the IRS were to challenge the availability of the NOLs. If the IRS was successful in challenging our NOLs, all or some portion of the NOLs would not be available to offset our future consolidated income and we may not be able to satisfy our obligations to Covanta under a tax sharing agreement described below, or to pay taxes that may be due from our consolidated tax group.

Reductions in our NOLs could occur in connection with the emergence from bankruptcy of the Mission Insurance entities. While we will attempt to manage the tax consequences of that transaction, taxable income could result which could materially reduce our NOLs. For a more detailed discussion of the Mission Insurance entities, please see Note 25 to Notes to Consolidated Financial Statements.

In addition, if our existing Insurance Services business were to require capital infusions from us in order to meet certain regulatory capital requirements, and were we to fail to provide such capital, some or all of our subsidiaries comprising our Insurance Services business could enter insurance insolvency proceedings. In such event, such subsidiaries would no longer be included in our consolidated tax return, and a portion, which could constitute a significant portion, of our remaining NOLs would no longer be available to us.

Covanta-Specific Risks

Covanta emerged from bankruptcy with a large amount of domestic debt, and we cannot assure you that its cash flow from domestic operations will be sufficient to pay this debt.

As of December 31, 2004, Covanta s outstanding domestic corporate debt was $236 million. Covanta s ability to service its domestic debt will depend upon:

- its ability to continue to operate and maintain its facilities consistent with historical performance levels;
- its ability to maintain compliance with its debt covenants;
- its ability to avoid increases in overhead and operating expenses in view of the largely fixed nature of its revenues;
- its ability to maintain or enhance revenue from renewals or replacement of existing contracts, which begin to expire in October 2007 and from new contracts to expand existing facilities or operate additional facilities;
- market conditions affecting waste disposal and energy pricing, as well as competition from other companies for contract renewals, expansions, and additional contracts, particularly after its existing contracts expire.
- the continued availability to Covanta of the benefit of Danielson s net operating losses under the Tax Sharing Agreement; and
- its ability to refinance its domestic corporate debt, whether in conjunction with the Ref-Fuel acquisition or otherwise.

Covanta is currently in compliance with all of its domestic debt covenants. For a more detailed discussion of Covanta s domestic debt covenants please see Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

The amount of unsecured claims for which Covanta is liable has not been determined and could exceed our estimates.

In connection with Covanta s emergence from bankruptcy, Covanta authorized the issuance of $50 million of unsecured notes under an indenture. Although Covanta estimates that it will issue such notes in an amount less than $30 million, the ultimate amount of unsecured notes will not be determined until remaining claims are resolved through settlement or litigation in Bankruptcy Court. We cannot assure you that the final amount of such notes issued will be less than Covanta s estimate, or that the ultimate resolution of such claims will result in liabilities of less than $50 million.

Covanta may not be able to refinance its domestic debt agreements prior to maturity.

Covanta issued high yield notes, which mature in 2011. Prior to maturity, Covanta is obligated to pay only interest, and no principal, with respect to these notes. Covanta s cash flow may be insufficient to pay the principal at maturity, which will be $230 million at such time. Consequently, Covanta may be obligated to refinance these notes prior to maturity. Covanta may refinance the notes during the first two years after issuance without paying a premium, and thereafter may refinance these notes but must pay a premium to do so.

Several of Covanta s contracts require it to provide certain letters of credit to contract counterparties. The aggregate stated amount of these letters declines materially each year, particularly prior to 2010. Covanta s financing arrangements under which these letters of credit are issued expire in 2009, and so it must refinance these arrangements in order to allow Covanta to continue to provide the letters of credit beyond the current expiration date.

Although the Company has received a commitment from Goldman Sachs Credit Partners, L.P. and Credit Suisse First Boston for a debt financing package for Covanta necessary to finance the proposed acquisition of Ref-Fuel, as well as to refinance the existing recourse debt of Covanta, such refinancing is contingent upon consummation of the Ref-Fuel acquisition.

We cannot assure you that Covanta will be able to obtain refinancing on acceptable terms, or at all, either in conjunction with the Ref-Fuel acquisition or otherwise.

Covanta s ability to grow its business is limited.

Covanta s ability to grow its domestic business by investing in new projects will be limited by debt covenants in its principal financing agreements, unless such financing agreements are refinanced, and from potentially fewer market opportunities for new waste-to-energy facilities. Covanta s business is based upon building and operating municipal solid waste processing and energy generating projects, which are capital intensive businesses that require financing through direct investment and the incurrence of debt. When we acquired Covanta and it emerged from bankruptcy proceedings in March 2004, Covanta entered into financing arrangements with restrictive covenants typical of financings for companies emerging from bankruptcy. These covenants essentially prohibit investments in new projects or acquisitions of new businesses and place restrictions on Covanta s ability to expand existing projects. The covenants prohibit borrowings to finance new construction, except in limited circumstances related to specifically identified expansions of existing facilities. The covenants also limit spending for new business development and require that excess cash flow be trapped to collateralize outstanding letters of credit.

Although the Company will be negotiating debt covenants for the refinancing of Covanta s debt in connection with the Ref-Fuel acquisition, such financing is contingent upon consummation of the Ref-Fuel acquisition. We cannot assure you that, when it seeks to refinance its domestic debt agreements, Covanta will be able to negotiate covenants that will provide it with more flexibility to grow its business.

Covanta s liquidity is limited by the amount of domestic debt issued when it emerged from bankruptcy.

Covanta believes that its cash flow from domestic operations will be sufficient to pay for its domestic cash needs, including debt service on its domestic corporate debt, and that its revolving credit facility will provide a

secondary source of liquidity. For the period March 11 through December 31, 2004, Covanta s cash flow from operating activities for domestic operations was $85.3 million. We cannot assure you, however, that Covanta s cash flow from domestic operations will not be adversely affected by adverse economic conditions or circumstances specific to one or more projects or that if such conditions or circumstances do occur, its revolving credit facility will provide Covanta with access to sufficient cash for such purposes.

Operation of Covanta s facilities and the construction of new or expanded facilities involve significant risks.

The operation of Covanta s facilities and the construction of new or expanded facilities involve many risks, including:

- the inaccuracy of Covanta s assumptions with respect to the timing and amount of anticipated revenues;
- supply interruptions;
- permitting and other regulatory issues, license revocation and changes in legal requirements;
- labor disputes and work stoppages;
- unforeseen engineering and environmental problems;
- unanticipated cost overruns;
- weather interferences, catastrophic events including fires, explosions, earthquakes, droughts and acts of terrorism; and
- performance below expected levels of output or efficiency.

We cannot predict the impact of these risks on Covanta s business or operations.

Expansion of Covanta s existing plants or construction of new plants may require Covanta to use additional new technology which may increase construction costs.

Expansions of existing plants and construction of new plants may require that Covanta incorporate recently developed and technologically complex equipment, especially in the case of newer environmental emission control technology. Inclusion of such new technology may materially increase the cost of construction.

Covanta s insurance and contractual protections may not always cover lost revenues, increased expenses or liquidated damages payments.

Although Covanta maintains insurance, obtains warranties from vendors, obligates contractors to meet certain performance levels and attempts, where feasible, to pass risks Covanta cannot control to the service recipient or output purchaser, the proceeds of such insurance, warranties, performance guarantees or risk sharing arrangements may not be adequate to cover lost revenues, increased expenses or liquidated damages payments.

Performance reductions could materially and adversely affect Covanta.

Any of the risks described in this Annual Report on Form 10-K or unforeseen problems could cause Covanta s projects to operate below expected levels, which in turn could result in lost revenues, increased expenses, higher maintenance costs and penalties for defaults under Covanta s service agreements and operating contracts. As a result, a project may operate at less than expected levels of profit or at a loss.

Most of Covanta s Service Agreements for waste-to-energy facilities provide for limitations on damages and cross-indemnities among the parties for damages that such parties may incur in connection with their performance under the contract. Such contractual provisions excuse Covanta from performance obligations to the extent affected by uncontrollable circumstances and provide for service fee adjustments if uncontrollable

circumstances increase its costs. We cannot assure you that these provisions will prevent Covanta from incurring losses upon the occurrence of uncontrollable circumstances or that if Covanta were to incur such losses it would continue to be able to service its debt.

Covanta and certain of its subsidiaries have issued or are party to performance guarantees and related contractual obligations undertaken mainly pursuant to agreements to construct and operate certain energy and water facilities. With respect to its domestic businesses, Covanta has issued guarantees to its municipal clients and other parties that Covanta s subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. The obligations guaranteed will depend upon the contract involved. Many of Covanta s subsidiaries have contracts to operate and maintain waste-to-energy facilities. In these contracts the subsidiary typically commits to operate and maintain the facility in compliance with legal requirements; to accept minimum amounts of solid waste; to generate a minimum amount of electricity per ton of waste; and to pay damages to contract counterparties under specified circumstances, including those where the operating subsidiary s contract has been terminated for default. In its operating history, Covanta has not incurred liability to pay material amounts under these guarantees, and has incurred no liability to repay project debt. Such contractual damages or other obligations could be material, and in circumstances where one or more subsidiary s contract has been terminated for its default, such damages could include amounts sufficient to repay project debt. Additionally, damages payable under such guarantees on Company-owned waste-to-energy facilities could expose Covanta to recourse liability on project debt. Covanta may not have sufficient sources of cash to pay such damages or other obligations. Although it has not incurred material liability under energy, water and waste-to-energy guarantees previously and has incurred no liability to repay project debt, we cannot assure you that Covanta will be able to continue to avoid incurring material payment obligations under such guarantees or that if it did incur such obligations that it would have the cash resources to pay them.

With respect to the international projects, CPIH, Covanta and certain of Covanta s domestic subsidiaries have issued guarantees of CPIH s operating obligations. The potential damages that may be owed under these guarantees may be material. Covanta is generally entitled to be reimbursed by CPIH for any payments it may make under guarantees related to international projects.

Covanta generates its revenue primarily under long-term contracts, and must avoid defaults under its contracts in order to service its debt and avoid material liability to contract counterparties.

Covanta must satisfy its performance and other obligations under its contracts to operate waste-to-energy facilities. These contracts typically require Covanta to meet certain performance criteria relating to amounts of waste processed, energy generation rates per ton of waste processed, residue quantity, and environmental standards. Covanta s failure to satisfy these criteria may subject it to termination of its Operating Contracts. If such a termination were to occur, Covanta would lose the cash flow related to the project, and incur material termination damage liability. In circumstances where the contract of one or more subsidiaries has been terminated due to Covanta s default, Covanta may not have sufficient sources of cash to pay such damages.

None of Covanta s operating contracts for its waste-to-energy facilities previously have been terminated for Covanta s default. We cannot assure you, however, that Covanta will be able to continue to be able to perform its obligations under such contracts in order to avoid such contract terminations, or damages related to any such contract termination, or that if it could not avoid such terminations that it would have the cash resources to pay amounts that may then become due.

Covanta may face increased risk of market influences on its domestic revenues after its contracts expire.

Covanta s contracts to operate waste-to-energy projects begin to expire in 2007, and its contracts to sell energy output generally expire when the project s operating contract expires. One of Covanta s contracts will expire in 2007. During the nine month period January 1 to December 31, 2004, this contract contributed $12.5 million in revenues. Expiration of these contracts will subject Covanta to greater market risk in maintaining and enhancing its revenues. As its operating contracts at municipally-owned projects approach expiration, Covanta will seek to enter into renewal or replacement contracts to continue operating such

projects. Covanta will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. The expiration of Covanta s existing energy sales contracts, if not renewed, will require Covanta to sell project energy output either into the electricity grid or pursuant to new contracts.

At some of Covanta s facilities, market conditions may allow Covanta to effect extensions of existing operating contracts along with facility expansions which would increase the waste processing capacity of these projects. Such extensions and expansions are currently being considered at a limited number of Covanta s facilities in conjunction with its municipal clients. If Covanta were unable to reach agreement with its municipal clients on the terms under which it would implement such extensions and expansions, or if the implementation of these extensions and expansions is materially delayed, this may adversely affect Covanta s cash flow and profitability.

Covanta s cash flow and profitability may be adversely affected if it is unable to obtain contracts acceptable to it for such renewals, replacements or additional contracts, or extension and expansion contracts. We cannot assure you that Covanta will be able to enter into such contracts or that the terms available in the market at the time will be favorable to Covanta.

Concentration of suppliers and customers may expose Covanta to heightened financial exposure.

Covanta often relies on single suppliers and single customers at Covanta s facilities, exposing such facilities to financial risks if any supplier or customer should fail to perform its obligations.

Covanta often relies on a single supplier to provide waste, fuel, water and other services required to operate a facility and on a single customer or a few customers to purchase all or a significant portion of a facility s output or capacity. In most cases, Covanta has long-term agreements with such suppliers and customers in order to mitigate the risk of supply interruption. The financial performance of these facilities depends on such customers and suppliers continuing to perform their obligations under their long-term agreements. A facility s financial results could be materially and adversely affected if any one customer or supplier fails to fulfill its contractual obligations and Covanta is unable to find other customers or suppliers to produce the same level of profitability. We cannot assure you that such performance failures by third parties will not occur, or that if they do occur, such failures will not adversely affect Covanta s cash flow or profitability.

In addition, for its waste-to-energy facilities, Covanta relies on its municipal clients as a source not only of waste for fuel but also of revenue from fees for disposal services Covanta provides. Because Covanta s contracts with its municipal clients are generally long term (none expires prior to 2007), Covanta may be adversely affected if the credit quality of one or more of its municipal clients were to decline materially. We cannot assure you that such credit quality will not decline, or that if one or more of Covanta s municipal clients credit quality does decline, that it would not adversely affect Covanta s domestic cash flow or profitability.

Covanta s international businesses emerged from bankruptcy with a large amount of debt, and we cannot assure you that its cash flow from international operations will be sufficient to pay this debt.

Covanta s subsidiary holding the equity interests in its international businesses, CPIH, is also highly leveraged, and its debt will be serviced solely from the cash generated from the international operations. Cash distributions from international projects are typically less dependable as to timing and amount than distributions from domestic projects, and we cannot assure you that CPIH will have sufficient cash flow from operations or other sources to pay the principal or interest due on its debt. As of December 31, 2004, Covanta s outstanding international debt was $180 million, consisting of $77 million of CPIH recourse debt and $103 million of project debt.

CPIH s ability to service its debt will depend upon:

- its ability to continue to operate and maintain its facilities consistent with historical performance levels;
- stable foreign political environments that do not resort to expropriation, contract renegotiations or currency or exchange changes;
- the financial ability of the electric and steam purchasers to pay the full contractual tariffs on a timely basis;
- the ability of its international project subsidiaries to maintain compliance with their respective project debt covenants in order to make equity distributions to CPIH; and
- its ability to sell existing projects in an amount sufficient to repay CPIH indebtedness at or prior to its maturity in March 2007, or to refinance its indebtedness at or prior to such maturity.

CPIH s debt is due in March 2007, and it will need to refinance its debt or obtain cash from other sources to repay this debt at maturity.

Covanta believes that cash from CPIH s operations, together with liquidity available under CPIH s revolving credit facility, will provide CPIH with sufficient liquidity to meet its needs for cash, including cash to pay debt service on CPIH s debt prior to maturity in March 2007. Covanta believes that CPIH will not have sufficient cash from its operations and its revolving credit facility to pay off its debt at maturity, and so if it is unable to generate sufficient additional cash from asset sales or other sources, CPIH will need to refinance its debt at or prior to maturity. While CPIH s debt is non-recourse to Covanta, it is secured by a pledge of Covanta s stock in CPIH and CPIH s equity interests in certain of its subsidiaries. While we have financing commitments to refinance Covanta s debt, and to repay CPIH s debt entirely, in connection with the acquisition of Ref-Fuel, such financing is contingent upon consummation of the Ref-Fuel acquisition. We cannot assure you that such additional cash will be available to CPIH, or that it will be able to refinance its debt on acceptable terms, or at all.

CPIH s assets and cash flow will not be available to Covanta.

Although CPIH s results of operations are consolidated with Danielson s and Covanta s for financial reporting purposes, as long as the existing CPIH term loan and revolver remain outstanding, CPIH is restricted under its existing credit agreements from distributing cash to Covanta. Under these agreements, CPIH s cash may only be used for CPIH s purposes and to service CPIH s debt. Accordingly, although reported on Danielson s and Covanta s consolidated financial statements, Covanta does not have access to CPIH s revenues or cash flows and will have access only to Covanta s domestically generated cash flows.

A sale or transfer of CPIH or its assets may not be sufficient to repay CPIH indebtedness.

Although CPIH s results of operations are consolidated with Danielson s and Covanta s for financial reporting purposes, due to CPIH s indebtedness and the terms of Covanta s credit agreements, CPIH s cash flow is available only to repay CPIH s debt. Similarly, in the event that CPIH determines that it is desirable to sell or transfer all or any portion of its assets or business, the proceeds would first be applied to reduce CPIH s debt. We cannot assure you that the proceeds of any such sale would be sufficient to repay all of CPIH s debt, consisting of principal and accrued interest or, if sufficient to repay CPIH s debt, that such proceeds would offset the loss of CPIH s revenues and earnings as reported by Danielson and Covanta in their respective consolidated financial statements.

Although Danielson has received a commitment from Goldman Sachs Credit Partners, L.P. and Credit Suisse First Boston for a debt financing package for Covanta necessary to finance the acquisition of Ref-Fuel, as well as to refinance the existing recourse debt of Covanta and repay all of CPIH s recourse debt, such financing is contingent upon consummation of the Ref-Fuel acquisition. We cannot assure you that this financing will close. In the absence of a successful closing of the Ref-Fuel acquisition and its related financing, we cannot assure you that CPIH will be able to obtain refinancing on acceptable terms, or at all.

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Exposure to international economic and political factors may materially and adversely affect Covanta s business.

CPIH s operations are entirely outside the United States and expose it to legal, tax, currency, inflation, convertibility and repatriation risks, as well as potential constraints on the development and operation of potential business, any of which can limit the benefits to CPIH of a foreign project.

CPIH s projected cash distributions from existing facilities over the next five years comes from facilities located in countries having sovereign ratings below investment grade, including Bangladesh, the Philippines and India. In addition, Covanta continues to provide operating guarantees and letters of credit for certain of CPIH s projects, which if drawn upon would require CPIH to reimburse Covanta for any related payments it may be required to make. The financing, development and operation of projects outside the United States can entail significant political and financial risks, which vary by country, including:

changes in law or regulations;

changes in electricity tariffs;

changes in foreign tax laws and regulations;

changes in United States, federal, state and local laws, including tax laws, related to foreign operations;

compliance with United States, federal, state and local foreign corrupt practices laws;

changes in government policies or personnel;

changes in general economic conditions affecting each country, including conditions in financial markets;

changes in labor relations in operations outside the United States;

political, economic or military instability and civil unrest; and

expropriation and confiscation of assets and facilities.

The legal and financial environment in foreign countries in which CPIH currently owns assets or projects also could make it more difficult for it to enforce its rights under agreements relating to such projects.

The occurrence of any of these risks could substantially delay the receipt of cash distributions from international projects or reduce the value of the project concerned. In addition, the existence of the operating guarantees and letters of credit provided by Covanta for CPIH projects could expose it to any or all of the risks identified above with respect to the CPIH projects, particularly if CPIH s cash flow or other sources of liquidity are insufficient to reimburse Covanta for amounts due under such instruments. As a result, these risks may have a material adverse effect on Covanta s business, consolidated financial condition and results of operations and on CPIH s ability to service its debt.

Exposure to foreign currency fluctuations may affect Covanta s costs of operations.

CPIH sought to participate in projects in jurisdictions where limitations on the convertibility and expatriation of currency have been lifted by the host country and where such local currency is freely exchangeable on the international markets. In most cases, components of project costs incurred or funded in the currency of the United States are recovered with limited exposure to currency fluctuations through negotiated contractual adjustments to the price charged for electricity or service provided. This contractual structure may cause the cost in local currency to the project s power purchaser or service recipient to rise from time to time in excess of local inflation. As a result, there is a risk in such situations that such power purchaser or service recipient will, at least in the near term, be less able or willing to pay for the project s power or service.

Exposure to fuel supply prices may affect CPIH s costs and results of operations.

Changes in the market prices and availability of fuel supplies to generate electricity may increase CPIH s cost of producing power, which could adversely impact our profitability and financial performance.

The market prices and availability of fuel supplies of some of CPIH s facilities fluctuate. Although CPIH believes that it has adequate and reliable fuel supplies and that its suppliers have adequate production and transportation systems to comply with their contractual requirements to supply CPIH s facilities, any price increase, delivery disruption or reduction in the availability of such supplies could affect CPIH s ability to operate CPIH s facilities and impair its cash flow and profitability. CPIH may be subject to further exposure if any of its future operations are concentrated in facilities using fuel types subject to fluctuating market prices and availability. Covanta may not be successful in its efforts to mitigate its exposure to supply and price swings.

Covanta s inability to obtain resources for operations may adversely affect its ability to effectively compete.

Covanta s waste-to-energy facilities depend on solid waste both for fuel and as a source of revenue. For most of Covanta s facilities, the prices it charges for disposal of solid waste are fixed under long-term contracts and the supply is guaranteed by sponsoring municipalities. However, for some of Covanta s waste-to-energy facilities, the availability of solid waste to Covanta, as well as the tipping fee that Covanta must charge to attract solid waste to its facilities, depends upon competition from a number of sources such as other waste-to-energy facilities, landfills and transfer stations competing for waste in the market area. In addition, Covanta may need to obtain waste on a short-term competitive basis as its long-term contracts expire at its owned facilities. There has been and may be further consolidation in the solid waste industry which would reduce the number of solid waste collectors or haulers that are competing for disposal facilities or enable such collectors or haulers to use wholesale purchasing to negotiate favorable below-market disposal rates. The consolidation in the solid waste industry has resulted in companies with vertically integrated collection activities and disposal facilities. Such consolidation may result in economies of scale for those companies as well as the use of disposal capacity at facilities owned by such companies or by affiliated companies. Such activities can affect both the availability of waste to Covanta for disposal at some of Covanta s waste-to-energy facilities and market pricing.

Compliance with environmental laws could adversely affect Covanta s results of operations.

Costs of compliance with existing and future environmental regulations by federal, state and local authorities could adversely affect Covanta s cash flow and profitability. Covanta s business is subject to extensive environmental regulation by federal, state and local authorities, primarily relating to air, waste (including residual ash from combustion) and water. Covanta is required to comply with numerous environmental laws and regulations and to obtain numerous governmental permits in operating Covanta s facilities. Covanta may incur significant additional costs to comply with these requirements. Environmental regulations may also limit Covanta s ability to operate Covanta s facilities at maximum capacity, or at all. If Covanta fails to comply with these requirements, Covanta could be subject to civil or criminal liability, damages and fines. Existing environmental regulations could be revised or reinterpreted and new laws and regulations could be adopted or become applicable to Covanta or its facilities, and future changes in environmental laws and regulations could occur. This may materially increase the amount Covanta must invest to bring its facilities into compliance. In addition, lawsuits by the Environmental Protection Agency, commonly referred to as the EPA, and various states highlight the environmental risks faced by generating facilities. Stricter environmental regulation of air emissions, solid waste handling or combustion, residual ash handling and disposal, and waste water discharge could materially affect Covanta s cash flow and profitability.

Covanta may not be able to obtain or maintain, from time to time, all required environmental regulatory approvals. If there is a delay in obtaining any required environmental regulatory approvals or if Covanta fails to obtain and comply with them, the operation of Covanta s facilities could be jeopardized or become subject to additional costs.

Federal energy regulation could adversely affect Covanta s revenues and costs of operations.

Covanta s business is subject to extensive energy regulations by federal and state authorities. The economics, including the costs, of operating Covanta s generating facilities may be adversely affected by any changes in these regulations or in their interpretation or implementation or any future inability to comply with existing or future regulations or requirements.

The Public Utility Holding Company Act of 1935 and the Federal Power Act, regulate public utility holding companies and their subsidiaries and place constraints on the conduct of their business. The FPA regulates wholesale sales of electricity and the transmission of electricity in interstate commerce by public utilities. Under the Public Utility Regulatory Policies Act of 1978, Covanta s domestic facilities are qualifying facilities (facilities meeting statutory size, fuel and ownership requirements), which are exempt from regulations under PUHCA, most provisions of the FPA and state rate regulation. Covanta s foreign projects are exempt from regulation under PUHCA.

If Covanta becomes subject to either the FPA or PUHCA, the economics and operations of Covanta s energy projects could be adversely affected, including rate regulation by the Federal Energy Regulation Commission, with respect to its output of electricity. If an alternative exemption from PUHCA was not available, Covanta could be subject to regulation by the SEC as a public utility holding company. In addition, depending on the terms of the project s power purchase agreement, a loss of Covanta s exemptions could allow the power purchaser to cease taking and paying for electricity or to seek refunds of past amounts paid. Such results could cause the loss of some or all contract revenues or otherwise impair the value of a project and could trigger defaults under provisions of the applicable project contracts and financing agreements. Defaults under such financing agreements could render the underlying debt immediately due and payable. Under such circumstances, Covanta cannot assure you that revenues received, the costs incurred, or both, in connection with the project could be recovered through sales to other purchasers.

Failure to obtain regulatory approvals could adversely affect Covanta s operations.

Covanta is continually in the process of obtaining or renewing federal, state and local approvals required to operate Covanta s facilities. While Covanta currently has all necessary operating approvals, Covanta may not always be able to obtain all required regulatory approvals, and Covanta may not be able to obtain any necessary modifications to existing regulatory approvals or maintain all required regulatory approvals. If there is a delay in obtaining any required regulatory approvals or if Covanta fails to obtain and comply with any required regulatory approvals, the operation of Covanta s facilities or the sale of electricity to third parties could be prevented, made subject to additional regulation or subject Covanta to additional costs.

The energy industry is becoming increasingly competitive, and Covanta might not successfully respond to these changes.

Covanta may not be able to respond in a timely or effective manner to the changes resulting in increased competition in the energy industry in both domestic and international markets. These changes may include deregulation of the electric utility industry in some markets, privatization of the electric utility industry in other markets and increasing competition in all markets. To the extent U.S. competitive pressures increase and the pricing and sale of electricity assumes more characteristics of a commodity business, the economics of Covanta s business may come under increasing pressure. Regulatory initiatives in foreign countries where Covanta has or will have operations involve the same types of risks.

Changes in laws and regulations affecting the solid waste and the energy industries could adversely affect Covanta s business.

Covanta s business is highly regulated. Covanta cannot predict whether the federal or state governments or foreign governments will adopt legislation or regulations relating to the solid waste or energy industries. These laws and regulations can result in increased capital, operating and other costs to Covanta, particularly with regard to enforcement efforts. The introduction of new laws or other future regulatory developments that

increase the costs of operation or capital to Covanta may have a material adverse effect on Covanta s business, financial condition or results of operations.

Insurance Services Specific Risks

Insurance regulations may affect NAICC s operations.

The insurance industry is highly regulated. NAICC is subject to regulation by state and federal regulators, and a significant portion of NAICC s operations are subject to regulation by the state of California. Changes in existing insurance regulations or adoption of new regulations or laws which could affect NAICC s results of operations and financial condition may include, without limitation, proposed changes to California regulations regarding a broker s fiduciary duty to select the best carrier for an insured, extension of California s Low Cost Automobile Program beyond Los Angeles and San Francisco counties and changes to California s workers compensation laws. We cannot predict the impact of changes in existing insurance regulations or adoption of new regulations or laws on NAICC s results of operations and financial condition.

The insurance products sold by NAICC are subject to intense competition.

The insurance products sold by NAICC are subject to intense competition from many competitors, many of whom have substantially greater resources than NAICC. The California non-standard personal automobile marketplace consists of over 100 carriers.

In order to decrease rates, insurers in California must obtain the prior permission for rate reductions from the California Department of Insurance. In lieu of requesting rate decreases, competitors may soften underwriting standards as an alternative means of attracting new business. Such tactics, should they occur, would introduce new levels of risk for NAICC and could limit NAICC s ability to write new policies or renew existing profitable policies. We cannot assure you that NAICC will be able to successfully compete in these markets and generate sufficient premium volume at attractive prices to be profitable. This risk is enhanced by the reduction in lines of business NAICC writes as a result of its decision to reduce underwriting operations.

If NAICC s loss experience exceeds its estimates, additional capital may be required.

Unpaid losses and LAE are based on estimates of reported losses, historical company experience of losses reported for reinsurance assumed, and historical company experience for unreported claims. Such liability is, by necessity, based on estimates that may change in the near term. NAICC cannot assure you that the ultimate liabilities will not exceed, or even materially exceed, the amounts estimated. If the ultimate liability materially exceeds estimates, then additional capital may be required to be contributed to some of our insurance subsidiaries. NAICC and the other insurance subsidiaries received additional capital contributions from Danielson in 2003 and 2002 and NAICC cannot provide any assurance that it and its subsidiaries will be able to obtain such additional capital on commercially reasonable terms or at all.

In addition, due to the fact that NAICC and its other insurance subsidiaries are in the process of running off several significant lines of business, the risk of adverse development and the subsequent requirement to obtain additional capital is heightened.

Failure to satisfy capital adequacy and risk-based capital requirements would require NAICC to obtain additional capital.

NAICC is subject to regulatory risk-based capital requirements. Depending on its risk-based capital, NAICC could be subject to four levels of increasing regulatory intervention ranging from company action to mandatory control. NAICC s capital and surplus is also one factor used to determine its ability to distribute or loan funds to us. If NAICC has insufficient capital and surplus, as determined under the risk-based capital test, it will need to obtain additional capital to establish additional reserves. NAICC cannot provide any assurance that it will be able to obtain such additional capital on commercially reasonable terms or at all.

Risks Related to the Ref-Fuel Acquisition

We may be unable to integrate the operations of Ref-Fuel and Danielson successfully and may not realize the full anticipated benefits of the acquisition

Achieving the anticipated benefits of the transaction will depend in part upon our ability to integrate the two companies businesses in an efficient and effective manner. Our attempt to integrate two companies that have previously operated independently may result in significant challenges, and we may be unable to accomplish the integration smoothly or successfully. In particular, the necessity of coordinating organizations in additional locations and addressing possible differences in corporate cultures and management philosophies may increase the difficulties of integration. The integration will require the dedication of significant management resources, which may temporarily distract management s attention from the day-to-day operations of the businesses of the combined company. The process of integrating operations after the transaction could cause an interruption of, or loss of momentum in, the activities of one or more of the combined company s businesses and the loss of key personnel. Employee uncertainty and lack of focus during the integration process may also disrupt the businesses of the combined company. Any inability of management to integrate the operations of Ref-Fuel and Danielson successfully could have a material adverse effect on the business and financial condition of Danielson.

We will incur significant transaction and combination-related costs in connection with the transaction

If the proposed transaction with Ref-Fuel closes, we expect that Danielson will be obligated to pay transaction fees and other expenses related to the transaction of approximately $45 million, including financial advisors fees, legal and accounting fees, and fees and expenses to refinance the existing Covanta recourse debt. Furthermore, we expect to incur significant costs, which we currently estimate to be approximately $20 million, associated with combining the operations of the two companies. However, we cannot predict the specific size of those charges before we begin the integration process. Although we expect that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, we cannot give any assurance that this net benefit will be achieved as planned in the near future, or at all.

Failure to close the Ref-Fuel acquisition may adversely affect the Danielson s financial situation

If Danielson is unable to consummate its planned acquisition of Ref-Fuel, Danielson will have incurred substantial transaction fees and other expenses in connection with its pursuit of the transaction, without achieving the benefits of the acquisition. If Danielson s failure to close the Ref-Fuel acquisition is due to Danielson s failure to complete the Ref-Fuel Rights Offering and the related financing for the transaction, and all other closing conditions are capable of being satisfied, then Danielson must pay the selling stockholders of Ref-Fuel a termination fee of $25 million, no less than $10 million of which must be paid in cash. In addition, if we fail to close the transaction, the refinancing of Covanta s existing recourse debt which is contemplated in connection with the acquisition will not occur. Covanta s and CPIH s need to either satisfy their debts upon maturity or refinance them will continue and there can be no assurance that Covanta or CPIH will be able to refinance their respective debts on acceptable terms, or at all, or obtain sufficient cash to satisfy their debts at maturity.

Fees payable in Danielson s stock if Ref-Fuel fails to close may have a dilutive effect on your interest

If Danielson fails to close the Ref-Fuel acquisition due to Danielson s failure to complete the Ref-Fuel Rights Offering and the related financing for the transaction, and all other closing conditions are capable of being satisfied, then Danielson must pay the selling stockholders of Ref-Fuel a termination fee of $25 million. No less than $10 million of this termination fee must be paid in cash and up to $15 million the fee may be paid in stock at Danielson s election, at price of $8.13 per share. In addition, in connection with their commitments to participate in the Ref Fuel Rights Offering and acquire their respective pro rata portions of the shares in the Ref-Fuel Rights Offering, Danielson has agreed to pay each of SZ Investments, TAVF and Laminar an amount equal to 1.5% to 2.25% of their respective equity commitments depending upon the timing of the transaction. If the Ref-Fuel Rights Offering is terminated or is not commenced before August 15, 2005,

Danielson may elect to pay this amount to SZ Investments, TAVF and Laminar in the form of stock at a price based upon the 10-day average closing price of Danielson s stock following termination of the Ref-Fuel Rights Offering or August 16, 2005 if the Ref-Fuel Rights Offering has not commenced. Payment of these fees in Danielson s common stock will have a dilutive effect on your relative ownership interest in our stock.

Ref-Fuel s business model includes greater risk in the waste disposal market than does Covanta s

While Covanta and Ref-Fuel both sell energy pursuant to long term contracts, Covanta typically sells a greater proportion of its aggregate waste processing capacity under long-term contracts than does Ref-Fuel. Consequently, more of Ref-Fuel s revenue from its waste-to-energy facilities is subject to market risk from fluctuations in waste market prices than Covanta s, and short-term fluctuations in the waste markets may have a greater impact on the combined company s waste-to-energy revenues than on those of Covanta alone.

EMPLOYEES

As of December 31, 2004, Danielson employed 1,837 full-time employees worldwide, of which a majority is employed in the United States

Of Danielson s employees in the United States, approximately 16% are unionized. Currently, Covanta is party to seven collective bargaining agreements: one of these agreements is scheduled to expire in 2005, two in 2006, and one in 2008. With respect to the remaining three agreements which have recently expired, the Company is in negotiations with the applicable collective bargaining representatives and Covanta currently expects to reach an agreement with such representative to extend such agreement on its current or similar terms.

Danielson considers relations with its employees to be good and does not anticipate any significant labor disputes in 2005.

AVAILABILITY OF INFORMATION

Danielson s Internet site (www.danielsonholding.com) makes available free of charge to interested parties Danielson s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, and all amendments and exhibits to those reports, all reports filed on Forms 3, 4 and 5 with respect to Danielson s common stock, as well as all other reports and schedules Danielson files electronically with the SEC, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Interested parties may also find reports, proxy and information statements and other information on issuers that file electronically with the SEC at the SEC s Internet site at www.sec.gov.

Item 2. *PROPERTIES*

During 2004, Danielson moved its executive offices from Chicago, Illinois to Fairfield, New Jersey. Danielson s executive offices are now located at 40 Lane Road, Fairfield, New Jersey, in an office building located on a 5.4 acre site owned by a subsidiary. In 2004, Danielson closed its office in Fairfax, Virginia, and relocated an office in Redding, California to Anderson, California. Additionally, Covanta sold its interests in two landfill gas projects situated on leased sites in Sun Valley and Los Angeles, California.

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The following table summarizes certain information relating to the locations of the properties owned or leased by Danielson or its subsidiaries:

	Location	Approximate Site Size (in Acres)(1)	Site Use	Nature of Interest(2)
	PARENT			
1.	Fairfield, New Jersey	5.4	Office space	Own
	INSURANCE SERVICES			
2.	Long Beach, California(3)	14,632 sq. ft.	Office space	Lease
	ENERGY SERVICES			
3.	Anderson, California	2,000 sq. ft	Office space	Lease
4.	City of Industry, California	953 sq. ft.	Office space	Lease
5.	Marion County, Oregon	15.2	Waste-to-energy facility	Own
6.	Alexandria/ Arlington, Virginia	3.3	Waste-to-energy facility	Lease
7.	Bristol, Connecticut	18.2	Waste-to-energy facility	Own
8.	Indianapolis, Indiana	23.5	Waste-to-energy facility	Lease
9.	Stanislaus County, California	16.5	Waste-to-energy facility	Lease
10.	Babylon, New York	9.5	Waste-to-energy facility	Lease
11.	Haverhill, Massachusetts	12.7	Waste-to-energy facility	Lease
12.	Haverhill, Massachusetts	16.8	Landfill Expansion	Lease
13.	Haverhill, Massachusetts	20.2	Landfill	Lease
14.	Lawrence, Massachusetts	11.8	RDF power plant(closed)	Own
15.	Lake County, Florida	15.0	Waste-to-energy facility	Own
16.	Wallingford, Connecticut	10.3	Waste-to-energy facility	Lease
17.	Fairfax County, Virginia	22.9	Waste-to-energy facility	Lease
18.	Union County, New Jersey	20.0	Waste-to-energy facility	Lease
19.	Huntington, New York	13.0	Waste-to-energy facility	Lease
20.	Warren County, New Jersey	19.8	Waste-to-energy facility	Lease
21.	Hennepin County, Minnesota	14.6	Waste-to-energy facility	Lease
22.		12.0	Waste-to-energy facility	Lease

	Onondaga County, New York			
23.	Bataan, the Philippines	30,049 sq. m.	Diesel power plant	Lease
24.	Zhejiang Province, People s Republic of China	33,303 sq. m.	Coal-fired cogeneration facility	Land Use Right reverts to China Joint Venture Partner upon termination of Joint Venture Agreement
25.	Shandong Province, People s Republic of China	33,303 sq. m.	Coal-fired cogeneration facility	Land Use Right reverts to China Joint Venture Partner upon termination of Joint Venture Agreement
26.	Jiangsu Province, People s Republic of China	65,043 sq. m.	Coal-fired co-generation facility	Land Use Right reverts to China Joint Venture Partner upon termination of Joint Venture Agreement

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	Location	Approximate Site Size (in Acres)(1)	Site Use	Nature of Interest(2)
27.	Rockville, Maryland	N/A	Landfill gas project	Lease
28.	San Diego, California	N/A	Landfill gas project	Lease
29.	Oxnard, California	N/A	Landfill gas project	Lease
30.	Salinas, California	N/A	Landfill gas project	Lease
31.	Santa Clara, California	N/A	Landfill gas project	Lease
32.	Stockton, California	N/A	Landfill gas project	Lease
33.	Burney, California	40.0	Wood waste project	Lease
34.	Jamestown, California	26.0	Wood waste project	Own (50%)
35.	Westwood, California	60.0	Wood waste project	Own
36.	Oroville, California	43.0	Wood waste project	Own
37.	Whatcom County, Washington	N/A	Hydroelectric project	Own (50%)
38.	Weeks Falls, Washington	N/A	Hydroelectric project	Lease
39.	Cavite, the Philippines	13,122 sq. m.	Heavy fuel oil project	Lease
40.	Cavite, the Philippines	10,200 sq. m.	Heavy fuel oil project	Lease
41.	Manila, the Philippines	468 sq. m.	Office space	Lease
42.	Bangkok, Thailand	676 sq. m.	Office space	Lease
43.	Chennai, India	1797 sq. ft.	Office space	Lease
44.	Samalpatti, India	2,546 sq. ft.	Office space	Lease
45.	Samayanallur, India	1,300 sq. ft.	Office space	Lease
46.	Samayanallur, India	17.1	Heavy fuel oil project	Lease
47.	Samayanallur, India	2.3	Heavy fuel oil project	Lease
48.	Samalpatti, India	30.3	Heavy fuel oil project	Lease
49.	Shanghai, China	145 sq. m.	Office space	Lease
50.	Imperial County, California	83.0	Undeveloped Desert Land	Own

(1) All sizes are in acres unless otherwise indicated.

(2) All ownership or leasehold interests relating to projects are subject to material liens in connection with the financing of the related project, except those listed above under item 10, 23-25, 27-32. In addition, all leasehold interests existed at least as long as the term of applicable project contracts, and several of the leasehold interests are subject to renewal and/or purchase options.

(3) NAICC entered into a five year lease in July 2004 and lease payments begin in February 2005.

Item 3. ***LEGAL PROCEEDINGS***

Danielson and/or its subsidiaries are party to a number of other claims, lawsuits and pending actions, most of which are routine and all of which are incidental to its business. Danielson assesses the likelihood of potential losses on an ongoing basis and when losses are considered probable and reasonably estimable, records as a loss an estimate of the ultimate outcome. If Danielson can only estimate the range of a possible loss, an amount representing the low end of the range of possible outcomes is recorded. The final consequences of these proceedings are not presently

determinable with certainty.

American Commercial Lines, Inc.

The petition with the U.S. Bankruptcy Court to reorganize under Chapter 11 of the U.S. Bankruptcy Code, that ACL and many of its subsidiaries and its immediate direct parent entity, American Commercial Lines Holdings, LLC, filed on January 31, 2003 has resulted in the confirmation of a plan of reorganization on December 30, 2004 that was effective as of January 11, 2005. Pursuant to ACL s plan of reorganization ACL is no longer a subsidiary of Danielson as Danielson s equity interest in ACL was cancelled and it received

warrants to purchase three percent of ACL s new common stock. See Note 3 to the Notes to the Consolidated Financial Statements.

Covanta Energy Corporation

Generally, claims and lawsuits against Covanta and its subsidiaries that had filed bankruptcy petitions and subsequently emerged from bankruptcy arising from events occurring prior to their respective petition dates have been resolved pursuant to the Reorganization Plan, and have been discharged pursuant to the March 5, 2004 order of the Bankruptcy Court which confirmed, the Reorganization Plan. However, to the extent that claims are not dischargeable in bankruptcy, such claims may not be discharged. For example, the claims of certain persons who were personally injured prior to the petition date but whose injury only became manifest thereafter may not be discharged pursuant to the Reorganization Plan.

Environmental Matters

Covanta s operations are subject to environmental regulatory laws and environmental remediation laws. Although Covanta s operations are occasionally subject to proceedings and orders pertaining to emissions into the environment and other environmental violations, which may result in fines, penalties, damages or other sanctions, the Company believes that it is in substantial compliance with existing environmental laws and regulations.

Covanta may be identified, along with other entities, as being among parties potentially responsible for contribution to costs associated with the correction and remediation of environmental conditions at disposal sites subject to CERCLA and/or analogous state laws. In certain instances, Covanta may be exposed to joint and several liabilities for remedial action or damages. Covanta s ultimate liability in connection with such environmental claims will depend on many factors, including its volumetric share of waste, the total cost of remediation, the financial viability of other companies that also sent waste to a given site and, in the case of divested operations, its contractual arrangement with the purchaser of such operations. Generally such claims arising prior to the first petition date were resolved in and discharged by the Chapter 11 Cases.

The potential costs related to the matters described below and the possible impact on future operations are uncertain due in part to the complexity of governmental laws and regulations and their interpretations, the varying costs and effectiveness of cleanup technologies, the uncertain level of insurance or other types of recovery and the questionable level of the Company s responsibility. Although the ultimate outcome and expense of any litigation, including environmental remediation, is uncertain, the Company believes that the following proceedings will not have a material adverse effect on the Company s consolidated financial position or results of operations.

In June, 2001, the EPA named Covanta s wholly-owned subsidiary, Ogden Martin Systems of Haverhill, Inc., now known as Covanta Haverhill, Inc., as one of 2,000 potentially responsible parties (PRPs) at the Beede Waste Oil Superfund Site, Plaistow, New Hampshire, a former waste oil recycling facility. The total quantity of waste oil alleged by the EPA to have been disposed of by PRPs at the Beede site is approximately 14.3 million gallons, of which Covanta Haverhill s contribution is alleged to be approximately 44,000 gallons. On January 9, 2004, the EPA signed its Record of Decision with respect to the cleanup of the site. According to the EPA, the costs of response actions incurred as of January 2004 by the EPA and the State of New Hampshire Department of Environmental Services (DES) total approximately $19 million, and the estimated cost to implement the remedial alternative selected in the Record of Decision is an additional $48 million. Covanta Haverhill, Inc. is participating in discussions with other PRPs concerning the EPA s selected remedy for the site, in anticipation of eventual settlement negotiations with the EPA and DES. Covanta Haverhill, Inc. s share of liability, if any, cannot be determined at this time as a result of uncertainties regarding the source and scope of contamination, the large number of PRPs and the varying degrees of responsibility among various classes of PRPs. The Company believes that based on the amount of waste oil materials Covanta Haverhill, Inc. is alleged to have sent to the site, its liability will not be material.

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Other Matters

During the course of the Chapter 11 Cases, Covanta and certain contract counterparties reached agreement with respect to material restructuring of their mutual obligations in connection with several waste-to-energy projects. Subsequent to March 10, 2004 Covanta were also involved in material disputes and/or litigation with respect to the Warren County, New Jersey and Lake County, Florida waste-to-energy projects and the Tampa Bay water project. During 2004, all disputes relating to the Lake County and Tampa Bay matters were resolved, and the Company s subsidiaries involved in these projects emerged from bankruptcy. As of December 31, 2004 Covanta s subsidiaries involved with the Warren County, New Jersey project remain in Chapter 11 and are not consolidated in the Company s consolidated financial statements. The Company expects that the outcome of the Warren County, New Jersey litigation described below will not adversely affect the Company.

The Covanta subsidiary (Covanta Warren) which operates the waste-to-energy facility in Warren County, New Jersey (the Warren Facility) and the Pollution Control Financing Authority of Warren County (Warren Authority) have been engaged in negotiations for an extended time concerning a potential restructuring of the parties rights and obligations under various agreements related to Covanta Warren s operation of the Warren Facility. Those negotiations were in part precipitated by a 1997 federal court of appeals decision invalidating certain of the State of New Jersey s waste-flow laws, which resulted in significantly reduced revenues for the Warren Facility. Since 1999, the State of New Jersey has been voluntarily making all debt service payments with respect to the project bonds issued to finance construction of the Warren Facility, and Covanta Warren has been operating the Warren Facility pursuant to an agreement with the Warren Authority which modifies the existing service agreement. Principal on the Warren Facility project debt is due annually in December of each year, while interest is due semi-annually in June and December of each year. The State of New Jersey provided sufficient funds to the project bond trustee to pay principal and interest to bondholders during June 2004.

Although discussions continue, to date Covanta Warren and the Warren Authority have been unable to reach an agreement to restructure the contractual arrangements governing Covanta Warren s operation of the Warren Facility.

Also as part of Covanta s emergence from bankruptcy, Covanta and Covanta Warren entered into several agreements approved by the Bankruptcy Court that permit Covanta Warren to reimburse Covanta for employees and employee-related expenses, provide for payment of a monthly allocated overhead expense reimbursement in a fixed amount and permit Covanta to advance up to $1.0 million in super-priority debtor-in-possession loans to Covanta Warren in order to meet any liquidity needs. As of December 31, 2004, Covanta Warren owed Covanta $1.9 million.

In the event the parties are unable to timely reach agreement upon and consummate a restructuring of the contractual arrangements governing Covanta Warren s operation of the Warren Facility, the Debtors may, among other things, elect to litigate with counterparties to certain agreements with Covanta Warren, assume or reject one or more executory contracts related to the Warren Facility, attempt to file a plan of reorganization on a non-consensual basis, or liquidate Covanta Warren. In such an event, creditors of Covanta Warren may receive little or no recovery on account of their claims.

Item 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

There are no submission of matters to a vote of the security holders of Danielson that are required to be reported on this Form 10-K. The results of the proposals voted on at Danielson s Annual Meeting of Shareholders held on October 5, 2004 were previously reported by Danielson on its Form 10-Q for the quarterly period ended September 30, 2004 that was filed with the SEC on November 9, 2004.

PART II

Item 5. ***Market for The Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***

Danielson s common stock is listed and traded on the American Stock Exchange (symbol: DHC). On March 9, 2005, there were approximately 1,078 holders of record of common stock. On March 9, 2005, the closing price of the common stock on the American Stock Exchange was $15.90.

The following table sets forth the high, low and closing stock prices of Danielson s common stock for the last two years, as reported on the American Stock Exchange Composite Tape.

	2004			2003		
	High	**Low**	**Close**	**High**	**Low**	**Close**
First Quarter	$ 10.03	$ 2.87	$ 9.30	$ 1.55	$ 0.64	$ 0.74
Second Quarter	10.40	5.40	6.91	1.60	0.71	1.60
Third Quarter	7.15	5.52	6.09	1.80	1.27	1.37
Fourth Quarter	8.60	6.00	8.45	3.25	1.26	2.91

Danielson has not paid dividends on its common stock and does not expect to declare or pay any dividends in the foreseeable future. Under current financing arrangements there are material restrictions on the ability of Danielson s subsidiaries to transfer funds to Danielson in the form of cash dividends, loans or advances that would likely materially limit the future payment of dividends on common stock. See Item 7 Management s Discussion, and Analysis of Financial Condition and Results of Operations for more detailed information on our credit agreements.

On December 2, 2003, Danielson entered into a note purchase agreement with the Bridge Lenders pursuant to which in consideration for the $40 million of bridge financing in the form of convertible notes and the agreement by the Bridge Lenders to arrange or provide for the $118 million second lien letter of credit facility and for Laminar to arrange or provide for the $10 million international revolving credit facility, Danielson issued to the Bridge Lenders an aggregate of 5,120,853 shares of common stock. At the time that Danielson entered into the note purchase agreement, agreed to issue the notes convertible into shares of common stock and issued the equity compensation to the Bridge Lenders, the closing price of the common stock on the American Stock Exchange on the day prior to announcement of the Covanta acquisition was $1.40 per share, which was below the $1.53 per share conversion price of the notes.

Pursuant to their terms, the notes were convertible into common stock at a price of $1.53 per share without action by the Bridge Lenders if all or any portion of the notes are not repaid pursuant to a rights offering, subject to certain agreed upon limitations necessitated by Danielson s NOLs.

In addition, under the note purchase agreement, Laminar agreed to convert an amount of convertible notes in order to acquire up to an additional 8.75 million shares of the common stock at $1.53 per share based upon the levels of public participation in the rights offering. Danielson issued the maximum of 8.75 million shares to Laminar pursuant to the conversion of approximately $13.4 million in principal amount of notes. Consequently, the $20 million principal amount of notes held by Laminar plus accrued but unpaid interest was repaid in full on June 11, 2004 through the issuance of 8.75 million shares of Danielson common stock to Laminar and $7.9 million of the proceeds from the rights offering.

The Bridge Lenders were all sophisticated investors that conducted due diligence on Danielson and were either affiliated with members of, or had the opportunity to ask questions of, management in connection with the drafting and negotiation of the note purchase agreement. The issuance of the common stock issued to the Bridge Lenders was exempt from registration pursuant to private offering exemption of Section 4(2) of the Securities Act of 1933, as amended.

In May 2004 Danielson commenced offering as contemplated by the note purchase agreement, and in June 2004 received proceeds of $26.6 million, which it used in part to repay the bridge lenders in full. Pursuant

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to a registration rights agreement, Danielson filed a shelf registration statement which was declared effective on August 24, 2004, to register the resale of 17,711,491 shares held by the Bridge Lenders.

Item 6. *Selected Financial Data*

	Years Ended				
	2004(1)	2003(2)	2002(3)	2001	2000
	(In thousands, except per share amounts)				
Statement of Operations Data					
Operating revenue	$ 578,555	$ 41,123	$ 531,501	$ 92,104	$ 84,331
Operating expense	501,200	54,029	528,168	106,365	85,073
Operating income (loss)	77,355	(12,906)	3,333	(14,261)	(742)
Other income (loss)			2,793		(1,906)
Interest expense, net	41,881	1,424	38,735		
Income (loss) before taxes, minority interest and equity income	35,474	(14,330)	(32,609)	(14,261)	1,164
Minority interest expense	6,869				
Income taxes	11,535	18	346	73	134
Equity in net income (loss) from unconsolidated investments	17,024	(54,877)			
Net income (loss)	34,094	(69,225)	(32,955)	(14,334)	1,030
Income (loss) per share(5)					
Basic	0.54	(1.46)	(0.82)	(0.48)	0.04
Diluted	0.52	(1.46)	(0.82)	(0.48)	0.04
Balance Sheet Data					
Cash and cash equivalents	$ 96,148	$ 17,952	$ 25,183	$ 17,866	$ 12,545
Restricted funds held in trust	239,918				
Investments	65,042	71,057	93,746	148,512	147,667
Properties net	819,400	254	654,575	131	56
Service and energy contracts	177,290				
Deferred tax asset	26,910				
Total assets	1,939,081	162,648	1,032,945	208,871	210,829
Deferred income taxes	109,465				
Unpaid losses and LAE	64,270	83,380	101,249	105,745	100,030
Recourse debt	312,896	40,000	597,246		
Project debt	944,737(6)				
Project debt premium	37,910				
Minority interest	83,350				
Shareholders equity	134,815	27,791	77,360	74,463	81,330
Book value per share of common stock(5)	1.84	0.50	1.63	2.48	2.74
Shares of common stock outstanding(4),(5)	73,430	55,105	47,459	30,039	29,716

(1) For the year ended December 31, 2004, Covanta s results of operations are included in Danielson s consolidated results since March 10, 2004. As a result of the consummation of the Covanta acquisition on March 10, 2004, the future performance of Danielson will predominantly reflect the performance of Covanta s operations which are significantly larger than Danielson s insurance operations. As a result, the nature of Danielson s business, the risks attendant to such business and the trends that it will face have

been significantly altered by the acquisition of Covanta. Accordingly, Danielson s historic financial performance and results of operations will not be indicative of its future performance.

(2) ACL, which was acquired on May 29, 2002, and certain of its subsidiaries, filed a petition on January 31, 2003 with the U.S. Bankruptcy Court for the Southern District of Indiana, New Albany Division to reorganize under Chapter 11 of the U.S. Bankruptcy Code. As a result of this filing, Danielson no longer maintained control of the activities of ACL and Danielson s equity interest in ACL was cancelled when ACL s plan of reorganization was confirmed on December 30, 2004 and it emerged from bankruptcy on January 11, 2005. Accordingly, Danielson no longer includes ACL and its subsidiaries as consolidated subsidiaries in Danielson s financial statements. Danielson s investments in these entities are presented using the equity method effective as of the beginning of the year ending December 31, 2003. Other (loss) income above consists of Danielson s equity in the net loss of ACL, GMS and Vessel Leasing in 2003.

(3) In 2002, Danielson purchased 100% of ACL, 5.4% of GMS and 50% of Vessel Leasing.

(4) Does not give effect to currently exercisable options, and, in 2001, and 2000, warrants to purchase shares of Danielson s common stock.

(5) Basic and diluted earnings per share and the average shares used in the calculation of basic and diluted earnings per share and book value per share of common stock and shares of common stock outstanding for all periods have been adjusted retroactively to reflect the bonus element contained in the rights offering issued on May 18, 2004.

(6) Includes $38 million of unamortized debt premium.

Item 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

Cautionary Note Regarding Forward-Looking Statements

Certain statements in the Annual Report on Form 10-K may constitute forward-looking statements as defined in Section 27A of the Securities Act of 1933 (the Securities Act), Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), the Private Securities Litigation Reform Act of 1995 (the PSLRA) or in releases made by the Securities and Exchange Commission, all as may be amended from time to time. Such forward looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Danielson and its subsidiaries, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward looking statements can be identified by, among other things, the use of forward-looking language, such as the words plan , believe , expect , anticipate , intend , estimat project , may , will , would , could , should , seeks , or scheduled to , or other similar words, or the negative or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the safe harbor provisions of such laws. Danielson cautions investors that any forward-looking statements made by Danielson are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to Danielson include, but are not limited to, the risks and uncertainties affecting their businesses described in Item 1 of Danielson s Annual Report on Form 10-K for the year ended December 31, 2004 and in registration statements and other securities filings by Danielson.

Although Danielson believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any of its forward-looking statements. Danielson s future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Annual Report on Form 10-K are made only as of the date hereof and Danielson does not

have or undertake any obligation to update or revise any forward-

looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

EXECUTIVE SUMMARY

Danielson is organized as a holding company with substantially all of its operations conducted in the insurance services industry prior to the acquisition of Covanta s energy business. As a result of the consummation of the Covanta acquisition on March 10, 2004, the future performance of Danielson will predominantly reflect the performance of Covanta s operations which are significantly larger than Danielson s insurance operations. Throughout 2004, Danielson also had subsidiaries engaged in the marine services industry which, beginning in 2003, were accounted for under the equity method. Most of these subsidiaries were involved in the bankruptcy proceeding of ACL, pursuant to which these subsidiaries were sold or reorganized. On December 30, 2004 a plan of reorganization was confirmed (without any material conditions) and on January 11, 2005, these subsidiaries emerged from bankruptcy, and Danielson s ownership interests in ACL were cancelled and it received warrants to purchase three percent of ACL s new common stock from certain creditors of ACL.

During 2004, DHC owned a direct 5.4% interest in GMS and a direct 50% interest in Vessel Leasing. Neither of these two companies filed for Chapter 11 protection. GMS was a joint venture among ACL, Danielson and a third party, which owned and operated marine terminals and warehouse operations. Vessel Leasing was a joint venture between ACL and Danielson which leased barges to ACL s barge transportation operations. Danielson, GMS and Vessel Leasing were not guarantors of ACL s debt nor were they liable for any of ACL s liabilities. On October 6, 2004, Danielson and ACL sold their interest in GMS to a third party joint venture member, and on January 13, 2005 Danielson sold its interest in Vessel Leasing to ACL. As a result, Danielson no longer is engaged in the marine services business.

The nature of Danielson s business, the risks attendant to such business and the trends that it will face have been significantly altered by the acquisition of Covanta and disposition of its marine services business. Accordingly, Danielson s prior financial performance will not be comparable with its future performance and readers are directed to Management s Discussion and Analysis of Covanta s Business below for a discussion of management s perspective on important factors of operating and financial performance.

In addition to the risks attendant to the operation of the Covanta energy business in the future and the integration of Covanta and its employees into Danielson, the ability of Danielson to utilize its net operating loss carryforwards to offset taxable income generated by the Covanta operations will have a material affect on Danielson s financial condition and results of operations. NOLs predominantly arose from predecessor insurance entities of Mission Insurance Group Inc. as more fully described in Note 25 to the Notes to the Consolidated Financial Statements and losses incurred in connection with the ACL investment.

Danielson had NOLs estimated to be approximately $516 million for federal income tax purposes as of the end of 2004. The NOLs will expire in various amounts from December 31, 2005 through December 31, 2023, if not used. The amount of NOLs available to Covanta will be reduced by any taxable income generated by current members of Danielson s tax consolidated group. The IRS has not audited any of Danielson s tax returns.

A portion of Danielson s NOLs were utilized in 2004 as a result of income Danielson recognized in connection with ACL s emergence from bankruptcy business (as described in Note 3 to the Notes to Consolidated Financial Statements), Covanta s operations and from income from certain grantor trusts relating to Danielson s historic insurance.

If Danielson were to undergo, an ownership change as such term is used in Section 382 of the Internal Revenue Code, the use of its NOLs would be limited. Danielson will be treated as having had an ownership change if there is a more than 50% increase in stock ownership during a 3-year testing period by five percent stockholders . Danielson s Certificate of Incorporation contains stock transfer restrictions that were designed to help preserve Danielson s NOLs by avoiding an ownership change. The transfer restrictions were

implemented in 1990, and Danielson expects that they will remain in-force as long as Danielson has NOLs. Danielson cannot be certain, however, that these restrictions will prevent an ownership change.

Danielson, on a parent-only basis, has continuing expenditures for administrative expenses and derives income primarily from investment returns on portfolio securities. Therefore, the analysis of Danielson s results of operations and financial condition is generally done on a business segment basis. Danielson s long-term strategic and business objective is to enhance the value of its investment in Covanta, and acquire businesses that will allow Danielson to earn an attractive return on its investments.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes appearing in this Annual Report on Form 10-K. This discussion and analysis of results of operations and financial condition has been prepared on a business segment basis. Danielson s business segments are Covanta s energy business, insurance operations, and Danielson s corporate parent activities. Separate discussion and analysis of each segment s results of operation and liquidity and capital resources are included herein.

The results of operations from Covanta are included in Danielson s consolidated results of operations from March 10, 2004. However, given the significance of the Covanta acquisition to Danielson s future results of operations and financial condition, the energy business segment discussion includes combined information for the year ended December 31, 2004 as compared to Predecessor information for the year ended December 31, 2003 in order to provide a more informative comparison of results. Predecessor information refers to financial information of Covanta and its subsidiaries pertaining to periods prior to Danielson s acquisition of Covanta on March 10, 2004.

Separate discussion and analysis is provided below with respect to Danielson s parent-only operations, as well as those of its Energy and Insurance segments.

MANAGEMENT S DISCUSSION AND ANALYSIS OF PARENT-ONLY OPERATIONS

As discussed below, On February 1, 2005, Danielson announced its proposed acquisition of Ref-Fuel. Upon closing of the proposed acquisition, Ref-Fuel will be a wholly-owned subsidiary of Covanta. The acquisition will markedly increase the size and scale of Covanta s waste-to-energy business, and thus Danielson s business. It will also provide Covanta with the opportunity to achieve cost savings by combining the businesses, as well as the opportunity to refinance its existing corporate debt, thereby lowering its cost of capital and obtaining less restrictive covenants than under its current financing arrangements.

If the purchase agreement is terminated with Ref-Fuel because of our failure to complete the Ref-Fuel Rights Offering and financing as described below, and all other closing conditions are capable of being satisfied, then we must pay the to selling stockholders of Ref-Fuel a termination fee of $25 million, of which no less than $10 million shall be paid in cash and of which up to $15 million may be paid in shares of Danielson s common stock, at Danielson s election, based upon a price of $8.13 per share. As of the date of the purchase agreement Danielson entered into a registration rights agreement granting registration rights to such owners with respect to such stock, and deposited $10 million in cash in an escrow account pursuant to the terms of an escrow agreement.

Danielson intends to finance this transaction through a combination of debt and equity financing. The equity component of the financing is expected to consist of an approximately $400 million pro rata, registered offering of warrants or other rights to purchase Danielson s common stock to all of Danielson s existing stockholders at $6.00 per share. In the Ref-Fuel Rights Offering, Danielson s existing stockholders will be issued rights to purchase Danielson s stock on a pro rata basis, with each holder entitled to purchase approximately 0.9 shares of Danielson s common stock at an exercise price of $6.00 per full share for each share of Danielson s common stock then held.

Three of Danielson s largest stockholders, SZ Investments, TAVF, and Laminar, representing ownership of approximately 40% of Danielson s outstanding common stock, have each severally committed to participate in the Ref-Fuel Rights Offering and acquire their pro rata portion of the shares.

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As a consideration for their commitments, Danielson will pay each of these stockholders an amount equal to 1.5% to 2.25% of their respective equity commitments, depending on the timing of the transaction. Danielson agreed to amend an existing registration rights agreement to provide these stockholders with the right to demand that we undertake an underwritten offering within twelve months of the closing acquisition of Ref-Fuel in order to provide such stockholders with liquidity.

The acquisition and financing are expected to close during the second quarter of 2005. Management is currently focused on obtaining all required regulatory approvals and obtaining financing for the transaction. There can be no assurance that the proposed acquisition or its related financings will be completed.

As a result of ACL s bankruptcy filing, while Danielson continued to exercise influence over the operating and financial policies of ACL throughout 2004, it no longer maintained control of ACL. Accordingly, for the years ended December 31, 2004 and 2003, Danielson accounted for its investments in ACL, GMS and Vessel Leasing using the equity method of accounting. Under the equity method of accounting, Danielson reports its share of the equity investees income or loss based on its ownership interest.

As a result of ACL s continued losses and Danielson management s belief that it would recover little, if any, of its investment in ACL, Danielson wrote off its remaining investment in ACL during the first quarter of 2003. The equity in net loss of unconsolidated Marine Services subsidiaries included a loss from ACL of $47 million, an other than temporary impairment of the remaining investment in ACL of $8.2 million and income from GMS and Vessel Leasing of $0.3 million. The GMS and Vessel Leasing investments were not considered to be impaired. The Marine Services subsidiaries operating results in 2002 were consolidated in Danielson s operating results from the date of acquisition, May 29, 2002, through December 27, 2002, but were deconsolidated in 2003 as a result of ACL s bankruptcy.

Cash Flow Parent

The following summarizes the actual inflows and outflows relating to the May 18, 2004 rights offering and subsequent repayment of bridge financing:

		(In millions)
Proceeds from Rights Offering		$ 42.0
Repayment of Bridge Financing:		
Principal	40.0	
Less conversion of Laminar shares	(13.4)	
Accrued interest at June 11, 2004	2.6	(29.2)
Warrant agent and other professional costs		(1.0)
Net Cash Inflow to Danielson		$ 11.8

Danielson s sources of funds are its investments as well as dividends, if any, received from its insurance and energy subsidiaries. Various state insurance requirements restrict the amounts that may be transferred to Danielson in the form of dividends or loans from its insurance subsidiaries without prior regulatory approval. Currently, NAICC cannot pay dividends or make loans to Danielson. Under its principal financing arrangements, Covanta is prohibited from paying dividends to Danielson.

For the year ended December 31, 2004, cash used in parent-only operating activities was $7 million. Cash used in operations was primarily attributable to wages and benefit costs, professional fees, directors fees, insurance and other working capital requirements of the holding company s business.

Net cash used in investing activities was $0.5 million in 2004 and was primarily comprised of proceeds from the sale of as its interest in GMS in October 2004 offset by the purchase of of investment securities.

Net cash used in investing activities was $33.8 million for the year ended December 31, 2003 and was primarily comprised of a deposit of $37 million to the escrow required for the Covanta acquisitions,

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contribution of $6 million to NAICC s statutory capital, repayment of a loan in the amount of $6 million received from an ACL affiliate and $4.1 million received from the sale of investment securities.

Net cash provided by financing activities was $17 million for the year ended December 31, 2004 and was comprised of $41 million of net proceeds from the rights offering, $3.5 million of proceeds from the exercise of options for common stock less payment of up to $0.9 million in costs due under the note purchase agreement and $26.6 million repayment of the bridge financing related to the acquisition of Covanta. Net cash used in financing activities was $36 million for the year ended December 31, 2003 and was comprised of $40 million of borrowing under the bridge financing agreement related to the Covanta acquisition less the early repayment of a $4 million promissory note paid to NAICC.

Liquidity and Capital Resources Parent

At December 31, 2004, Danielson, on a parent-only basis, held cash and investments of approximately $16.2 million, which was available to pay general corporate expenses and for general working capital purposes. On March 10, 2004, Danielson entered into a corporate reimbursement agreement with Covanta. Corporate expenses including administrative costs, professional fees and other costs and services provided to Covanta as well as other operating expenses will be reimbursed by Covanta.

As of the date of the Ref-Fuel Purchase Agreement Danielson entered into a registration rights agreement granting registration rights to the selling stockholders of Ref-Fuel with respect to such stock, and deposited $10 million in cash in an escrow account pursuant to the terms of an escrow agreement. See Recent Developments Agreement to Acquire American Ref-Fuel Holdings Corp. below for a description of the proposed acquisition of Ref-Fuel.

Parent Expenses 2004 vs. 2003

Total parent company investment income decreased to $0.5 million for the year ended December 31, 2004 as compared to $1.4 million for the year ended December 31, 2003 primarily due to lower realized investment gains. Realized investment gains at Parent were $0.3 million in 2004 compared to $1.1 million in 2003.

Interest expense of $43.7 million for the year ended December 31, 2004 relates to parent company and Energy Services recourse debt of $318.4 million for the year ended December 31, 2004. See Note 21 of Notes to the Consolidated Financial Statements for details.

As noted above, Danielson accounted for its investments in Marine Services subsidiaries under the equity method. For the year ended December 31, 2004, the equity in net loss of unconsolidated Marine Services subsidiaries included Danielson s share of GMS and Vessel Leasing s reported net income of $0.5 million.

Parent company expenses were primarily the result of the corporate services agreement between Danielson and Covanta, pursuant to which Danielson provides to Covanta, at Covanta s expense, certain administrative and professional services and Covanta pays most of Danielson s expenses. Such expenses totaled $3.5 million for the period March 11, 2004 through December 31, 2004. In addition, Danielson and Covanta have entered into an agreement pursuant to which Covanta provides, at Danielson s expense, payroll and benefit services for Danielson employees, which totaled $0.5 million for the period March 11, 2004 through December 31, 2004.

Parent Expenses 2003 vs. 2002

Total parent company investment income decreased to $1.4 million for the year ended December 31, 2003 as compared to $9.5 million for the year ending December 27, 2002 primarily due to recognition of $8.4 million in gain on ACL bonds owned by Danielson that were contributed as part of the purchase price of ACL Holdings recognized during 2002.

Parent company administrative expense decreased $0.7 million to $4.2 million for the year ended December 2003 as compared to $4.9 million for the year ended December 2002. The decrease was primarily

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due to a reduction of facility and payroll related costs. In 2003, Danielson entered into a corporate services agreement with Equity Group Investments, LLC (EGI). Samuel Zell, the former Chairman of the Board, Chief Executive Officer and President of Danielson, is also the Chairman of EGI. EGI provided financial and administrative services to Danielson. Subsequent to the ACL acquisition in 2002, ACL provided similar support services to Danielson.

Interest expense decreased to $1.4 million for the year ended December 31, 2003 compared to $38.7 million during the year ended December 27, 2002. Interest expense in 2003 was due to the accrual of one month of interest on the bridge financing required for the Covanta acquisition. Interest expense in 2002 was primarily due to ACL s and GMS interest expense after their acquisition.

Segment Cash Flow Information

Cash flow information for each of Danielson s business segments for the years ended December 31, 2004 and 2003 reconciles to the condensed consolidated statements of cash flows as follows (in thousands of dollars):

	Year Ended December 31, 2004			
	Energy	**Insurance**	**Corporate**	**Total**
Net cash provided by (used in) operating activities	$ 113,831	$ (18,715)	$ (7,050)	$ 88,066
Net cash provided by investing activities(1)	59,509	10,852	(550)	69,811
Net cash (used in) provided by financing activities	(95,228)	(1,436)	16,983	(79,681)
Net increase in cash and cash equivalents	78,112	(9,299)	9,383	78,196

	Year Ended December 31, 2003			
	Energy	**Insurance**	**Corporate**	**Total**
Net cash used in operating activities	$	$ (23,207)	$ 36	$ (23,171)
Net cash provided by (used in) investing activities		23,535	(33,801)	(10,266)
Net cash provided by (used in) financing activities		5,436	36,014	41,450
Net increase in cash and cash equivalents		5,764	2,249	8,013

(1) Includes cash acquired of $57,795 in Energy segment

MANAGEMENT S DISCUSSION AND ANALYSIS OF COVANTA S BUSINESS

Covanta s Business Segments

Covanta has two business segments: (a) Domestic, the businesses of which are owned and/or operated through subsidiaries (referred to herein has Domestic Covanta); and (b) International, the businesses of which are owned and/or operated through CPIH. As described below under Covanta s Capital Resources and Commitments and Covanta s Liquidity , Domestic Covanta and CPIH have separate recourse debt.

In its Domestic segment, Covanta designs, constructs and operates key infrastructure for municipalities and others in waste-to-energy and independent power production. Domestic Covanta s principal business, from which Covanta earns most of its revenue, is the operation of waste-to-energy facilities. Waste-to-energy facilities combust municipal solid waste as a means of environmentally sound waste disposal, and produce energy that is sold as electricity or steam to utilities and other purchasers. Domestic Covanta generally operates waste-to-energy facilities under long-term contracts with municipal clients. Some of these facilities are owned by Domestic Covanta, while others are owned by the municipal client or other third parties. For those facilities owned by it, Domestic Covanta retains the

ability to operate such projects after current contracts expire. For those facilities not owned by Domestic Covanta, municipal clients generally have the contractual right, but not the obligation, to extend the contract and continue to retain Domestic Covanta s service after the initial expiration date. For all waste-to-energy projects, Domestic Covanta receives revenue from two primary sources: fees it charges for processing waste received; and payments for electricity and steam.

In addition to its waste-to-energy projects, Domestic Covanta operates, and in some cases has ownership interests in, other renewable energy projects which generate electricity from wood waste, landfill gas and hydroelectric resources. The electricity from these projects is sold to utilities. For these projects, Domestic Covanta receives revenue from electricity sales, and in some projects cash from equity distributions.

Domestic Covanta also operates one water project, which produces potable water that is distributed by a municipal entity. For this project, Domestic Covanta receives revenue from service fees it charges the municipal entity. Domestic Covanta previously had operated several small waste water treatment projects pursuant to contractual arrangements with municipal entities or other customers. During 2004, Domestic Covanta s operating contracts for these projects were either terminated or transferred to third parties. The termination of these operations did not have a material effect on Covanta. Covanta does not expect to grow its water business, and may consider further divestitures.

In its International segment as of December 31, 2004, CPIH has ownership interests in, and/or operates, independent power production facilities in the Philippines, China, Bangladesh, India, and Costa Rica and one waste-to-energy facility in Italy. During the third quarter of 2004, it sold its interest in one project in Spain. The Costa Rica facilities generate electricity from hyrdroelectric resources while the other independent power production facilities generate electricity and steam by combusting coal, natural gas or heavy fuel oil. For these projects, CPIH receives revenue from operating fees, electricity and steam sales and in some cases cash from equity distributions.

Optimizing Covanta s Cash

An important objective of management is to provide reliable service to its clients while generating sufficient cash to meet its debt service and other liquidity needs. Maintaining historic facility production and optimizing cash receipts is necessary to assure that Covanta has sufficient cash to fund operations, make appropriate and permitted capital expenditures and meet scheduled debt service payments under its current principal financing arrangements. Under its current principal financing arrangements, Covanta does not currently expect to receive any cash contributions from Danielson, and is prohibited, under its principal financing arrangements, from using its cash to issue dividends to Danielson.

Covanta believes that when combined with its other sources of liquidity, Domestic Covanta s operations should generate sufficient cash to meet operational needs, capital expenditures and debt service due prior to maturity on its recourse debt. Therefore in order to optimize cash flows, management believes it must seek to continue to operate and maintain Domestic Covanta s facilities consistent with historical performance levels, and to avoid increases in overhead and operating expenses in view of the largely fixed nature of Domestic Covanta s revenues. Management will also seek to maintain or enhance Domestic Covanta s cash flow from renewals or replacement of existing contracts (which begin to expire in October 2007) and from new contracts to expand existing facilities or operate additional facilities. Domestic Covanta s ability to grow cash flows by investing in new projects is limited by debt covenants in its principal financing agreements, and by the scarcity of opportunities for new waste-to-energy facilities.

Covanta believes that CPIH s operations should also generate sufficient cash to meet its operational needs, capital expenditures and debt service prior to maturity on its recourse debt. However, due to risks inherent in foreign operations, CPIH s receipt of cash distributions can be less regular and predictable than that of Domestic Covanta. Management believes that it must continue to operate and maintain CPIH s facilities consistent with historical performance levels to enable its subsidiaries to comply with respective debt covenants and make cash distributions to CPIH. It will also seek to refinance its corporate indebtedness, or sell existing projects in an amount sufficient to repay such indebtedness, at or prior to its maturity in March 2007. In those jurisdictions where its subsidiaries energy purchasers, fuel suppliers or contractors may experience difficulty in meeting payment or performance obligations on a timely basis, CPIH must seek arrangements which permit the subsidiary to meet all of its obligations. CPIH s ability to grow by investing in new projects is limited by debt covenants in its principal financing agreements.

Domestic Covanta and CPIH each emerged from bankruptcy with material amounts of corporate debt. As of December 31, 2004, Domestic Covanta had outstanding recourse debt in the principal amount of

$235.7 million, comprised of (i) secured notes due in 2011 in the amount of $207.7 million (accreting to $230 million at maturity) and (ii) unsecured notes due 2012 in the amount of $24 million (which are estimated to increase to approximately $28 million through the issuance of additional notes). As of December 31, 2004, Domestic Covanta also had credit facilities for liquidity and the issuance of letters of credit in the amount of $240.3 million, which credit facilities expire in 2009. As of December 31, 2004, CPIH had outstanding recourse debt in the principal amount of $76.9 million and credit facilities for liquidity in the amount of $9.1 million. Additional information on Domestic Covanta s and CPIH s debt and credit facilities is provided below in Capital Resources and Commitments and in Liquidity.

Creditors under Domestic Covanta s debt and credit facilities do not have recourse to CPIH, and creditors under CPIH s debt and credit facilities do not have recourse to Domestic Covanta. Cash generated by Domestic Covanta businesses is managed and held separately from cash generated by CPIH businesses. Therefore, under current financing arrangements, the assets and cash flow of each of Domestic Covanta and CPIH are not available to the other, either to repay the debt or to satisfy other obligations.

Domestic Covanta s ability to optimize its cash flow should be enhanced under the Tax Sharing Agreement with Danielson. This agreement provides that Danielson will file a federal tax return for its consolidated group of companies, including the subsidiaries which comprise Domestic Covanta, and that certain of Danielson s NOLs will be available to offset the federal tax liability of Domestic Covanta. Consequently, Domestic Covanta s federal income tax obligations will be substantially reduced. Covanta is not obligated to make any payments to Danielson with respect to the use of these NOLs. The NOLs will expire in varying amounts from December 31, 2005 through December 31, 2023 if not used. The IRS has not audited Danielson s tax returns. See Note 25 to the Notes to Consolidated Financial Statements for additional information regarding Danielson s NOLs and factors which may affect its availability to offset taxable income of Domestic Covanta. If the NOLs were not available to offset the federal income tax liability of Domestic Covanta, Domestic Covanta may not have sufficient cash flow available to pay debt service on the Domestic Covanta corporate credit facilities. Because CPIH is not included as a member of Danielson s consolidated taxpayer group, the Tax Sharing Agreement does not benefit it.

Refinancing Covanta s and CPIH s Corporate Debt

Management believes that demonstrating Domestic Covanta s ability to maintain consistent and substantial cash available for corporate debt service and letter of credit fees will enable it to refinance its corporate debt, as well as attract alternative sources of credit. Refinancing Domestic Covanta s credit facilities may enable it to reduce the costs of its indebtedness and letters of credit, remove or relax restrictive covenants and provide Domestic Covanta with the additional flexibility to exploit appropriate growth opportunities in the future. Covanta also believes that operating cash flows will not be sufficient to repay the High Yield Notes at maturity in 2011. Accordingly, Covanta will have to derive such funds from refinancing, asset sales, or other sources. Domestic Covanta may refinance, without prepayment premium, the High Yield Notes prior to March 10, 2006. In addition, Domestic Covanta has three letter of credit facilities under which it obtained letters of credit required under agreements with customers and others. These facilities are of shorter duration than the related obligation of Domestic Covanta to provide letters of credit. Domestic Covanta will have to renew or replace these facilities in order to meet such obligations.

CPIH s corporate debt matures in March 2007. CPIH believes that its operating cash flows alone will not be sufficient to repay this debt at maturity. Accordingly, CPIH will have to derive such funds from refinancing, asset sales, or other sources.

As described below in Proposed Refinancing, Danielson has received commitments to refinance both Domestic Covanta s and CPIH s recourse debt. If it is able to close such refinancing, the Company expects to achieve both a lower overall cost with respect to its existing recourse debt and less restrictive covenants than under its current financing arrangements.

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Covanta s Earnings

Covanta s emergence from bankruptcy did not affect the operating performance of its facilities or their ability to generate cash. However, as a result of the application of fresh start and purchase accounting adjustments required upon Covanta s emergence from bankruptcy and acquisition by Danielson, the carrying value of Covanta s assets was adjusted to reflect their current estimated fair value based on discounted anticipated cash flows and estimates of management in consultation with valuation experts. These adjustments will result in future changes in non-cash items such as depreciation and amortization which will not be consistent with the amounts of such items for prior periods. Such future changes for post-emergence periods may affect earnings as compared to pre-emergence periods.

In addition, Covanta s consolidated financial statements have been further adjusted to deconsolidate its subsidiaries that remain in bankruptcy (Remaining Debtors) from the consolidated group until they emerged or were disposed of after March 10, 2004.

Although management has endeavored to use its best efforts to make appropriate estimates of value, the estimation process is subject to inherent limitations and is based upon the preliminary work of Covanta and its valuation consultants. Moreover, under applicable accounting principles to the extent that relevant information remains to be developed and fully evaluated, such preliminary estimates may be adjusted during the year following emergence from Chapter 11 and acquisition by Danielson. The adjusted values assigned to depreciable and amortizable assets may affect Covanta s GAAP earnings.

Domestic Covanta owns certain waste-to-energy facilities for which the debt service (principal and interest) on project debt is expressly included as a component of the service fee paid by the municipal client. As of December 31, 2004, the principal amount of project debt outstanding with respect to these projects was approximately $670 million. In accordance with GAAP, regardless of the actual amounts paid by the municipal client with respect to this component, Covanta records revenues with respect thereto based on levelized principal payments during the contract term, which are then discounted to reflect when the principal payments are actually paid by the municipal client. Accordingly, the amount of revenues recorded does not equal the actual payment of this component by the municipal client in any given contract year and the difference between the two methods gives rise to the unbilled service receivable recorded on Covanta s balance sheet. The interest expense component of the debt service payment is recorded based upon the actual amount of this component paid by the municipal client.

Covanta also owns two waste-to-energy projects for which debt service is not expressly included in the fee it is paid. Rather, Covanta receives a fee for each ton of waste processed at these projects. As of December 31, 2004, the principal amount of project debt outstanding with respect to these projects was approximately $172 million. Accordingly, Domestic Covanta does not record revenue reflecting principal on this project debt. Its operating subsidiaries for these projects make equal monthly deposits with their respective project trustees in amounts sufficient for the trustees to pay principal and interest when due.

Covanta Operating Performance and Seasonality

Covanta has historically performed its operating obligations without experiencing material unexpected service interruptions or incurring material increases in costs. In addition, in its contracts at domestic projects Domestic Covanta generally has limited its exposure for risks not within its control. For additional information about such risks and damages that Domestic Covanta may owe for its unexcused operating performance failures, see Risk Factors included in Part I, Item 1. In monitoring and assessing the ongoing operating and financial performance of Covanta s domestic businesses, management focuses on certain key factors: tons of waste processed, electricity and steam sold and boiler availability.

A material portion of Covanta s domestic service revenues and energy revenues is relatively predictable because it is derived from long-term contracts where Domestic Covanta receives a fixed operating fee which escalates over time and a portion (typically 10%) of energy revenues. Domestic Covanta receives these revenues for performing to base contractual standards, including standards for waste processing and energy generation efficiency. These standards vary among contracts, and at three of its domestic waste-to-energy

projects Covanta receives service revenue based entirely on the amount of waste processed instead of a fixed operating fee, and retains 100% of energy revenues generated. In addition, Domestic Covanta has benefited during 2004 from historically favorable pricing in energy and scrap metals markets. Domestic Covanta may receive material additional service and energy revenue if its domestic waste-to-energy projects operate at levels exceeding these contractual standards. Its ability to meet or exceed such standards at its domestic projects, and its general financial performance, is affected by the following:

Seasonal or long-term changes in market prices for waste, energy, or scrap metals, for projects where Domestic Covanta sells into those markets;

Seasonal, geographic and other variations in the heat content of waste processed, and thereby the amount of waste that can be processed by a waste-to-energy facility;

Its ability to avoid unexpected increases in operating and maintenance costs while ensuring that adequate facility maintenance is conducted so that historic levels of operating performance can be sustained;

Contract counter parties ability to fulfill their obligations, including the ability of Domestic Covanta s various municipal customers to supply waste in contractually committed amounts, and the availability of alternate or additional sources of waste if excess processing capacity exists at Domestic Covanta s facilities; and

The availability and adequacy of insurance to cover losses from business interruption in the event of casualty or other insured events.

Covanta s quarterly income from domestic operations within the same fiscal year typically differs substantially due to seasonal factors, primarily as a result of the timing of scheduled plant maintenance and the receipt of annual incentive fees, at many waste-to-energy facilities.

Domestic Covanta usually conducts scheduled maintenance twice each year at each of its domestic facilities, which requires that individual boiler units temporarily cease operations. During these scheduled maintenance periods, Domestic Covanta incurs material repair and maintenance expenses and receives less revenue, until the boiler units resume operations. This scheduled maintenance typically occurs during periods of off-peak electric demand in the spring and fall. The spring scheduled maintenance period generally occurs during February, March and April and is typically more comprehensive and costly than the work conducted during the fall maintenance period, which usually occurs between mid-September and mid-November. As a result, Domestic Covanta has typically incurred its highest maintenance expense in the first quarter.

Domestic Covanta earns annual incentive revenues at most of its waste-to-energy projects by processing waste during each contract year in excess of certain contractual levels. As a result, such revenues are recognized if the annual performance threshold has been achieved, which can occur only near the end of each respective contract year. Many contract years coincide with the applicable municipal client s fiscal year, and as a result, the majority of this incentive revenue has historically been recognized in the second quarter and to a lesser extent in the fourth quarter.

Given the seasonal factors discussed above relating to its domestic business, Domestic Covanta has typically experienced its highest operating income from its domestic projects during the second quarter and lowest operating income during the first quarter.

Covanta s cash provided by domestic operating activities also varies seasonally. Generally, cash provided by domestic operating activities follows income with a one to two month timing delay for maintenance expense payables and incentive revenue receivables. In addition, most capital expense projects are conducted during the scheduled maintenance periods. Further, certain substantial operating expenses are accrued consistently each month throughout the year while the corresponding cash payments are made only a few times each year. Generally, the first quarter is negatively impacted to some extent as a result of such seasonal payments. These factors typically have caused Domestic Covanta s operating cash flow from its domestic projects to be the lowest during the first quarter and the highest during the third quarter.

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Covanta s annual and quarterly financial performance can be affected by many factors, several of which are outside Domestic Covanta s control as are noted above. These factors can overshadow the seasonal dynamics described herein; particularly, with regard to quarterly cash from operations, which can be materially affected by changes in working capital.

CPIH Operating Performance and Seasonality

Management believes that it must continue to operate and maintain CPIH s facilities consistent with historical performance levels to enable its subsidiaries to comply with respective debt covenants and make cash distributions to CPIH. In monitoring and assessing the ongoing performance of CPIH s businesses, management focuses primarily on electricity sold and plant availability at its projects. Several of CPIH s facilities, unlike Covanta s domestic facilities, generate electricity for sale only during periods when requested by the contract counterparty to the power purchase agreement. At such facilities, CPIH receives payments to compensate it for providing this capacity, whether or not electricity is actually delivered, if and when required. CPIH s financial performance is also impacted by:

Changes in project efficiency due to equipment performance or auxiliary load;

Changes in fuel price for projects in which such costs are not completely passed through to the electricity purchaser through tariff adjustments, or delays in the effectiveness of tariff adjustments;

The amounts of electricity actually requested by purchasers of electricity, and whether when such requests are made, CPIH s facilities are then available to deliver such electricity;

Its ability to avoid unexpected increases in operating and maintenance costs while ensuring that adequate facility maintenance is conducted so that historic levels of operating performance can be sustained;

The financial condition and creditworthiness of purchasers of power and services provided by CPIH;

Fluctuations in the value of the domestic currency against the value of the U.S. dollar for projects in which CPIH is paid in whole or in part in the domestic currency of the host country;

Restrictions in repatriating dividends from the host country; and

Political risks associated with international projects.

CPIH s quarterly income from operations and equity income vary based on seasonal factors, primarily as a result of the scheduling of plant maintenance at the Quezon and Chinese facilities and lower electricity sales during the Chinese holidays. The annual major scheduled maintenance for the Quezon facility is typically planned for the first or early second quarter of each fiscal year, which reduces CPIH equity income from unconsolidated subsidiaries during that period. Boiler maintenance at CPIH s Chinese facilities typically occurs in either the first or second fiscal quarters, which increases expense and reduces revenue. In addition, electricity sales are lower in the first quarter due to lower demand during the Chinese New Year. As a result of these seasonal factors, income from CPIH will typically be higher during the second half of the year compared to the first half.

Cash distribution from operating subsidiaries and partnerships to CPIH also vary seasonally but are generally unrelated to income seasonality. CPIH receives on a monthly basis modest distributions of operating fees. In addition, CPIH receives partnership distributions, which are typically prescribed by project debt documents and occur no more than several times per year for each project. Scheduled cash distributions from the Quezon and Haripur facilities, which are material, occur during the second and fourth quarters. As a result CPIH s cash available to service the CPIH term loan is typically much greater during the second and fourth quarters than during the first and third quarters.

CPIH s annual and quarterly financial performance can be affected by many factors several of which are outside CPIH s control as noted above. These factors can overshadow the seasonal dynamics described herein.

Recent Developments Agreement to Acquire American Ref-Fuel Holdings Corp.

On January 31, 2005, Danielson, entered into a stock purchase agreement, (Purchase Agreement) with Ref-Fuel, an owner and operator of waste-to-energy facilities in the northeast United States, and (Selling Stockholders) to purchase 100% of the issued and outstanding shares of Ref-Fuel capital stock. Under the terms of the Purchase Agreement, Danielson will pay $740 million in cash for the stock of Ref-Fuel and will assume the consolidated net debt of Ref-Fuel, which as of December 31, 2004 was approximately $1.2 billion net of debt service reserve funds and other restricted funds held in trust for payment of debt service. After the transaction is completed, Ref-Fuel will be a wholly-owned subsidiary of Covanta.

The acquisition is expected to close when all of the closing conditions to the Purchase Agreement have been satisfied or waived. These closing conditions include the receipt of approvals, clearances and the satisfaction of all waiting periods as required under the Hart-Scott-Rodino Antitrust Act of 1976 and as required by certain governmental authorities such as the Federal Energy Regulatory Commission and other applicable regulatory authorities. Other closing conditions of the transaction include Danielson s completion of debt financing and an equity rights offering, as further described below, Danielson providing letters of credit or other financial accommodations in the aggregate amount of $100 million to replace two currently outstanding letters of credit that have been entered into by two respective subsidiaries of Ref-Fuel and issued in favor of a third subsidiary of Ref-Fuel, and other customary closing conditions. While it is anticipated that all of the applicable conditions will be satisfied, there can be no assurance as to whether or when all of those conditions will be satisfied or, where permissible, waived.

Either Danielson or the selling stockholders of Ref-Fuel may terminate the Purchase Agreement if the acquisition does not occur on or before June 30, 2005, but if a required governmental or regulatory approval has not been received by such date then either party may extend the closing to a date that is no later than the later of August 31, 2005 or the date 25 days after which Ref-Fuel has provided to Danielson certain financial statements described in the Purchase Agreement.

If the Purchase Agreement is terminated because of our failure to complete the rights offering and financing as described below, and all other closing conditions are capable of being satisfied, then we must pay the to selling stockholders of Ref-Fuel a termination fee of $25 million, of which no less than $10 million shall be paid in cash and of which up to $15 million may be paid in shares of Danielson s common stock, at our election, based upon a price of $8.13 per share. As of the date of the Purchase Agreement Danielson entered into a registration rights agreement granting registration rights to the selling stockholders of Ref-Fuel with respect to such stock, and deposited $10 million in cash in an escrow account pursuant to the terms of an escrow agreement.

Danielson intends to finance this transaction through a combination of debt and equity financing. The equity component of the financing is expected to be obtained through the Ref-Fuel Rights Offering, which shall consist of an approximately $400 million registered, pro rata offering of warrants or other rights to purchase Danielson s common stock to all of Danielson s existing stockholders at $6.00 per share. In this Ref-Fuel Rights Offering, Danielson s existing stockholders will be issued rights to purchase Danielson s stock on a pro rata basis, with each holder entitled to purchase approximately 0.9 shares of Danielson s common stock at an exercise price of $6.00 per full share for each share of Danielson s common stock then held. Danielson will file a registration statement with the SEC with respect to such rights offering and the statements contained herein shall not constitute an offer to sell or solicitation of an offer to buy shares of Danielson s common stock. Any such offer or solicitation will be made in compliance with all applicable securities laws.

Three of Danielson s largest stockholders, SZ Investments (collectively with its affiliate EGI-Fund (05-07) Investors, L.L.C.), TAVF, and Laminar, representing ownership of approximately 40% of Danielson s outstanding common stock, have each severally committed to participate in the Ref-Fuel Rights Offering and to acquire their pro rata portion of the shares.

As a consideration for their commitments, Danielson will pay each of these stockholders an amount equal to 1.5% to 2.25% of their respective equity commitments, depending on the timing of the transaction. Danielson has also agreed to amend an existing registration rights agreement to provide these stockholders

with the right to demand that we undertake an underwritten offering within twelve months of the closing acquisition of Ref-Fuel in order to provide such stockholders with liquidity.

Danielson has received a commitment from Goldman Sachs Credit Partners, L.P. and Credit Suisse First Boston for a debt financing package necessary to finance the acquisition, as well as to refinance the existing recourse debt of Covanta and provide additional liquidity. As discussed below, this financing will replace entirely all of Domestic Covanta s and CPIH s corporate debt that was issued on March 10, 2004. The financing is expected to consist of two tranches, each of which is secured by pledges of the stock of Covanta s subsidiaries that has not otherwise been pledged, guarantees from certain of Covanta s subsidiaries and all other available assets of Covanta s subsidiaries. The first tranche, a first priority senior secured bank facility, is expected to be comprised of a funded $250 million term loan facility, a $100 million revolving credit facility and a $340 million letter of credit facility. The revolving credit facility and the letter of credit facility will be available for Covanta s needs in connection with its domestic and international businesses, including the existing businesses of Ref-Fuel. The second tranche is a second priority senior secured term loan facility consisting of a funded $450 million term loan facility, of which a portion may be connected to fixed rate notes.

The closing of the financing and receipt of proceeds under the Ref-Fuel Rights Offering are closing conditions under the Purchase Agreement. Immediately upon closing of the acquisition, Ref-Fuel will become a wholly-owned subsidiary of Covanta, and Covanta will control the management and operations of the Ref-Fuel facilities. The current project and other debt of Ref-Fuel subsidiaries will be unaffected by the acquisition, except that the revolving credit and letter of credit facility of Ref-Fuel Company LLC (the direct parent of each Ref-Fuel project company) will be cancelled and replaced with new facilities at the Covanta level. For additional information concerning the combined capital structure of Covanta and Ref-Fuel following the acquisition, see Liquidity, and Capital Resources and Commitments, below.

There can be no assurance that Danielson will be able to complete the acquisition of Ref-Fuel.

Covanta s Operating Results

2004 vs. 2003

The discussion below provides comparative information regarding Covanta s historical consolidated results of operations. The information provided below with respect to revenue, expense and certain other items for periods during 2004 was affected materially by several factors which did not affect such items for comparable periods during 2003. These factors principally include:

The application of fresh start and purchase accounting following Covanta s emergence from bankruptcy, which are described in Note 2 to the Consolidated Financial Statements;

The exclusion of revenue and expense after March 10, 2004 relating to the operations of the Remaining Debtors (which prior to August 6, 2004 included subsidiaries involved with the Tampa Bay Project and prior to December 14, 2004 included the subsidiaries involved with the Lake County facility), which were no longer included as consolidated subsidiaries after such date;

The exclusion of revenue and expense after May 2004 relating to the operations of the MCI facility, which commenced a reorganization proceeding under Philippine law on such date, and is no longer included as a consolidated subsidiary after such date;

The reduction of revenue and expense during 2004 from one hydroelectric facility because of the scheduled expiration of an operating agreement relating to such facility; and

The reduction of revenue and expense as a result of project restructurings effected during 2003 and the first quarter of 2004 as part of Covanta s overall restructuring and emergence from bankruptcy.

The factors noted above must be taken into account in developing meaningful comparisons between the periods compared below.

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The Predecessor and Successor periods for 2004 have been combined on a non-GAAP basis to facilitate the following year to year comparison of Covanta s operations. Only the Successor period is included in Danielson s consolidated financial statements and the Predecessor information is presented only to facilitate the review of Covanta s operating results.

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Consolidated Results

The following table summarizes the historical consolidated results of operations of Covanta for the years ended December 31, 2004 and 2003 (in thousands of dollars):

	For the Period January 1, through March 10, 2004	For the Period March 11, through December 31, 2004	Combined Results for the Year Ended December 31, 2004	Results for the Year Ended December 31, 2003
Service revenues	$ 89,867	$ 374,622	$ 464,489	$ 499,245
Electricity and steam sales	53,307	181,074	234,381	277,766
Construction revenues	58	1,506	1,564	13,448
Other revenues				9
Total revenues	143,232	557,202	700,434	790,468
Plant operating expenses	100,774	352,617	453,391	500,627
Construction costs	73	1,925	1,998	20,479
Depreciation and amortization	13,426	55,821	69,247	71,932
Net interest on project debt	13,407	32,586	45,993	76,770
Other operating costs and expenses	(209)	1,366	1,157	2,209
Net (gain) loss on sale of businesses and equity investments	(175)	(245)	(420)	7,246
Selling, general and administrative expenses	7,597	38,076	45,673	35,639
Other income net	(1,923)	(1,952)	(3,875)	(1,119)
Write-down of and obligations related to assets held for use				16,704
Total costs and expenses	132,970	480,194	613,164	730,487
Operating income	10,262	77,008	87,270	59,981
Interest income	935	1,858	2,793	2,948
Interest expense	(6,142)	(34,706)	(40,848)	(39,938)
Reorganization items-expense	(58,282)		(58,282)	(83,346)
Gain on cancellation of pre-petition debt	510,680		510,680	
Fresh start adjustments	(399,063)		(399,063)	

Income (loss) from continuing operations before income taxes, minority interests and equity in net income from unconsolidated investments		58,390		44,160		102,550		(60,355)
Income tax (expense) benefit		(30,240)		(23,637)		(53,877)		18,096
Minority interests		(2,511)		(6,919)		(9,430)		(8,905)
Equity in net income from unconsolidated investments		3,924		17,535		21,459		24,400
Gain from discontinued operations								78,814
Cumulative effect of change in accounting principle								(8,538)
Net income (loss)	$	29,563	$	31,139	$	60,702	$	43,512

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The following general discussion should be read in conjunction with the above table, the consolidated financial statements and the notes to those statements and other financial information appearing and referred to elsewhere in this report. Additional detail on comparable revenues, costs and expenses and operating income of Covanta is provided in the Domestic Segment and International Segment discussions below.

Consolidated revenues for 2004 decreased $90 million compared to 2003, which resulted from a reduction in energy sales in both the domestic and the international segments primarily due to the factors described above. Additional reductions in revenue are attributable to decreases in service fees and construction revenues in the domestic segment. See separate segment discussion below for details relating to these variances.

Consolidated total costs and expenses before operating income for 2004 decreased $117.3 million compared to 2003, primarily due to the factors described above. Included in the reduction of total costs and expenses in 2004, was lower depreciation and amortization expense of $2.7 million. This decrease in depreciation and amortization was primarily due to the factors described above offset by service and energy contract amortization of $16.1 million in 2004 resulting from recording the estimated fair value of such contract assets and amortizing them over their remaining estimated useful lives. Additionally, on March 10, 2004, property, plant and equipment were recorded at their fair value, and subsequently, the estimated useful lives of property plant and equipment were adjusted resulting in revised depreciation expense.

Operating income for the combined period ended December 31, 2004 increased $27.3 million compared to 2003. The improvement in operating income was due to the operating factors described above.

Equity in net income of unconsolidated investments decreased $2.9 million in 2004 from a $3 million decrease in the domestic segment primarily due to the sale of the geothermal business in December of 2003.

Interest expense for 2004 increased $0.9 million compared to 2003. The increase was primarily attributable to a $6.2 million increase in the international segment primarily due to the CPIH term loan which debt was incurred upon emergence from Chapter 11. These increases were offset by a $5.3 million decrease in the domestic segment primarily attributable to the restructuring of contracts at the Onondaga County, New York and Hennepin County, Minnesota facilities in 2003.

Reorganization items for 2004 decreased $25.1 million compared to 2003. The decrease was primarily the result of a decrease in bankruptcy exit costs of $8.9 million and a $20.7 million reduction in legal and professional fees, offset by an increase in severance costs of $4.6 million in the period ended March 10, 2004.

Gain on cancellation of pre-petition debt was $510.7 million for 2004. Gain on cancellation of pre-petition debt resulted from the cancellation on March 10, 2004 of Covanta s pre-petition debt and other liabilities subject to compromise net of the fair value of cash and securities distributed to petition creditors.

Fresh start adjustments were $399.1 million for 2004. Fresh start adjustments represent adjustments to the carrying amount of Covanta s assets and liabilities to fair value in accordance with the provisions of SOP 90-7. See Note 32 to the Consolidated Financial Statements.

The gain from discontinued operations in 2003 was $78.8 million due to the rejection of a waste-to-energy lease, sale of the geothermal business, and the final disposition of the Arrowhead Pond interests.

The cumulative effect of change in accounting principle of $8.5 million in 2003 related to the January 1, 2003 adoption of SFAS No. 143.

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Domestic Segment

The following table summarizes the historical results of operations of the Domestic segment for the years ended December 31, 2004 and 2003 (in thousands of dollars):

	For the Period January 1, through March 10, 2004	For the Period March 11, through December 31, 2004	Combined Results for the Year Ended December 31, 2004	Results for the Year Ended December 31, 2003
Service revenues	$ 88,697	$ 369,531	$ 458,228	$ 492,065
Electric & steam sales	18,942	81,894	100,836	113,584
Construction revenues	58	1,506	1,564	13,448
Other revenues				4
Total revenues	$ 107,697	$ 452,931	$ 560,628	$ 619,101
Operating income	$ 7,132	$ 62,232	$ 69,364	$ 35,846

Total revenues for the Domestic segment for 2004 decreased $58.5 million compared to 2003. Service revenues declined $33.8 million, which was comprised of a $12.5 million decrease resulting from contracts which were restructured at the Hennepin and Onondaga facilities (including the elimination of project debt at the Hennepin facility) during the second half of 2003 as part of Covanta s overall restructuring. It also reflected a $22.5 million reduction of service revenues due to deconsolidation of the Remaining Debtors after March 10, 2004, and a $6.5 million decrease due to the elimination of 2004 revenues on two bio-gas facilities, which resulted from the consolidation of the partnership. These decreases were offset by a $9.3 million increase resulting primarily from higher scrap metal prices, escalation increases under fixed service agreements, and increased supplemental waste processed.

Electricity and steam sales for 2004 decreased $12.7 million compared to 2003. The decrease was primarily due to a $16.2 million decrease resulting from the expiration of a lease at one domestic hydroelectric facility, $1.5 million from the deconsolidation of the Remaining Debtors, and a $7.2 million decrease due to fresh start adjustments related to the elimination of amortization on the deferred gain relating to the Haverhill energy contract. The foregoing decreases were offset by revenue increases of $3.7 million primarily related to increased energy pricing at the Union and Alexandria facilities, and a $7 million increase due to the consolidation of a bio-gas facility in 2004 previously recorded on the partnership in 2003.

Construction revenues for 2004 decreased $11.9 million compared to 2003. A decrease of $13.1 million was due to Covanta s completion of the Tampa Bay desalination facility, offset by a $1.1 million increase relating to initial work paid by clients in connection with planned waste-to-energy plant expansions.

Plant operating costs for 2004 decreased $28.1 million compared to 2003. $18.9 million of this decrease was due to the deconsolidation of the Remaining Debtors noted in the revenue discussion above, and $13.5 million of this decrease was due to the expiration of a lease contract at a domestic hydroelectric facility in October 2003. These reductions were offset by an increase in domestic operating expense of $4.3 million primarily attributable to facility operation and maintenance cost.

Construction costs for 2004 decreased $18.5 million compared to 2003 primarily attributable to Covanta s completion of the Tampa Bay desalination facility, offset in part by increased plant expansions at three waste-to-energy facilities.

Depreciation and amortization for 2004 increased $3.3 million compared to 2003. This increase in depreciation and amortization was due to service and energy contract amortization of $16.1 million in 2004 resulting from recording the estimated fair value of such contract assets at March 10, 2004 and amortizing them over their remaining estimated useful lives. Additionally on March 10, 2004, property, plant and equipment were recorded at their fair value, and subsequently, the estimated useful lives of property plant and equipment were adjusted resulting in revised depreciation expense. These increases were offset by decreases in depreciation and amortization expense resulting from the deconsolidation of the remaining debtors and the sale and restructuring of businesses in 2003.

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Net interest on project debt for 2004 decreased $27 million compared to 2003. The decrease was primarily the result of a reduction in project debt due to exclusion of debt service related to the deconsolidation of the Remaining Debtors noted above, the restructuring of debt at two domestic facilities in the last six months of 2003, and the reduction of project debt on another facility.

Write-off of assets held for use for 2004 decreased $16.7 million compared to 2003 due to the provision for arena commitments recorded in the second half of 2003.

Selling, general and administrative expenses had a net increase totaling $4.7 million in 2004 compared to 2003 primarily due to a $8.1 million increase in professional and management fees offset by a $3.7 million decrease in wages and benefits.

Income from operations for the Domestic segment for 2004 increased by $34 million compared to 2003. This increase was comprised of net increases due to cessation of construction activities ($6.6 million), higher energy and scrap metal revenues as well as increased supplemental waste processed ($13 million), lower interest expense on project debt ($27 million), a decrease in write-off of assets held for use ($16.7 million) and a ($5.8 million) decrease in operating costs and expenses related to the wind down of non-energy businesses. These increases were offset by net decreases due to higher operating and maintenance expenses ($4.3 million), the expiration of a hydroelectric lease ($2.7 million), restructuring of existing projects ($12.5 million), the deconsolidation of Remaining Debtors ($5.1 million), the elimination of amortization of deferred gains due to fresh start adjustments ($7.2 million), increases in selling, general and administrative expense ($4.7 million) and the increase in depreciation expense due to fresh start accounting adjustments ($3.3 million).

International Segment

The following table summarizes the historical results of operations of the International segment for the years ended December 31, 2004 and 2003 (in thousands of dollars):

	For the Period January 1, through March 10, 2004	For the Period March 11, through December 31, 2004	Combined Results for the Year Ended December 31, 2004	Results for the Year Ended December 31, 2003
Service revenues	$ 1,170	$ 5,091	$ 6,261	$ 7,180
Electric & steam sales	34,365	99,180	133,545	164,182
Construction revenues				
Other revenues				5
Total revenues	$ 35,535	$ 104,271	$ 139,806	$ 171,367
Operating income	$ 3,130	$ 14,776	$ 17,906	$ 24,135

Total revenues for the International segment for 2004 compared to 2003 decreased by $31.5 million. This decrease primarily resulted from the deconsolidation of the Philippines Magellan Project (MCI) facility totaling $17.2 million, a $12 million energy sales reduction due to lower demand in 2004 at the CPIH facilities in India and a $4.6 million decrease due to the expiration of contracts at one of the CPIH facilities in the Philippines. These decreases were offset by a $3 million increase due to higher steam tariffs at CPIH s facilities in China.

International plant operating costs were lower by $19.1 million, of which $18.1 million was due to deconsolidation of the MCI facility and $8 million was due to lower demand at CPIH s facilities in India, offset by a $8.2 million

increase in fuel costs at CPIH s facilities in China.

Depreciation and amortization for 2004 decreased $6 million as a result of fresh start accounting adjustments.

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Net interest on project debt for 2004 decreased $3.7 million compared to 2003. The decrease resulted from a $1.6 million decrease due to the deconsolidation of the MCI facility and a $2.9 million decrease due to lower interest rates at two facilities in India.

Income from operations for the International segment for 2004 decreased $6.7 million compared to 2003 due to a decrease in revenues discussed above, an increase in fuel costs at the CPIH facilities in China and increased overhead costs at CPIH post emergence offset by a combination of lower plant operating costs in India, reductions in depreciation expense as a result of fresh start accounting adjustments, the deconsolidation of the MCI facility and a reduction of interest on project debt.

COVANTA S CAPITAL RESOURCES AND COMMITMENTS

The following chart summarizes the various components and amounts of Domestic Covanta and CPIH project and corporate debt as of December 31, 2004 (In millions). Danielson has no obligations with respect to any of the project or corporate debt of Covanta, CPIH, or their respective subsidiaries.

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The following table summarizes Covanta s gross contractual obligations including: project debt, recourse debt, leases and other contractual obligations as of December 31, 2004. (Amounts expressed in thousands of dollars. Note references are to the Notes to the Consolidated Financial Statements):

	Payments Due by Period				
	Total	**Less Than One Year**	**1 to 3 Years**	**4 to 5 Years**	**After 5 Years**
Domestic Covanta project debt (Note 20)(1)	$ 842,154	$ 84,718	$ 269,019	$ 144,213	$ 344,204
CPIH project debt (Note 20)	102,583	24,983	43,839	28,543	5,218
Total project debt (Note 20)	944,737	109,701	312,858	172,756	349,422
Domestic Covanta high yield notes (Note 19)	207,736				207,736
Domestic Covanta unsecured notes (Note 19)	28,000		11,700	7,800	8,500
CPIH term loan (Note 19)	76,852		76,852		
Other recourse debt (Note 19)	308	112	196		
Total debt obligations of Covanta	1,257,633	109,813	401,606	180,556	565,658
Less:					
Non-recourse project debt	(944,737)	(109,701)	(312,858)	(172,756)	(349,422)
Non-recourse CPIH term loan (Note 19)	(76,852)		(76,852)		
Covanta recourse debt	$ 236,044	$ 112	$ 11,896	$ 7,800	$ 216,236
Covanta operating leases (Note 22)	$ 312,961	$ 18,950	$ 57,850	$ 24,716	211,445
Less: Non-recourse rental payments (Note 22)	(279,696)	(15,392)	(50,582)	(23,062)	(190,660)
Covanta recourse leases	$ 33,265	$ 3,558	$ 7,268	$ 1,654	$ 20,785
Interest payments	$ 428,651	$ 71,113	$ 167,522	$ 81,995	$ 108,021
Less: Non-recourse interest payments	(277,006)	(50,013)	(104,280)	(39,846)	(82,867)
Covanta recourse interest(3)	$ 151,645	$ 21,100	$ 63,242	$ 42,149	$ 25,154
Pension plans obligations (Note 24)(4)	$ 3,100	$ 3,100			
Post-retirement plans obligations (Note 24)	$ 18,059	$ 1,744	$ 5,283	$ 3,670	$ 7,362
Total Covanta contractual obligations	**$ 442,113**	**$ 29,614**	**$ 87,689**	**$ 55,273**	**$ 269,537**

Notes to table:

(1) Includes $38 million of Domestic Covanta s unamortized project debt premiums.

(2) Payment obligations for the project debt associated with waste-to-energy facilities owned by Covanta are limited recourse to the operating subsidiary and non-recourse to Covanta, subject to operating performance guarantees and commitments.

(3) Includes letter of credit fees through the year Covanta anticipates they will no longer be required.

(4) Covanta expects to make minimum contributions of $3.1 million to its defined benefit plans in 2005. Pension Contribution information for other years presented in the table is not available.

Domestic Project Debt. Financing for Domestic Covanta s waste-to-energy projects is generally accomplished through tax-exempt and taxable municipal revenue bonds issued by or on behalf of the municipal client. For most facilities owned by a Domestic Covanta subsidiary, the issuer of the bonds loans the bond proceeds to a Covanta subsidiary to pay for facility construction. The municipality then pays to the subsidiary as part of its service fee amounts necessary to pay debt service on the project bonds. For such facilities, project-related debt is included as Project debt (short- and long-term) in Danielson s consolidated financial statements. Generally, such project debt is secured by the revenues generated by the project and

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other project assets including the related facility. Such project debt of Domestic Covanta subsidiaries is described in the table above as non-recourse project debt. The only potential recourse to Covanta with respect to project debt arises under the operating performance guarantees described below.

With respect to such facilities, debt service is in most instances an explicit component of the fee paid by the municipal client. Such fees are paid by the municipal client to the trustee for the applicable project debt and held by the trustee until applied as required by the project debt documentation. While these funds are held by the trustee they are reported as restricted funds held in trust on Danielson s consolidated balance sheet. These funds are not generally available to Covanta.

International Project Debt. Financing for projects in which CPIH has an ownership or operating interest is generally accomplished through commercial loans from local lenders or financing arranged through international banks, bonds issued to institutional investors and from multilateral lending institutions based in the United States. Such debt is generally secured by the revenues generated by the project and other project assets and is without recourse to CPIH or Domestic Covanta. Project debt relating to two CPIH projects in India is included as Project debt (short- and long-term) in Danielson s consolidated financial statements. In most projects, the instruments defining the rights of debt holders generally provide that the project subsidiary may not make distributions to its parent until periodic debt service obligations are satisfied and other financial covenants complied with.

Recourse Debt. Domestic Covanta s and CPIH s recourse debt obligations arise from its Chapter 11 proceeding and are outlined on the following table:

Domestic Covanta Debt

Designation	Principal Amount	Interest	Principal Payments	Security
High Yield Notes	$207.7 million (as of December 31, 2004) accreting to an aggregate principal amount of $230 million	Payable semi-annually in arrears at 8.25% per annum on $230 million	Due on maturity in March 2011	Third priority lien in substantially all of the assets of the domestic borrowers (including Covanta) not subject to prior liens. Guaranteed by Covanta s domestic subsidiaries which are borrowers.

Designation	Principal Amount	Interest	Principal Payments	Security
Unsecured Notes	$28 million (est.), based on determination of allowed pre-petition unsecured obligations	Payable semi-annually in arrears at 7.5% per annum	Annual amortization payments of $3.9 million beginning March 2006 with the remaining balance due at maturity in March 2012	Unsecured and subordinated in right of payment to all senior indebtedness of Covanta including, the First Lien Facility and the Second Lien Facility, the High Yield Notes; will

	otherwise rank equal with, or be senior to, all other indebtedness of Covanta.

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CPIH Debt

Designation	Principal Amount	Interest	Principal Payments	Security
Term Loan Facility	$76.9 million (as of December 31, 2004)	Payable monthly in arrears at 10.5% per annum, 6.0% of such interest to be paid in cash and the remaining 4.5% to the extent available and otherwise payable as increase to the principal amount of the loan	Due on maturity in March 2007	Second priority lien on substantially all of the CPIH borrowers assets not otherwise pledged.

The First Lien Facility, the Second Lien Facility, the High Yield Notes and Unsecured Notes provide that Domestic Borrowers must comply with certain affirmative and negative covenants. In addition, the CPIH Term Loan Facility and the CPIH Revolving Credit Facility provide that CPIH Borrowers must comply with certain affirmative and negative covenants. Below are descriptions of such covenants as well as other material terms and conditions of such agreements.

Material Terms of High Yield Notes: Interest is due semi-annually in arrears on the principal amount of the outstanding High Yield Notes at a rate of 8.25% per annum. The High Yield Notes are secured by a third priority lien on Covanta s domestic assets. In addition, all or part of the High Yield Notes are pre-payable by Covanta at par of 100% of the accreted value prior to March 15, 2006 and thereafter at a premium starting at 104.625% of par and decreasing during the remainder of the term of the High Yield Notes. There are no mandatory sinking fund provisions. Upon the occurrence of a change of control event and certain sales of assets, Covanta is obligated to offer to repurchase all or any part of the High Yield Notes at 101% of par on the accreted value.

Covanta must comply with certain covenants, including among others:

restrictions on the payment of dividends, the repurchase of stock, the incurrence of indebtedness and liens and the repayment of subordinated debt, unless certain specified financial and other conditions are met;

restrictions on the sale of certain material amounts of assets or securities, unless specified conditions are met;

restrictions on material transactions with affiliates;

limitations on engaging in new lines of business; and

preserving its corporate existence and its material rights and franchises.

The High Yield Notes shall become immediately due and payable in the event that Covanta or certain of its affiliates become subject to specified events of bankruptcy or insolvency, and shall become immediately due and payable upon action taken by the trustee under the indenture or holders of a certain specified percentage of principal under outstanding High Yield Notes, in the event that any of the following occurs after expiration of applicable cure periods:

a failure by Covanta to pay amounts due under the High Yield Notes or certain other debt instruments;

a judgment or judgments are rendered against Covanta that involve an amount in excess of $10 million, to the extent not covered by insurance; and

a failure by Covanta to comply with its obligations under the indenture relating to the High Yield Notes.

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Material Terms of Unsecured Notes: Covanta has authorized the issuance of up to $50 million in principal amount of Unsecured Notes as distributions to certain creditors in its bankruptcy proceeding, of which it expects to issue approximately $28 million. Interest will be payable semi-annually at a rate of 7.5%. Annual amortization payments of approximately $3.9 million will be paid beginning in 2006, with the balance due on maturity in March 2012. There are no mandatory sinking fund provisions and Covanta may redeem the Unsecured Notes at any time without penalty or premium. Upon the occurrence of a change of control event and certain sales of assets, Covanta is obligated to offer to repurchase all or any part of the Unsecured Notes at 101% of par value.

Covanta must comply with certain covenants, including among others:

restrictions on the payment of dividends, the repurchase of stock, the incurrence of indebtedness and liens and the repayment of subordinated debt, unless certain specified financial and other conditions are met;

restrictions on the sale of certain material amounts of assets or securities, unless specified conditions are met;

restrictions on material transactions with affiliates; and

preserving its corporate existence and its material rights and franchises.

The Unsecured Notes shall become immediately due and payable in the event that Covanta or certain of its affiliates become subject to specified events of bankruptcy or insolvency and shall become immediately due and payable, upon action taken by the trustee under the indenture of holders of a certain specified percentage of principal under outstanding Unsecured Notes in the event that any of the following occurs after expiration of applicable cure periods:

a failure by Covanta to pay amounts due under the High Yield Notes or certain other debt instruments; and

a failure by Covanta to comply with its obligations under the indenture pertaining to the Unsecured Notes.

Material Terms of CPIH Term Loan Facility: CPIH s term loan facility is secured by a second priority lien on the same collateral, junior only to the lien with respect to the CPIH revolver described in Covanta s Liquidity below. The principal amount of the CPIH term debt, as of December 31, 2004, was $76.9 million. The CPIH term debt matures in March 2007 and bears interest at the rate per annum of 10.5% (6.0% of such interest to be paid in cash and the remaining 4.5% to be paid in cash to the extent available and otherwise such interest shall be paid in kind by adding it to the outstanding principal balance).

The mandatory prepayment provisions, affirmative covenants, negative covenants and events of default under the CPIH Term Loan Facility are similar to those found in the First Lien Facility and the Second Lien Facility described below.

Other Commitments.

Covanta s other commitments as of December 31, 2004 were as follows (in thousands of dollars):

	Commitments Expiring by Period		
	Total	Less Than One Year	More Than One Year
Letters of credit	$ 192,946	$ 21,463	$ 171,483
Surety bonds	19,444		19,444
Total other commitments net	$ 212,390	$ 21,463	$ 190,927

The letters of credit were issued pursuant to the facilities described below under Liquidity to secure the Company s performance under various contractual undertakings related to its domestic and international

projects, or to secure obligations under its insurance program. Each letter of credit relating to a project is required to be maintained in effect for the period specified in related project contracts, and generally may be drawn if it is not renewed prior to expiration of that period.

Two of these letters of credit relate to a waste-to-energy project and are provided under the First Lien Facility. This facility currently provides for letters of credit in the amount of approximately $120 million and generally reduces semi-annually as the related contractual requirement reduces until 2009, when the letters of credit are no longer contractually required to be maintained. The other letters of credit are provided under the Second Lien Facility and one unsecured letter of credit facility, in support of Domestic Covanta s businesses and to continue existing letters of credit required by CPIH s businesses. Some of these letters of credit reduce over time as well, and one of such reducing letters of credit may be cancelled if Covanta receives an investment grade rating from both Moody s Investors Service and Standard & Poor s. As of December 31, 2004, Domestic Covanta had approximately $47 million in available capacity for additional letters of credit under the Second Lien Facility.

The following table describes the reduction in letter of credit requirements, through 2010, for all existing letters of credit; the table does not include amounts with respect to new letters of credit that may be issued (in thousands of dollars):

	December 31,				
	2005	**2006**	**2007**	**2008**	**2009**
Total First Lien LCs	$ 108,967	$ 89,775	$ 90,918	$ 44,466	$
Total Second Lien LCs	60,487	60,487	55,487	50,487	50,487
Total Other LCs	2,029	1,728	1,500	1,500	1,500
Total Combined LCs	$ 171,483	$ 151,990	$ 147,905	$ 96,453	$ 51,987

Covanta believes that it will be able to fully perform its contracts to which these letters of credit relate, and that it is unlikely that letters of credit would be drawn because of a default of its performance obligations. If any of Covanta s letters of credit were to be drawn under its current debt facilities, the amount drawn would be immediately repayable to the issuing bank.

The surety bonds listed on the table above relate to performance under its former waste water treatment operating contracts ($8.5 million) and possible closure costs for various energy projects when such projects cease operating ($10.9 million). Were these bonds to be drawn upon, Covanta would ordinarily have a contractual obligation to indemnify the surety company. However, since these indemnity obligations arose prior to Covanta s bankruptcy filing, the surety companies indemnity claims would entitle them to share only in a limited distribution along with other unsecured creditors under the Reorganization Plan. Because such claims share in a fixed distribution under the Reorganization Plan, Covanta expects that any such distribution will not affect the obligations of Domestic Covanta or CPIH. The sureties may have additional rights to make claims against retainage or other funds owed to Covanta with respect to projects for which surety bonds were issued. Covanta expects that enforcement of such rights will not have any material impact upon results of operations and financial condition of Domestic Covanta or CPIH.

Covanta and certain of its subsidiaries have issued or are party to performance guarantees and related contractual obligations undertaken mainly pursuant to agreements to construct and operate certain energy and water facilities. With respect to its domestic businesses, Covanta has issued guarantees to municipal clients and other parties that Covanta s subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Such contractual damages or other obligations could be material, and in circumstances where one or more subsidiary s contract has been terminated for its default, such damages could include amounts sufficient to repay project debt. For facilities owned by municipal clients and operated by Covanta, Covanta s potential maximum liability as of December 31, 2004 associated with the repayment of the municipalities debt on such facilities

is in excess of $1 billion. This amount was not recorded as a liability in Danielson s Consolidated Balance Sheet as of December 31, 2004 as Covanta believes that it had not incurred such liability at the date of the financial statements. Additionally,

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damages payable under such guarantees on Covanta-owned waste-to-energy facilities could expose Covanta to recourse liability on project debt shown on the foregoing table. Covanta also believes that it has not incurred such damages at the date of the financial statements. If Covanta is asked to perform under one or more of such guarantees, its liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt, which is presently not estimable.

With respect to its international businesses, Covanta has issued guarantees of certain of CPIH s operating subsidiaries contractual obligations to operate power projects. The potential damages owed under such arrangements for international projects may be material. Depending upon the circumstances giving rise to such domestic and international damages, the contractual terms of the applicable contracts, and the contract counterparty s choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than Covanta s then-available sources of funds. To date, Covanta has not incurred material liabilities under its guarantees, either on domestic or international projects.

COVANTA S LIQUIDITY

An important objective of management is to provide reliable service to its clients while generating sufficient cash to meet its liquidity needs. Maintaining historic facility production and optimizing cash receipts is necessary to assure that the Company has sufficient cash to fund operations, make appropriate and permitted capital expenditures and meet scheduled debt service payments. Under its current principal financing arrangements, Covanta does not expect to receive any cash contributions from Danielson and is prohibited, under its principal financing arrangements, from using its cash to issue dividends to Danielson.

At December 31, 2004, Domestic Covanta had $63.1 million in unrestricted cash. Restricted funds held in trust largely reflects payments from municipal clients under Service Agreements as the part of the service fee due reflecting debt service. These payments are made directly to the trustee for the related project debt and are held by it until paid to project debt holders. Covanta does not have access to these funds. In addition, as of December 31, 2004, Domestic Covanta had $32.8 million in cash held in restricted accounts to pay for additional emergence expenses that are estimated to be paid after emergence. Cash held in such reserve accounts is not available for general corporate purposes.

During the year, CPIH made payments of $19.6 million to reduce outstanding principal on its term loan, a portion of which was funded by the sale of its interest in an energy facility in Spain. At December 31, 2004, CPIH had $3.8 million in its domestic accounts. CPIH also had **$**11.1 million related to cash held in foreign bank accounts that could be difficult to transfer to the U.S. due to the: (i) requirements of the relevant project financing documents; (ii) applicable laws affecting the foreign project; (iii) contractual obligations; and (iv) prevention of material adverse tax liabilities to Covanta and subsidiaries. While CPIH s existing term loan and revolver are outstanding CPIH s cash balance is not available to be transferred to Domestic Covanta.

CPIH s receipt of cash distributions can be less consistent and predictable than that of Domestic Covanta because of restrictions associated with project financing arrangements at the project level and other risks inherent with foreign operations. As a result of these factors, CPIH may have sufficient cash during some months to pay principal on its corporate debt, but have insufficient cash to pay principal during other months. To the extent that CPIH has insufficient cash in a given month to pay the full amount of interest then due on its term loan facility at the rate of 10.5%, it is permitted to pay up to 4.5% of such interest in kind, which amount is added to the principal amount outstanding.

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Domestic Covanta and CPIH have entered into the following credit facilities which provide liquidity and letters of credit relating to their respective businesses. As of December 31, 2004, neither Domestic Covanta nor CPIH had made any borrowings under their respective liquidity facilities.

Designation	Purpose	Term	Security
Domestic Covanta Facilities			
First Lien Facility	To provide for letter of credit required for a Covanta waste-to-energy facility	Expires March 2009	First priority lien in substantially all of the assets of the domestic borrowers (including Covanta) not subject to prior liens. Guaranteed by Covanta s subsidiaries which are domestic borrowers. Also, to the extent that no amounts have been funded under the revolving loan or letters of credit, Covanta is obligated to apply excess cash to collateralize its reimbursement obligations with respect to outstanding letters of credit, until such time as such collateral equals 105% of the maximum amount that may at any time be drawn under outstanding letters of credit.
Second Lien Facility	To provide for certain existing and new letters of credit and up to $10 million in revolving credit for general corporate purposes	Expires March 2009	Second priority lien in substantially all of the assets of the domestic borrowers not subject to prior liens. Guaranteed by domestic borrowers. Also, to the extent that no amounts have been funded under the revolving loan or letters of credit, Covanta is obligated to apply excess cash to collateralize its reimbursement obligations with respect to outstanding letters of credit, until such time as such collateral equals 105% of the maximum amount that may at any time be drawn under outstanding letters of credit.
CPIH Facility			
Revolving Loan Facility	Up to $9.1 million	Expires March 2007	First priority lien on the stock of CPIH and substantially all of the CPIH borrowers assets not otherwise pledged.

See Note 17 to the Notes to Consolidated Financial Statements.

All obligations under Covanta s financing arrangements which existed prior to and during its bankruptcy proceeding were discharged on March 10, 2004, the effective date of the Reorganization Plan. On the same date and pursuant to the Reorganization Plan, Covanta entered into new credit facilities, as described below.

The Domestic Borrowers entered into two credit facilities to provide letters of credit and liquidity in support of Covanta s domestic operations and to maintain existing letters of credit in support of its international operations. The Domestic Borrowers entered into the First Lien Facility, secured by a first priority lien on substantially all of the assets of the Domestic Borrowers not subject to prior liens (the Collateral). The First Lien Facility provides commitments for the issuance of letters of credit in the initial aggregate face amount of up to $139 million with

respect to waste-to-energy facility. The First Lien Facility reduces semi-annually as the contractually required letter of credit for this facility reduces. As of December 31, 2004, this requirement was approximately $119.7 million. Additionally, the Domestic Borrowers

entered into the Second Lien Facility, secured by a second priority lien on the Collateral. The Second Lien Facility is a letter of credit and liquidity facility in the aggregate amount of $118 million up to $10 million of which may be used for cash borrowings on a revolving basis for general corporate purposes. Among other things, the Second Lien Facility will provide Covanta with the ability to obtain new letters of credit as may be required with respect to various domestic waste-to-energy facilities, as well as to maintain existing letters of credit with respect to international projects. Both the First Lien Facility and the Second Lien expire in March 2009.

The Domestic Borrowers also entered into the Domestic Intercreditor Agreement with the respective lenders under the First Lien Facility and Second Lien Facility and the trustee under the indenture for the High Yield Notes. It provides for certain provisions regarding the application of payments made by the Domestic Borrowers among the respective creditors and certain matters relating to priorities upon the exercise of remedies with respect to the Collateral.

Under these facilities, as described below, Covanta is obligated to apply excess cash to collateralize its reimbursement obligations with respect to outstanding letters of credit, until such time as such collateral equals 105% of the maximum amount that may at any time be drawn under outstanding letters of credit. In accordance with the annual cash flow and the excess cash on hand provisions of the First and Second Lien Facilities, Domestic Covanta deposited $3.2 million and $10.5 million on January 3, 2005 and March 1, 2005, respectively, into a restricted collateral account for this purpose. This restricted collateral will become available to the Domestic Borrowers if it refinances is current recourse debt.

Material Terms of First and Second Lien Facilities: Both the First Lien Facility and the Second Lien Facility provide for mandatory prepayments of all or a portion of amounts funded by the lenders under letters of credit and the revolving loan upon the sales of assets, incurrence of additional indebtedness, availability of annual cash flow, or cash on hand above certain base amounts, and change of control transactions. To the extent that no amounts have been funded under the revolving loan or letters of credit, Covanta is obligated to apply excess cash to collateralize its reimbursement obligations with respect to outstanding letters of credit, until such time as such collateral equals 105% of the maximum amount that may at any time be drawn under outstanding letters of credit.

The First Lien Facility and the Second Lien Facility require cash collateral to be posted for issued letters of credit if Covanta has cash in excess of specified amounts. Covanta paid a 1% upfront fee upon entering into the First Lien Facility, and will pay with respect to each issued letter of credit (i) a fronting fee equal to the greater of $500 or 0.25% per annum of the daily amount available to be drawn under such letter of credit, (ii) a letter of credit fee equal to 2.5% per annum of the daily amount available to be drawn under such letter of credit, and (iii) an annual fee of $1,500.

The revolving loan component of the Second Lien Facility bears interest at either (i) 4.5% over a base rate with reference to either the Federal Funds rate of the Federal Reserve System or Bank One s prime rate, or (ii) 6.5% over a formula Eurodollar rate, the applicable rate to be determined by Covanta (increasing by 2% over the then applicable rate in specified default situations). Covanta also paid an upfront fee of $2.8 million upon entering into the Second Lien Facility, and will pay (i) a commitment fee equal to 0.5% per annum of the daily calculation of available credit, (ii) an annual agency fee of $30,000, and (iii) with respect to each issued letter of credit an amount equal to 6.5% per annum of the daily amount available to be drawn under such letter of credit.

The terms of both of these facilities require Covanta to furnish the lenders with periodic financial, operating and other information. In addition, these facilities further restrict, without a consent of its lenders under these facilities, Covanta s ability to, among others:

incur indebtedness, or incur liens on its property, subject to specific exceptions;

pay any dividends on or repurchase any of its outstanding securities, subject to specific exceptions;

make new investments, subject to specific exceptions;

deviate from specified financial ratios and covenants, including those pertaining to consolidated net worth, adjusted EBITDA, and capital expenditures;

sell any material amount of assets, enter into a merger transaction, liquidate or dissolve;

enter into any material transactions with shareholders and affiliates; amend its organization documents; and

engage in a new line of business.

All unpaid principal of and accrued interest on the revolving loan, and an amount equal to 105% of the maximum amount that may at any time be drawn under outstanding letters of credit, would become immediately due and payable in the event that Covanta or certain of its affiliates (including Danielson) become subject to specified events of bankruptcy or insolvency. Such amounts shall also become immediately due and payable, upon action taken by a certain specified percentage of the lenders, in the event that any of the following occurs after the expiration of applicable cure periods:

a failure by Covanta to pay amounts due under the Domestic Covanta Facilities or other debt instruments;

breaches of representations, warranties and covenants under the Domestic Covanta Facilities;

a judgment or judgments are rendered against Covanta that involve an amount in excess of $5 million, to the extent not covered by insurance;

any event that has caused a material adverse effect on Covanta;

a change in control;

the Intercreditor Agreement or any security agreement pertaining to the Domestic Covanta Facilities ceases to be in full force and effect;

certain terminations of material contracts; or

any securities issuance or equity contribution which is reasonably expected to have a material adverse effect on the availability of NOLs.

Material Terms of CPIH Revolving Loan Facility: CPIH Borrowers entered a revolving credit facility, which is secured by a pledge of the stock of CPIH and a first priority lien on substantially all of the CPIH Borrowers assets not otherwise pledged. The revolver provided an initial commitment for cash borrowings of up to $10 million for purposes of supporting the international independent power business. The amount of this commitment reduces per formula in the event of asset sale, receipt of insurance or condemnation proceeds, issuance of new CPIH indebtedness, receipt of tax refunds and/or cash on hand in excess of stated liquidity requirements. Through December 31, 2004, CPIH had not sought to make draws on this facility and the outstanding commitment amount has been reduced to $9.1 million.

The CPIH revolving credit facility has a maturity date of three years and to the extent drawn upon bears interest at the rate of either (i) 7% over a base rate with reference to either the Federal Funds rate of the Federal Reserve System or Deutsche Bank s prime rate, or (ii) 8% over a formula Eurodollar rate, the applicable rate to be determined by CPIH (increasing by 2% over the then applicable rate in specified default situations). CPIH also paid a 2% upfront fee of $0.2 million, and will pay (i) a commitment fee equal to 0.5% per annum of the average daily calculation of available credit, and (ii) an annual agency fee of $30,000.

The CPIH Borrowers also entered into the International Intercreditor Agreement, with the respective lenders under the revolver and the term debt, and Reorganized Covanta, that sets forth, among other things, certain provisions regarding the application of payments made by the CPIH Borrowers among the respective lenders and reorganized

Covanta and certain matters relating to the exercise of remedies with respect to the collateral pledged under the loan documents.

Certain Domestic Borrowers are guarantors of performance obligations of some international projects or are the reimbursement parties with respect to letters of credit issued to secure obligations relating to some

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international projects. The International Intercreditor Agreement provides that the Domestic Borrowers will be entitled to reimbursements of operating expenses incurred by the Domestic Borrowers on behalf of the CPIH Borrowers and payments, if any, made with respect to the above mentioned guarantees and reimbursement obligations.

The mandatory prepayment provisions, affirmative covenants, negative covenants and events of default under the two international credit facilities are similar to those found in the First Lien Facility and the Second Lien Facility.

Covanta believes cash available to CPIH and its subsidiaries, together with borrowing under the CPIH revolver will provide CPIH with sufficient liquidity to meet its operational needs and pay required debt service due prior to maturity. Covanta believes that CPIH will need to refinance its indebtedness at or prior to maturity in March 2007 unless asset sales affected prior to such time are sufficient to repay all CPIH indebtedness. Although Danielson has received a commitment to refinance the CPIH recourse debt, there can be no assurance that CPIH will be able to refinance such indebtedness at maturity or that such assets sales will be sufficient to repay CPIH indebtedness prior to its maturity.

Covanta Non-GAAP Financial Measures

The following summarizes unaudited non-GAAP financial information for Covanta. Certain items are included that are not measured under U.S. generally accepted accounting principles (GAAP) and are not intended to supplant the information provided in accordance with GAAP. Furthermore, these measures may not be comparable to those used by other companies. The following information should be read in conjunction with the financial statements and footnotes included herein.

Domestic Covanta and CPIH must each generate substantial cash flow from operations, upon which they depend as an important source of liquidity to pay project operating and capital expenditures, project debt, taxes, corporate operating expenses, and corporate debt and letter of credit fees. Management believes that a useful measure of the sufficiency of Domestic Covanta s and CPIH s respective cash generated from operations is that amount available to pay corporate debt service and letter of credit fees after all other obligations are paid.

The following table provides additional information with respect to cash available to pay Domestic Covanta s and CPIH s corporate debt and letter of credit fees, for the period March 11 through December 31, 2004 in thousands of dollars.

	DOMESTIC	CPIH	CONSOLIDATED
Operating Income	$ 62,232	$ 14,776	$ 77,008
Depreciation and amortization	48,805	7,016	55,821
Change in unbilled service receivables	11,221		11,221
Project debt principal repaid	(42,535)	(25,408)	(67,943)
Borrowings for facilities		14,488	14,488
Change in restricted funds held in trust	(7,871)	(5,968)	(13,839)
Change in restricted funds for emergence costs	65,681		65,681
Change in accrued emergence costs	(65,681)		(65,681)
Change in other liabilities	(2,545)	(459)	(3,004)
Distributions to minority partners	(5,272)	(2,989)	(8,261)
Distributions from investees and joint ventures		14,705	14,705
Dividends from equity investees		3,106	3,106
Amortization of premium and discount	(10,457)		(10,457)
Proceeds from sale of businesses		1,799	1,799
Investments in facilities	(10,083)	(1,794)	(11,877)
Change in other assets	(3,947)	12,636	8,689

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	DOMESTIC	CPIH	CONSOLIDATED
Cash generated for recourse debt and letter of credit fees, pre-tax	39,548	31,908	71,456
Corporate income taxes paid:			
Foreign		(2,779)	(2,779)
State	(2,926)		(2,926)
Federal	(1,000)	(1,100)	(2,100)
Cash generated for recourse debt and letter of credit fees, after taxes	35,622	28,029	63,651
Cash balance, beginning of period	45,307	12,488	57,795
Cash available for corporate debt and letter of credit fees	80,929	40,517	121,446
Recourse debt service and letter of credit fees paid-net	(17,759)	(5,902)	(23,661)
Payment of principal recourse debt	(47)	(19,626)	(19,673)
Cash balance, end of period	$ 63,123	$ 14,989	$ 78,112

Reconciliation of cash generated for corporate debt and letter of credit fees after taxes to cash provided by operating activities for the period March 11, 2004 through December 31, 2004 (in thousands of dollars):

Cash generated for recourse debt and letter of credit fees	$ 63,651
Investment in facilities	11,877
Borrowing for facilities	(14,488)
Distributions from investees and joint ventures	(14,705)
Distribution to minority partners	8,261
Change in restricted funds held in trust	13,839
Payment of project debt	67,943
Recourse debt service and letter of credit fees paid net	(23,661)
Other cash provided in investing activities	1,114
Cash provided by operating activities for the period March 11, 2004 to December, 2004	$ 113,831

PROPOSED REFINANCING OF DEBT, LIQUIDITY AND LETTER OF CREDIT FACILITIES

In connection with the proposed acquisition of Ref-Fuel, Danielson has received commitments to finance the acquisition and to refinance all of Domestic Covanta s and CPIH s recourse debt. The financing is not expected to alter the project debt of Covanta s subsidiaries, or the existing corporate and project debt of Ref-Fuel s subsidiaries other than a revolving loan facility being replaced. The following chart indicates the anticipated combined capital structure of Covanta and its subsidiaries following the proposed acquisition. Amounts shown below are as of December 31, 2004 unless otherwise indicated (in millions).

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Many of the material terms of Covanta s proposed new debt and refinanced debt, including interest rates, security and covenants have not been finalized. Such proposed debt will consist of first and second lien secured facilities. The first lien facilities are expected to include:

$100 million revolving loan facility, expiring 2011;

$340 million letter of credit facility expiring 2011; and

$250 million variable rate term loan facility due 2012.

The second lien facility is expected to consist of a $450 million variable rate term loan facility due 2012, a portion of which may be converted to fixed rate notes.

In connection with the debt financing commitments of Goldman Sachs Credit Partners, LLP and Credit Suisse First Boston, Danielson has agreed to establish a dedicated cash reserve to be used if necessary to contribute capital into NAICC in order to maintain certain risk-based capital ratios. Danielson estimates such reserve will be funded with approximately $6.5 million in cash at closing of the financing.

The acquisition of Ref-Fuel and the refinancing of Covanta s and CPIH s existing corporate debt are or will be subject to numerous conditions. These include:

successful closing of the Ref-Fuel Rights Offering;

receipt of all regulatory approvals; and

the absence of material adverse changes to Covanta s and Ref-Fuel s businesses.

Danielson will incur no fees or obligations to Goldman Sachs Credit Partners, LLP, Credit Suisse First Boston, or any other lenders seeking to participate in the proposed debt financing or refinancing, if the acquisition, or the related financing or refinancing does not occur.

There can be no assurance that the acquisition, or the related refinancings of Domestic Covanta s and CPIH s corporate debt, will occur.

OTHER

Quezon Power

Manila Electric Company (Meralco), the sole power purchaser for Covanta s Quezon Project, is engaged in discussions and legal proceedings with instrumentalities of the government of the Philippines relating to past billings to its customers, cancellations of recent tariff increases, and potential tariff increases. The outcome of these proceedings may affect Meralco s financial condition.

Quezon Project management continues to negotiate with Meralco with respect to proposed amendments to the power purchase agreement to modify certain commercial terms under the existing contract, and to resolve issues relating to the Quezon Project s performance during its first year of operation. Following the first year of the operation, in 2001, based on a claim that the plant s performance did not merit full payment, Meralco withheld a portion of each of several monthly payments to the Quezon Project that were due under the terms of the power purchase agreement. The total withheld amount was $10.8 million. Although the Quezon Project was able to pay all of its debt service and operational costs, the withholding by Meralco constituted a default by Meralco under the power purchase agreement and a potential event of default under the project financing agreements. To address this issue, Quezon Project management agreed with project lenders to hold back cash from distributions in excess of the reserve requirements under the financing agreements in the amount of approximately $20.5 million.

In addition to the issues under the power purchase agreement, issues under the financing agreements arose during late 2003 and 2004 regarding compliance with the Quezon Project operational parameters and the Quezon Project s inability to obtain required insurance coverage. In October 2004, Covanta and other Quezon project participants, with the consent of the Quezon Project lenders, amended certain of the Quezon Project documents to address such operational matters, resolving all related contract issues. Subsequently, the

project lenders granted a waiver with respect to the insurance coverage issue because contractual coverage levels were not then commercially available on reasonable terms. At approximately the same time, Quezon Project management sought, and successfully obtained, a reduction of the hold back amount discussed above, resulting in a new excess hold back of approximately $10.5 million with effect from November 2004.

Adverse developments in Meralco s financial condition or delays in finalizing the power purchase agreement amendments and potential consequent lender actions are not expected to adversely affect Covanta s liquidity, although it may have a material affect on CPIH s ability to repay its debt prior to maturity. In late 2004, Meralco successfully refinanced $228 million in expiring short-term debt on a long-term 7 year basis, improving Meralco s financial condition.

Insurance

Danielson has obtained insurance for its assets and operations that provide coverage for what Danielson believes are probable maximum losses, subject to self-insured retentions, policy limits and premium costs which Danielson believes to be appropriate. However, the insurance obtained does not cover Danielson for all possible losses.

Off Balance Sheet Arrangements

During 2004, subsidiaries of Covanta were parties to lease arrangements with Covanta s municipal clients at its Union County, New Jersey and its Alexandria, Virginia waste-to energy facilities. At its Union County facility, Covanta s operating subsidiary leases the facility from the Union County Utilities Authority (the UCUA) under a lease that expires in 2023, which Covanta may extend for an additional five years. Rent under the lease is sufficient to allow the UCUA to repay tax exempt bonds issued by it to finance the facility and which mature in 2023.

At its Alexandria facility, a Covanta subsidiary is a party to a lease related to certain pollution control equipment that was required in connection with the Clean Air Act amendments of 1990, and which were financed by the City of Alexandria and by Arlington County, Virginia. Covanta s subsidiary owns this facility, and rent under this lease is sufficient to pay debt service on tax exempt bonds issued to finance such equipment and which mature in 2013.

Covanta is also a party to lease arrangements pursuant to which it leases rolling stock in connection with its waste-to-energy and independent power facilities, as well as certain office equipment. Rent payable under these arrangements is not material to the Company s financial condition.

Covanta generally uses operating lease treatment for all of the foregoing arrangements. A summary of the Company s operating lease obligations is contained in Note 22 to the consolidated financial statements.

Covanta and certain of its subsidiaries have issued or are party to performance guarantees and related contractual obligations undertaken mainly pursuant to agreements to construct and operate certain energy and water facilities. With respect to its domestic businesses, Covanta has issued guarantees to municipal clients and other parties that Covanta s subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Such contractual damages or other obligations could be material, and in circumstances where one or more subsidiary s contract has been terminated for its default, such damages could include amounts sufficient to repay project debt. For facilities owned by municipal clients and operated by Covanta, Covanta s potential maximum liability as of December 31, 2004 associated with the repayment of the municipalities debt on such facilities is in excess of $1 billion. This amount was not recorded as a liability in Danielson s Consolidated Balance Sheet as of December 31, 2004 as Covanta believes that it had not incurred such liability at the date of the financial statements. Additionally, damages payable under such guarantees on Covanta-owned waste-to-energy facilities could expose Covanta to liability under the limited recourse provisions on project debt related to its facilities. See Note 20 to the Notes to Consolidated Financial Statements for additional information relating to Covanta s project debt. Covanta also believes that it has not incurred such damages at the date of the financial statements. If the local subsidiaries contractual breach of pertinent sections of their contract were to occur, its liability for damages

upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt, which is presently not estimable.

With respect to its international businesses, Covanta has issued guarantees of certain of CPIH s operating subsidiaries contractual obligations to operate power projects. The potential damages owed under such arrangements for international projects may be material. Depending upon the circumstances giving rise to such domestic and international damages, the contractual terms of the applicable contracts, and the contract counterparty s choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than Covanta s then-available sources of funds.

To date, Covanta has not incurred material liabilities under its guarantees, either on domestic or international projects.

The Company has investments in several investees and joint ventures which are accounted for under the equity and cost methods and therefore does not consolidate the financial information of those companies. (See Note 5 to the Notes to the Consolidated Financial Statements for additional information regarding these leases.)

Contract Structures and Duration

Covanta attempts to structure contracts related to its domestic waste-to-energy projects as fixed price operating contracts which escalate in accordance with indices Covanta believes appropriate to reflect price inflation, so that its revenue is relatively stable for the contract term. Covanta s returns will be similarly stable if it does not incur material unexpected operation and maintenance or other expense. In addition, most of Covanta s waste-to-energy project contracts are structured so that contract counterparties generally bear the costs associated with events or circumstances not within Covanta s control, such as uninsured force majeure events and changes in legal requirements. The stability of Covanta s domestic revenue and returns could be affected by its ability to continue to enforce these obligations. Also, at some of Covanta s waste-to-energy facilities, commodity price risk is further mitigated by passing through commodity costs to contract counterparties. With respect to its domestic and international independent power projects, such structural features generally do not exist because either Covanta operates and maintains such facilities for its own account or does so on a cost-plus rather than a fixed fee basis.

Certain energy contracts related to domestic projects provide for energy sales prices linked to the avoided costs of producing such energy and, therefore, energy revenues fluctuate with various economic factors. In most of Covanta s waste-to-energy projects, the operating subsidiary retains only a fraction of the energy revenues (generally 10%) with the balance used to provide a credit to the Client Community against its disposal costs. Therefore, the Client Community derives most of the benefit and risk of changing energy prices. One of Covanta s waste-to-energy facilities sells electricity to the regional electricity grid without a contract and is therefore subject to energy market price fluctuation.

At some of Covanta s domestic and international independent power projects, Covanta s operating subsidiary purchases fuel in the open markets. Covanta is exposed to fuel price risk at these projects. At other plants, fuel costs are contractually included in Covanta s electricity revenues, or fuel is provided by Covanta s customers. In some of Covanta s international projects, the project entity (which in some cases is not a subsidiary of Covanta) has entered into long term fuel purchase contracts that protect the project from changes in fuel prices, provided counterparties to such contracts perform their commitments.

Covanta s Service Agreements for domestic waste-to-energy projects begin to expire in 2007, and energy sales contracts at Covanta-owned waste-to-energy projects generally expire at or after the date on which that project s Service Agreement expires. Expiration of these contracts will subject Covanta to greater market risk in maintaining and enhancing its revenues. As its Service Agreements at municipally-owned projects expire, Covanta will seek to enter into renewal or replacement contracts to continue operating such projects. As its Service Agreements at facilities it owns begin to expire, Covanta intends to seek replacement or additional contracts for waste supplies, and because project debt on these facilities will be paid off at such time, Covanta believes it will be able to offer disposal services at rates that will attract sufficient quantities of waste and

provide acceptable revenues. Covanta will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. At Covanta s domestic facilities, the expiration of existing energy sales contracts will require Covanta to sell project energy output either into the electricity grid or pursuant to new contracts. There can be no assurance that Covanta will be able to enter into such renewals, replacement or additional contracts, or that the terms available in the market at the time will be favorable to Covanta.

Covanta s opportunities for growth by investing in new domestic projects will be limited by existing debt covenants, as well as by competition from other companies in the waste disposal business. Because its business is based upon building and operating municipal solid waste processing and energy generating projects, which are capital intensive businesses, in order to provide meaningful growth Covanta must be able to invest its own funds, obtain debt financing, and provide support to its operating subsidiaries. When Covanta was acquired by Danielson and emerged from its bankruptcy proceeding in March 2004, it entered into financing arrangements with restrictive covenants typical of work out financings. These covenants essentially prohibit investments in new projects or acquisitions of new businesses, and place restrictions on Covanta s ability to expand existing projects. The covenants also prohibit borrowings to finance new construction, except in limited circumstances related to specifically identified expansions of existing facilities. In addition, the covenants limit spending for new business development and require that excess cash flow be trapped to collateralize outstanding letters of credit.

Covanta intends to pursue opportunities to expand the processing capacity where Client Communities have encountered significantly increased waste volumes without corresponding competitively-priced landfill availability. Other than expansions at existing waste-to-energy projects, Covanta does not expect to engage in material development activity which will require significant equity investment. There can be no assurance that Covanta will be able to implement expansions at existing facilities.

Domestic Covanta Waste-To-Energy Project Ownership Structures

Covanta s waste-to-energy business originally was developed in response to competitive procurements conducted by municipalities for waste disposal services. One of the threshold decisions made by each municipality early in the procurement process was whether it, or the winning vendor, would own the facility to be constructed; there were advantages and disadvantages to the municipality with both ownership structures. As a result, Domestic Covanta today operates many publicly owned facilities, and owns and operates many others. In addition, as a result of acquisitions of additional projects originally owned or operated by another vendor, Domestic Covanta operates several projects under a lease structure where a third party lessor owns the project. In all cases, Domestic Covanta operates each facility pursuant to a long-term contract, and provides the same service in consideration of a monthly service fee paid by the municipal client.

Under both ownership structures, the municipalities typically borrowed funds to pay for the facility construction by issuing bonds. In a private ownership structure, the municipal entity loans the bond proceeds to Domestic Covanta s project subsidiary, and the facility is recorded as an asset, and the project debt is recorded as a liability, on Covanta s consolidated balance sheet. In a public ownership structure, the municipality would pay for construction without loaning the bond proceeds to Domestic Covanta.

Regardless of whether a project was owned by Domestic Covanta or its municipal client, the municipality is generally responsible for repaying the project debt after construction is complete. Where it owns the facility, the municipality pays periodic debt service directly to a trustee under an indenture. For most projects where Domestic Covanta owns the facility, the municipal client pays debt service as a component of its monthly service fee payment to Domestic Covanta. As of December 31, 2004, the principal amount of project debt outstanding with respect to these projects was approximately $670 million. As with a public ownership structure, this debt service payment is retained by a trustee, and is not held or available to Covanta for general use. In these private ownership structures, Covanta records on its consolidated financial statements revenue with respect to debt service (both principal and interest) on project debt, and expense for depreciation and interest on project debt.

Domestic Covanta also owns two waste-to-energy projects for which debt service is not expressly included in the fee it is paid. Rather, Domestic Covanta receives a fee for each ton of waste processed at these projects. As of December 31, 2004, the principal amount of project debt outstanding with respect to these projects was approximately $172 million. Accordingly, Domestic Covanta does not record revenue reflecting principal on this project debt. Its operating subsidiaries for these projects make equal monthly deposits with their respective project trustees in amounts sufficient for the trustees to pay principal and interest when due.

For Domestic Covanta-owned projects, all cash held by trustees is recorded as restricted funds held in trust. For facilities not owned by Domestic Covanta, Covanta does not incur, nor does it record project debt service obligations, project debt service revenue or project debt service expense.

Domestic Covanta generates electricity and/or steam for sale at all of its waste-to-energy projects, regardless of ownership structure. During the term of its operating contracts with its municipal clients, most of the revenue from electricity and steam sales (typically 90%) benefits the municipal client as a reduction to its monthly service fee obligation to Covanta.

Generally, the term of Domestic Covanta s operating contracts with its municipal clients coincides with the term of the bonds issued to pay for the project construction. Therefore, another important difference between public and private ownership of Domestic Covanta s waste-to-energy projects is project ownership after these contracts expire. In many cases, the municipality has contractual rights (not obligations) to extend the contract. If a contract is not extended on a publicly owned project, Domestic Covanta s role, and its revenue, with respect to that project would cease. If a contract is not extended on a Domestic Covanta-owned project, it would be free to enter into new revenue generating contracts for waste supply (with the municipality, other municipalities, or private waste haulers) and for electricity or steam sales. Domestic Covanta would in such cases have no remaining project debt to repay from project revenue, and would be entitled to retain 100% of energy sales revenue.

Material Weakness in Internal Controls and Procedures

As set forth in Item 9A Controls and Procedures, Danielson reported that management had identified a material weakness in its internal controls and procedures over financial reporting. Specifically, during the course of its audit of Danielson s 2004 financial statements, Ernst & Young LLP, Danielson s independent auditors, identified errors, principally related to complex manual fresh start accounting calculations, predominantly affecting Covanta s investments in its international businesses. Fresh start accounting was required following Covanta s emergence from bankruptcy on March 10, 2004, pursuant to Statement of Financial Position (SOP) 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code. These errors, the net effect of which was immaterial (less than $2 million in pretax income) were corrected in Danielson s 2004 Consolidated Financial Statements prior to their issuance. However, management has determined that errors in complex fresh start and other technical accounting areas originally went undetected due to insufficient technical in-house expertise necessary to provide sufficiently rigorous review.

While the errors in financial reporting that related to the material weakness were corrected and had an immaterial net effect on Danielson s Consolidated Financial Statements, Danielson s management intends to correct the material weakness as soon as possible. Because a material weakness is defined as a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of annual or interim financial statements will not be prevented or detected, Danielson s management believes that prompt remediation of the material weakness will mitigate the uncertainty presented by the possibility of material misstatements in Danielson s reported financial information and in the accuracy and completeness of its financial reports. If Danielson is again unable to assert that its internal control over financial reporting is effective in any future period, the existence of the reported material weakness could represent a trend or uncertainty affecting the accuracy of Danielson s consolidated financial statements. Although the material weakness reported related primarily to complicated fresh start accounting calculations, which will no longer be applicable after March 10, 2005, similarly complicated accounting calculations may be required in connection with CPIH s international operations and Danielson s pending acquisition of Ref-Fuel. As a result, as of the date of this Amendment Danielson has identified and undertaken

several actions to remediate the reported material weakness in internal controls over financial reporting. Due to the nature of the control deficiency related to this material weakness, and pending completion of its review process for its first quarter 2005 interim financial statements, Danielson believes it is premature, as of the date of this Amendment, to determine whether it has effectively corrected the reported material weakness. See also Risk Factors failure to maintain an effective system of internal controls over financial reporting may have an adverse effect on our stock price for continuing risks of the failure to maintain an effective system of financial reporting controls and procedures, including risks of exposing Danielson to regulatory sanctions and a loss of investor confidence in Danielson.

Supplemental Financial Information About Domestic Covanta And CPIH

The following condensed consolidating balance sheets, statements of operations and statements of cash flow provide additional financial information for Domestic Covanta and CPIH. Because Domestic Covanta and CPIH have had separate capital structures and cash management systems only since the Company emerged from bankruptcy on March 10, 2004, therefore comparable information did not exist prior to the Company s emergence from bankruptcy. For this reason, this supplemental information covers the period March 11, 2004 through December 31, 2004.

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CONDENSED CONSOLIDATING BALANCE SHEETS
For the Period Ended December 31, 2004

	DOMESTIC	CPIH	CONSOLIDATED
		(In thousands of dollars)	
ASSETS			
Current Assets:			
Cash and cash equivalents	$ 63,123	$ 14,989	$ 78,112
Marketable securities available for sale	3,100		3,100
Restricted funds for emergence costs	32,805		32,805
Restricted funds held in trust	92,829	23,263	116,092
Unbilled service receivable	58,206		58,206
Other current assets	156,995	44,067	201,062
Total current assets	407,058	82,319	489,377
Property, plant and equipment-net	758,727	101,246	859,973
Restricted funds held in trust	104,580	19,246	123,826
Service and energy contracts and other intangible assets	187,932	705	188,637
Unbilled service receivable	107,894	4,152	112,046
Other assets	36,159	60,504	96,663
Total assets	$ 1,602,350	$ 268,172	$ 1,870,522
LIABILITIES AND SHAREHOLDERS EQUITY:			
Current liabilities:			
Current portion of recourse debt	$ 112	$	$ 112
Current portion of project debt	84,719	24,982	109,701
Accrued emergence costs	32,805		32,805
Other current liabilities	126,142	25,035	151,177
Total current liabilities	243,778	50,017	293,795
Recourse debt	235,932	76,852	312,784
Project debt	757,435	77,601	835,036
Deferred income taxes	156,326	9,860	166,186
Other liabilities	95,460	2,388	97,848
Total liabilities	1,488,931	216,718	1,705,649
Minority interests	45,940	39,480	85,420
Total shareholders equity	67,479	11,974	79,453
Total Liabilities, minority interests and shareholders equity	$ 1,602,350	$ 268,172	$ 1,870,522

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
For the Period March 11, through December 31, 2004

	DOMESTIC	CPIH	CONSOLIDATED
		(In thousands of dollars)	
Total revenues	$ 452,931	$ 104,271	$ 557,202
Depreciation and amortization	48,805	7,016	55,821
Net interest on project debt	23,786	8,800	32,586
Plant operating and other costs and expenses	318,108	73,679	391,787
Total costs and expenses	390,699	89,495	480,194
Operating income	62,232	14,776	77,008
Interest expense (net of interest income of $518 and $1,340)	(26,911)	(5,937)	(32,848)
Income tax expense	(15,381)	(8,256)	(23,637)
Minority interests	(3,966)	(2,953)	(6,919)
Equity in net income from unconsolidated investments	1,216	16,319	17,535
Net income	$ 17,190	$ 13,949	$ 31,139

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
For the Period March 11, through December 31, 2004

	DOMESTIC	CPIH	CONSOLIDATED
		(In thousands of Dollars)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 17,190	$ 13,949	$ 31,139
Adjustments to Reconcile Net income to Net Cash Provided by Operating Activities:			
Depreciation and amortization	48,805	7,016	55,821
Deferred income taxes	10,202	2,133	12,335
Equity in income from unconsolidated investments	(1,216)	(16,319)	(17,535)
Dividends from equity investees		3,106	3,106
Accretion of principal on Senior Secured Notes	2,736		2,736
Amortization of premium and discount	(10,457)		(10,457)
Minority interests	3,966	2,953	6,919
Other	4,007	(119)	3,888
Management of Operating Assets and Liabilities:			
Unbilled service receivables	11,221		11,221
Restricted funds held in trust for emergence costs	65,681		65,681
Other assets	(6,321)	14,003	7,682
Accrued emergence costs	(65,681)		(65,681)
Other liabilities	5,156	1,820	6,976

Net cash provided by operating activities	85,289	28,542	113,831

	DOMESTIC	CPIH	CONSOLIDATED
	(In thousands of Dollars)		
CASH FLOWS FROM INVESTING ACTIVITIES			
Investments in facilities	(10,083)	(1,794)	(11,877)
Proceeds from sale of business		1,799	1,799
Distributions from investees		14,705	14,705
Other	(1,665)	(1,248)	(2,913)
Net cash (used in) provided by investing activities	(11,748)	13,462	1,714
CASH FLOWS FROM FINANCING ACTIVITIES			
Borrowings for facilities		14,488	14,488
(Increase) decrease in restricted funds held in trust	(7,871)	(5,968)	(13,839)
Payment of project debt	(42,535)	(25,408)	(67,943)
Payment of recourse debt	(47)	(19,626)	(19,673)
Other	(5,272)	(2,989)	(8,261)
Net cash used in financing activities	(55,725)	(39,503)	(95,228)
NET INCREASE IN CASH AND CASH EQUIVALENTS	17,816	2,501	20,317
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	45,307	12,488	57,795
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 63,123	$ 14,989	$ 78,112

MANAGEMENT DISCUSSION AND ANALYSIS OF INSURANCE SERVICES

The operations of Danielson s insurance subsidiary, National American Insurance Company of California, and its subsidiary Valor Insurance Company, Incorporated are primarily property and casualty insurance. Effective July 2003, the decision was made to focus exclusively on the California non-standard personal automobile insurance market. Effective July 7, 2003, NAICC ceased writing new policy applications for commercial automobile insurance and began the process of providing the required statutory notice of its intention not to renew existing policies. As of December 31, 2004, there were not any commercial automobile policies in-force versus policies equivalent to $2.9 in unearned premiums as of December 31, 2003.

Results of Operations 2004 vs. 2003

Insurance Operating Results

Net earned premiums were $18 million and $35.9 million for the years ended 2004 and 2003. The change in earned premiums was a direct result of Insurance Services exiting the commercial automobile market in 2003. Net written premiums were $15.2 million for 2004 consisting entirely of non-standard personal automobile policies.

Net investment income was $2.4 million and $4 million for 2004 and 2003, respectively. The decrease was primarily due to a decrease in the fixed income portfolio basis as well as a reduction in the portfolio yield. Fixed income invested assets portfolio decreased by only $12.1 million in 2004 despite net loss and loss adjustment expenses (LAE) reserves declining by $18.9 million. The differential was a result of management reducing its cash and short-term investment positions. Due to the decrease in written premiums on business placed in run-off noted

above, NAICC also experienced negative underwriting cash flows. For the years ended 2004 and 2003, the weighted average yield on the bond portfolio was 3.8% and 4.9%, respectively. Of the $1.6 million change in investment income, $0.2 million was the result of amortization recognized on a single bond that was called prior to its maturity date. The effective duration of the portfolio at December 31, 2004 was 2.3 years which management believed was appropriate given the relative short-tail nature of the auto programs and projected run-off of all other lines of business.

Net realized investment gains of $0.2 million were recognized in 2004 compared to $1 million in 2003. The difference in activity is attributed to management engaging new investment advisors in June 2003 to rebalance the portfolio to address extension, credit and reinvestment risk exposures. Concurrently, interest rates were at 40 year lows and the stock market rebounded significantly in 2003 providing for more robust gains. For 2004, interest rates remained relatively low providing for some gain activity, but the portfolio provided better matching of principal pay-down to claim settlements thus not requiring the same level of disposition activity.

The net loss and LAE ratios were 71.5% in 2004 and 102.3% in 2003. The decrease in the loss and LAE ratio during 2004 was attributable to much more stable development activity on prior accident years. Although commercial automobile, assumed property and casualty, and Valor workers compensation reserves continued to generate unfavorable claim activity, the non-standard personal automobile and California workers compensation performed better than anticipated.

The non-standard personal automobile loss and allocated LAE (ALAE) ratio were 49.3% for accident year 2004 versus 60.4% for accident year 2003 recorded in 2003. The accident year 2003 loss and ALAE ratio reduced to 53.7% by 2004 year-end. Non-standard personal automobile claim frequency was 7.7 and 7.9 per 1000 vehicle months for accident years 2004 and 2003, respectively. Claim severity trended favorably for non-standard decreasing by 5.6% from the prior year. Meanwhile average premium per vehicle on the non-standard personal automobile remained constant, despite the mix of business moving towards non-owner policies 33% in 2004 versus 28% in 2003. Historically non-owner policies yield loss and ALAE ratios 10% to 30% lower than owner policies.

Workers compensation reforms were enacted in California in late 2003 and again in April 2004. The effects of the reforms were designed to curb medical cost spending and appear to have resulted in more favorable settlement activity. Although the reforms did not eliminate systemic abuse, they do appear to have modified the behavior of claimants, providers, and applicant attorneys. Although the impact of the reforms can not be measured, management was able to recognize favorable development in the amount of $1.6 million.

Policy acquisition costs as a percentage of net earned premiums were 24.6% in 2004 and 22.2% in 2003. Policy acquisition costs include expenses which are directly related to premium volume (i.e., commissions, premium taxes and state assessments) as well as certain underwriting expenses which vary with and are directly related to policy issuance. The increase was a result of profit commissions earned by the general agent responsible for the marketing, underwriting and policy administration of the non-standard personal automobile program. The recognition of the profit commission was a direct result of favorable reserve development recognized on accident year 2003 and slightly improved results for accident year 2004.

General and administrative expenses were $4.4 million in 2004 compared to $6.7 million in 2003. In 2004, management recognized additional pension expense of $0.8 million related to participants electing to receive lump sum distributions of the pension plan and severance costs of $0.1 million related to the outsourcing of its workers compensation claims. In 2003 additional allowance for uncollectible reinsurance recoverable of $1.3 million and $0.2 million in employee severance expenses related to business contraction inflated normal expenses. Normalizing both years for items noted, general and administrative costs expenses reduced by $1.6 million. Management continues to examine its expense structure; however, given the decreases in premium production and its obligation to run-off several lines of business, a core amount of fixed governance costs is required and consequently its expense ratio will run higher than industry averages until it can increase premium production.

Results of Operations 2003 vs. 2002

Insurance Operating Results

Net earned premiums were $35.9 million and $62.2 million for the years ended 2003 and 2002, respectively. The change in net earned premiums during 2003 was directly related to the change in net written premiums. Net written premiums were $30.4 million and $52.7 million in 2003 and 2002, respectively. Net earned premiums exceeded net written premiums in 2002 due to a significant reduction in NAICC s

commercial automobile line and the decision made in 2001 to exit both the workers compensation line of business in all states and private passenger automobile outside of California. Workers compensation net written premiums decreased $7.3 million during 2003 over the comparable period in 2002. The commercial automobile net written premiums decreased from $19.5 million in 2002 to $11.9 million in 2003 due to the decision to exit the line in July 2003. Net written premiums for personal automobile lines decreased by $7.4 million during 2003 primarily due to underwriting restrictions placed on the non-standard California private passenger automobile program and the decline in net written premiums outside of California.

Net investment income decreased primarily due to a decrease in the fixed income portfolio basis as well as a reduction in the portfolio yield. Fixed income invested asset portfolio decreased by $5.6 million in 2003, despite net loss and LAE reserves declining by $8.6 million. The differential was a result of NAICC disposing of substantially all of its equity security holdings in the fourth quarter of 2003 and reinvesting those proceeds, approximately $4.1 million, in fixed income securities. Additionally, NAICC received $2 million in additional paid-in capital from Danielson at year-end. Due to the decrease in written premiums on business placed in run-off noted above, NAICC also experienced negative underwriting cash flows. As of December 31, 2003 and 2002, the weighted average yield on NAICC s portfolio was 4.9% and 5.9%, respectively. The effective duration of the portfolio at December 31, 2003 was 2.3 years which management believed was appropriate given the relative short-tail nature of the auto programs and projected run-off of all lines of business.

In 2003, NAICC recognized $1 million in gains from fixed income securities that were maturing in 2004 as a consequence of a dynamic interest rate environment throughout the year. In 2002, a realized investment gain of $5.2 million was recognized upon conversion of the ACL notes into equity. This gain was offset by a $5.1 million loss on non-affiliated equity securities and a $0.9 million gain on fixed maturities. Of the $5.1 million loss on equity securities, $1 million was recorded for other than temporary declines in fair value. NAICC had a net unrealized loss of $1.4 million on its equity portfolio at the end of December 2002 and a modest net unrealized gain at December 31, 2003.

Net losses and LAE ratios were 102.3% in 2003 and 96.3% in 2002. The increase in the loss and LAE ratio during 2003 was attributable to further recognition of prior accident year reserve development on workers compensation and commercial automobile insurance. NAICC has historically priced its non-standard private passenger and commercial auto premium at 68% to 69% of its expected loss and ALAE costs in order to balance its expense structure and market conditions. In 2003, NAICC believed it had a far more successful underwriting year, posting loss and ALAE ratios of 60.4% and 59.5% for its California non-standard auto and entire commercial auto program. These results were commensurate with industry results for 2003 driven primarily by the hard insurance market. Non-standard private passenger and commercial auto claim frequency was 7.9 and 10.6 per 1,000 vehicle months in accident year 2003 compared to 9.5 and 10.8 per 1,000 vehicle months in 2002, respectively. Severity was favorable for both lines as well in 2003 compared to 2002 by reduction of average cost per claim of three percent and six percent for the personal and commercial auto lines, respectively. Although both these indicators were favorable in 2003, the average premium per vehicle on commercial lines had the most significant effect on the loss and ALAE ratio. The average premium per vehicle on commercial lines increased 17.8% for the 2003 accident year. With respect to the personal automobile insurance, the mix of business moving towards non-owner policies 28% in 2003 versus 10% in 2002 had the most significant impact for this program s improved loss and LAE ratio.

Policy acquisition costs as a percentage of net earned premiums were 22.2% in 2003 and 22.7% in 2002. The modest decrease was a result of change in the mix of business and a favorable renegotiation by management of its commission structure with its general agent in the fourth quarter of 2003.

General and administrative expenses increased in 2003 over 2002 levels by $0.8 million primarily due to recording an additional allowance for uncollectible reinsurance recoverable of $1.3 million and $0.2 million in employee severance expenses related to business contraction. Exclusive of the two items noted above, expenses decreased $0.7 million compared to 2002 due to decreased production and previously implemented cost containment efforts.

Cash Flow from Insurance Operations

Cash used in operations was $18.7 million, $23.2 million and $23.7 million for the years ended December 31, 2004 and 2003, respectively. The ongoing use of cash in operations was due to Insurance Services continuing to make payments related to discontinued lines and territories in excess of premium receipts from the non-standard personal automobile. This negative cash flow restricted Insurance Services from fully re-investing bond maturity proceeds and in some circumstances required the sale of bonds in order to meet obligations as they arose. Cash provided from investing activities was $10.9 million for the year ended December 31, 2004 compared with $17.5 million and $17.6 million for the comparable period in 2003 and 2002, respectively. The $6.7 million decrease in cash provided by investing activities compared to the year ended December 31, 2003 was primarily the result of larger cash balances held at 2003 year-end. There was no cash provided by financing activities for the year ended December 31, 2004 and 2002 compared to the $10 million for 2003 resulted from a $6 million capital contribution by Danielson and the early repayment of a $4 million promissory note in 2003.

Liquidity and Capital Resources of Insurance Operations

Insurance Services requires both readily liquid assets and adequate capital to meet ongoing obligations to policyholders and claimants, as well as to pay ordinary operating expenses. Insurance Services meets both its short-term and long-term liquidity requirements through operating cash flows that include premium receipts, investment income and reinsurance recoveries. To the extent operating cash flows do not provide sufficient cash flow, Insurance Services relies on the sale of invested assets. Insurance Services investment policy guidelines require that all loss and LAE liabilities be matched by a comparable amount of investment grade assets. Danielson believes that Insurance Services currently has both adequate capital resources and sufficient reinsurance to meet its current operating requirements.

The National Association of Insurance Commissioners provides minimum solvency standards in the form of risk based capital requirements (RBC). The RBC model for property and casualty insurance companies requires that carriers report their RBC ratios based on their statutory annual statements as filed with the regulatory authorities. Insurance Services consolidated RBC is in excess of Company Action Level.

Two other common measures of capital adequacy for insurance companies are premium-to-surplus ratios (which measure current operating risk) and reserves-to-surplus ratios (which measure financial risk related to possible changes in the level of loss and LAE reserves). A commonly accepted standard for net written premium-to-surplus ratio is 3.0 to 1, although this varies with different lines of business. Insurance Services annualized premium-to-year-end statutory surplus ratio of 0.9 to 1 remains well under current industry standards. Insurance Services ratio of loss and LAE reserves to statutory surplus of 2.7 to 1 at December 31, 2004 was within industry guidelines.

Unpaid Losses and Loss Adjustment Expenses

Insurance Services estimates reserves for unpaid losses and LAE based on reported losses and historical experience, including losses reported by other insurance companies for reinsurance assumed, and estimates of expenses for investigating and adjusting all incurred and unadjusted claims. Key assumptions used in the estimation process could have significant effects on the reserve balances. Insurance Services regularly evaluates their estimates and assumptions based on historical experience adjusted for current economic conditions and trends. Changes in the unpaid losses and LAE can materially effect the statement of operations. Different estimates could have been used in the current period, and changes in the accounting estimates are reasonably likely to occur from period to period based on the economic conditions. Since the loss reserving process is complex and subjective, the ultimate liability may vary significantly from our estimates.

NAICC S Investments

California and Montana insurance laws and regulations regulate the amount and type of NAICC s investments. NAICC s investment portfolio is comprised primarily of fixed maturities and is weighted heavily

toward investment grade short and medium term securities. See Note 4 of the Notes to the Consolidated Financial Statements.

The following table sets forth a summary of NAICC s investment portfolio at December 31, 2004 (in thousands of dollars):

	Amortized Cost	Fair Value
Investments by investment by grade:		
Fixed maturities:		
U.S. Government/ Agency	$ 27,024	$ 27,070
Mortgage-backed	13,625	13,440
Corporate (AAA to A)	15,533	15,588
Corporate (BBB)	1,082	1,112
Total fixed maturities	57,264	57,210
Equity securities	1,324	1,432
Total	$ 58,588	$ 58,642

Letters of Credit

NAICC pledges assets and posts letters of credit for the benefit of other insurance companies it does business with in the event that NAICC is not able to pay their reinsurers. NAICC had pledged assets of $7 million and had letters of credit outstanding of $3.1 million at December 31, 2004.

Contractual Obligations and Commitment Summary

Insurance services contractual commitments under lease operating lease agreements total approximately $2.6 million at December 31, 2004 and are due as follows: $0.8 million in 2005 and 2006, $0.3 million in each year 2007 through 2009 and $0.1 million thereafter.

Discussion of Critical Accounting Policies

In preparing its consolidated financial statements in accordance with U.S. generally accepted accounting principles, Danielson is required to use judgment in making estimates and assumptions that affect the amounts reported in its financial statements and related notes. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of Danielson s critical accounting policies are those subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly as forecast, and the best estimates routinely require adjustment.

Purchase Accounting

Danielson applied purchase accounting in accordance with SFAS No. 141 Business Combinations , for its acquisition of Covanta. As described in Note 2 to the Notes to the Consolidated Financial Statements, Danielson valued the acquired assets and liabilities assumed at fair value. The estimates of fair value used by Danielson reflect its best estimate based on the work of Danielson and independent valuation consultants and, where such work has not been completed, such estimates have been based on Danielson s experience and relevant information available to management. These estimates, and the assumptions used by Danielson and by its valuation consultants, are subject to inherent uncertainties and contingencies beyond Danielson s control. For example, Danielson used the discounted cash flow method to estimate value of many of its assets. This entails developing projections about future cash flows and adopting an appropriate discount rate. Danielson can not predict with certainty actual cash flows and the selection of a discount rate is heavily

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dependent on judgment. If different cash flow projections or discount rates were used, the fair values of Danielson s assets and liabilities could be materially increased or decreased. Accordingly, there can be no assurance that such estimates and assumptions reflected in the valuations will be realized, or that further adjustments will not occur. The assumptions and estimates used by Danielson therefore have substantial effect on Danielson s balance sheet. In addition because the valuations impact depreciation and amortization, changes in such assumptions and estimates may effect earnings in the future.

Long-lived Assets

Danielson has estimated the useful lives over which it depreciates its long-lived assets. Such estimates are based on Danielson s experience and management s expectations as to the useful lives of the various categories of assets it owns, as well as practices in industries Danielson believes are comparable. Estimates of useful lives determine the rate at which Danielson depreciates such assets and utilizing other estimates could impact both Danielson s balance sheet and earnings statements.

Danielson reviews its long-lived assets for impairment when events or circumstances indicate that the carrying value of such assets may not be recoverable over the estimated useful life. Determining whether an impairment has occurred typically requires various estimates and assumptions, including which cash flows are directly attributable to the potentially impaired asset, the useful life over which the cash flows will occur, their amount and the assets residual value, if any. Also, impairment losses require an estimate of fair value, which is based on the best information available. Danielson principally uses internal discounted cash flow estimates, but also uses quoted market prices when available and independent appraisals as appropriate to determine fair value. Cash flow estimates are derived from historical experience and internal business plans with an appropriate discount rate applied.

Accordingly, inaccuracies in the assumptions used by management in establishing these estimates, and in the assumptions used in establishing the extent to which a particular asset may be impaired, could potentially have a material effect on Danielson s consolidated financial statements.

Net Operating Loss Carryforwards Deferred Tax Assets

As described in Note 25 to the Notes to the Consolidated Financial Statements, Danielson has recorded a deferred tax asset related to the NOLs. The amount recorded was calculated based upon future taxable income arising from (a) the reversal of temporary differences during the period the NOLs are available and (b) future operating income expected from Covanta s domestic business, to the extent it is reasonably predictable.

Danielson cannot be certain that the NOLs will be available to offset the tax liability of Danielson. CPIH and its subsidiaries and Covanta Lake will not be consolidated with the balance of Danielson for federal income tax purposes. If the NOLs were not available to offset the tax liability of Covanta (other than CPIH and Covanta Lake), Covanta does not expect to have sufficient cash flow available to pay debt service on the Domestic Facilities described above under Liquidity/ Cash Flow.

Danielson estimated that it had NOLs of approximately $516 million for federal income tax purposes as of the end of 2004. The NOLs will expire in various amounts beginning on December 31, 2005 through December 31, 2023, if not used. The amount of NOLs available to Covanta will be reduced by any taxable income generated by current members of Danielson s tax consolidated group including certain grantor trust relating to the Mission Insurance entities.

The Internal Revenue Service (IRS) has not audited any of Danielson s tax returns for the years in which the losses giving rise to the NOLs were reported, and it could challenge any past and future use of the NOLs.

Under applicable tax law, the use and availability of Danielson s NOLs could be limited if there is a more than 50% increase in stock ownership during a 3-year testing period by stockholders owning 5% or more of Danielson s stock. Danielson s Certificate of Incorporation contains stock transfer restrictions that were designed to help preserve Danielson s NOLs by avoiding such an ownership change. Danielson expects that

the restrictions will remain in-force as long as Danielson has NOLs. There can be no assurance, however, that these restrictions will prevent such an ownership change.

Loss Contingencies

As described in Note 29 in the Notes to Consolidated Financial Statements, Danielson s subsidiaries are party to a number of claims, lawsuits and pending actions, most of which are routine and all of which are incidental to its business. Danielson assesses the likelihood of potential losses with respect to these matters on an ongoing basis and when losses are considered probable and reasonably estimable, records as a loss an estimate of the ultimate outcome. If Danielson can only estimate the range of a possible loss, an amount representing the low end of the range of possible outcomes is recorded and disclosure is made regarding the possibility of additional losses. Danielson reviews such estimates on an ongoing basis as developments occur with respect to such matters and may in the future increase or decrease such estimates. There can be no assurance that Danielson s initial or adjusted estimates of losses will reflect the ultimate loss Danielson may experience regarding such matters. Any inaccuracies could potentially have a material effect on Danielson s Consolidated Financial Statements.

Revenue Recognition

Covanta s revenues are generally earned under contractual arrangements and fall into three categories: service revenues, electricity and steam revenues, and construction revenues.

Service revenues consist of the following:

1) Fees earned under contract to operate and maintain waste-to-energy, independent power and water facilities are recognized as revenue when earned, regardless of the period they are billed;

2) Fees earned to service project debt (principal and interest) where such fees are expressly included as a component of the service fee paid by the Client Community pursuant to applicable waste-to-energy Service Agreements. Regardless of the timing of amounts paid by Client Communities relating to project debt principal, Covanta records service revenue with respect to this principal component on a levelized basis over the term of the Service Agreement. Unbilled service receivables related to waste-to-energy operations are discounted in recognizing the present value for services performed currently in order to service the principal component of the project debt. Such unbilled receivables amounted to $156 million at December 31, 2004;

3) Fees earned for processing waste in excess of Service Agreement requirements are recognized as revenue beginning in the period Covanta processes waste in excess of the contractually stated requirements;

4) Tipping fees earned under waste disposal agreements are recognized as revenue in the period waste is received; and

5) Other miscellaneous fees such as revenue for scrap metal recovered and sold are generally recognized as revenue when scrap metal is sold.

Electricity and Steam Sales

Revenue from the sale of electricity and steam are earned at energy facilities and are recorded based upon output delivered and capacity provided at rates specified under contract terms or prevailing market rates net of amounts due to Client Communities under applicable Service Agreements.

Construction Revenues

Revenues under fixed-price construction contracts, including construction, are recognized on the basis of the estimated percentage of completion of services rendered. Construction revenues also include design, engineering and construction management fees. In 2004, Covanta incurred some preliminary construction costs for which it has not billed the municipality or received reimbursement Covanta anticipates the contracts will be finalized in 2005 at which time it expects to be fully reimbursed for such costs.

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Unpaid Losses and Loss Adjustment Expenses

Insurance Services establishes loss and LAE reserves that are estimates of amounts needed to pay claims and related expenses in the future for insured events that have already occurred. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain.

Reserves are typically comprised of (1) case reserves for claims reported and (2) reserves for losses that have occurred but for which claims have not yet been reported, referred to as incurred but not reported (IBNR) reserves, which include a provision for expected future development on case reserves. Case reserves are estimated based on the experience and knowledge of claims staff regarding the nature and potential cost of each claim and are adjusted as additional information becomes known or payments are made. IBNR reserves are derived by subtracting paid loss and LAE and case reserves from estimates of ultimate loss and LAE. Actuaries estimate ultimate loss and LAE using various generally accepted actuarial methods applied to known losses and other relevant information. Like case reserves, IBNR reserves are adjusted as additional information becomes known or payments are made.

Ultimate loss and LAE are generally determined by extrapolation of claim emergence and settlement patterns observed in the past that can reasonably be expected to persist into the future. In forecasting ultimate loss and LAE with respect to any line of business, past experience with respect to that line of business is the primary resource, but cannot be relied upon in isolation. Insurance Service s own experience, particularly claims development experience, such as trends in case reserves, payments on and closings of claims, as well as changes in business mix and coverage limits, are the most important information for estimating its reserves.

Uncertainties in estimating ultimate loss and LAE are magnified by the time lag between when a claim actually occurs and when it is reported and settled. This time lag is sometimes referred to as the claim-tail . The claim-tail for most property coverages is typically short (usually a few days up to a few months). The claim-tail for automobile liability is relatively short (usually one to two years) and liability/casualty coverages, such as general liability, multiple peril coverage, and workers compensation, can be especially long as claims are often reported and ultimately paid or settled years, even decades, after the related loss events occur. During the long claims reporting and settlement period, additional facts regarding coverages written in prior accident years, as well as about actual claims and trends may become known and, as a result, Insurance Services may adjust its reserves. If management determines that an adjustment is appropriate, the adjustment is booked in the accounting period in which such determination is made in accordance with GAAP. Accordingly, should reserves need to be increased or decreased in the future from amounts currently established, future results of operations would be negatively or positively impacted, respectively.

Insurance Services uses independent actuaries which it significantly relies on to form a conclusion on reserve estimates. Those independent actuaries use several generally accepted actuarial methods to evaluate Insurance Services loss reserves, each of which has its own strengths and weaknesses. The independent actuaries place more or less reliance on a particular method based on the facts and circumstances at the time the reserve estimates are made and through discussions with Insurance Services management.

Insurance Services reserves include provisions made for claims that assert damages from asbestos and environmental (A&E) related exposures against policies issued prior to 1985. Asbestos claims relate primarily to injuries asserted by those who came in contact with asbestos or products containing asbestos. Environmental claims relate primarily to pollution and related clean-up cost obligations, particularly as mandated by federal and state environmental protection agencies. In addition to the factors described above regarding the reserving process, Insurance Services estimates its A&E reserves based upon, among other factors, facts surrounding reported cases and exposures to claims, such as policy limits, existence of other underlying primary coverage and deductibles, current law, past and projected claim activity and past settlement values for similar claims, as well as analysis of industry studies and events, such as recent settlements and asbestos-related bankruptcies. The cost of administering A&E claims, which is an important factor in estimating loss reserves, tends to be higher than in the case of non-A&E claims due to the higher legal costs typically associated with A&E claims. Due to the inherent difficulties in estimating ultimate A&E

exposures, Insurance Services and its contracted independent actuaries do not estimate a range for A&E incurred losses.

Due to the factors discussed above and others, the process used in estimating unpaid losses on LAE cannot provide an exact result. Danielson s results of operation for each of the past three years have been adversely affected by insurance loss development related to prior years of $2.5 million, $13.5 million and $10.4 million for 2004, 2003 and 2002 respectively. The prior year development recognized in 2004, 2003 and 2002, expressed as a percentage of the previous years reported loss and LAE reserves, net of reinsurance recoveries, was 3.9%, 17.0% and 11.8%, respectively. The lines of business significantly contributing to the adverse development include workers compensation, commercial automobile and property and casualty. Workers compensation was most affected by changes in California legislation that occurred in 1995 and took several years to develop, with such development being different than the experience prior to 1995. In 2003 and 2004 new California legislative reforms have taken hold that appear to be reversing some of the prior recognized adverse development. Commercial automobile was most significantly impacted by case strengthening related to a change in claims administration in 2002, coupled with the recognition that development factors of prior years were not as indicative of the business written for those respective years due to changes in risk profile and limits. Due to stabilization of claims staff and recognition of the profile change that occurred in 1999, the adjustments recorded to commercial automobile in 2003 and 2004 are likely to hold. Given the nature of the casualty line of business, most notably the A&E liabilities, it is difficult to assess whether the extent of adverse adjustments recognized in the past will be required in future periods.

The table below shows Insurance Services recorded loss and LAE reserves, net of reinsurance recoveries, as of December 31, 2004 by line of business compared to the high and low ends of the reserve range that our contracted actuaries have determined to be acceptable for issuing their opinions. Given the nature and extent of long-tail liabilities versus total net reserves and the fact that net reserves have historically shown adverse development, Insurance Services can not provide assurances that its estimate of loss and LAE reserves will not adversely develop outside of the individual line of business ranges and in such instances could materially effect the statement of operations. However as Insurance Services is limited in its current policy writing to the non-standard personal automobile program, the extent of adverse development recognized in the past will likely not re-occur. (In thousands of dollars).

Range of Reserves by Line of Business	**Low**	**Reported**	**High**
On-going lines of business:			
Private passenger automobile SCJ programs	$ 5,706	$ 6,006	$ 6,452
Discontinued lines of business:			
Private passenger automobile Non-SCJ programs	644	678	728
Commercial automobile	9,238	9,724	10,454
Workers compensation	18,021	18,970	20,867
Property and casualty Non A&E	2,506	2,638	2,836
Property and casualty A&E		8,212	
Net unpaid losses and LAE at end of year		$ 46,228	

The probability that ultimate losses will fall outside of the ranges of estimates by line of business is higher for each line of business individually than it is for the sum of the estimates for all lines taken together due to the effects of diversification. Moreover, it would not be appropriate to add the ranges for each line of business to obtain a range around the total net reserves as each line of business is not completely correlated. Although management believes the reserves are reasonably stated, ultimate losses may deviate, perhaps materially, from the recorded reserve amounts and could be above the high end of the range of actuarial projections.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation

(SFAS 123) and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123, no longer will be an alternative to financial statement recognition. Danielson is required to adopt SFAS 123R in the third quarter of fiscal 2005, beginning July 1, 2005. Under SFAS 123R, Danielson must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. Danielson is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on Danielson s consolidated results of operations and earnings per share. Danielson has not yet determined the method of adoption or the effect of adopting SFAS 123R, and it has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

See Note 4 of the Notes to the Consolidated Financial Statements for a summary of additional accounting policies and new accounting pronouncements.

Related Party Transactions

Employment Arrangements

See the descriptions of Danielson s employment agreements with Anthony Orlando, Craig Abolt and Timothy Simpson contained in Item 11 of this Form 10-K.

Affiliate Agreements

SZ Investments, a company affiliated with Samuel Zell, the former Chief Executive Officer and Chairman of Danielson s Board of Directors, and William Pate, the current Chairman of Danielson s Board, was a holder through its affiliate, HYI Investments, L.L.C. (HYI), of approximately 42% of the senior notes and payment-in-kind notes of ACL, a former unconsolidated subsidiary of Danielson. In addition, Danielson agreed to provide SZI Investments unlimited demand registration rights with respect to the ACL notes held by HYI. ACL emerged from Chapter 11 bankruptcy proceedings in 2004 with its plan of reorganization being confirmed without material condition as of December 30, 2004 and effective as of January 11, 2005. Pursuant to the terms of ACL s plan of reorganization the notes held by HYI were converted into equity of ACL.

Following ACL s emergence from bankruptcy, Danielson sold its entire 50% interest in Vessel Leasing LLC to ACL for $2.5 million on January 13, 2005. The price and other terms and conditions of the sale were negotiated on an arm s length-basis for Danielson by a special committee of its Board of Directors.

Danielson entered into a corporate services agreement dated as of September 2, 2003, pursuant to which Equity Group Investments, L.L.C., agreed to provide certain administrative services to Danielson, including, among others, shareholder relations, insurance procurement and management, payroll services, cash management, tax and treasury functions, technology services, listing exchange compliance and financial and corporate record keeping. Samuel Zell, a former Chief Executive Office and Chairman of Danielson s Board, is also the Chairman of EGI, and William Pate, the current Chairman of Danielson s Board, are also executive officers of EGI. Under the agreement, Danielson paid to EGI $20,000 per month plus specified out-of-pocket fees and expenses incurred by EGI under this corporate services agreement. Danielson and EGI terminated this agreement with the integration of Covanta s operations with Danielson s as of November 2004.

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As part of the investment and purchase agreement dated as of December 2, 2003 pursuant to which Danielson agreed to acquire Covanta, Danielson arranged for a new replacement letter of credit facility for Covanta, secured by a second priority lien on Covanta s available domestic assets, consisting of commitments for the issuance of standby letters of credit in the aggregate amount of $118 million. This financing was provided by SZ Investments, TAVF and Laminar, a significant creditor of Covanta (collectively, SZ Investments, TAVF and Laminar, the Bridge Lenders). Each of SZ Investments, TAVF and Laminar or an affiliate own over five percent of Danielson s common stock. As mentioned above, Samuel Zell, the former Chief Executive Officer and William Pate, are affiliated with SZ Investments. David Barse, a director of Danielson, is affiliated with TAVF. This second lien credit facility has a term of five years. The letter of credit component of the second lien credit facility requires cash collateral to be posted for issued letters of credit in the event Covanta has cash in excess of specified amounts. Covanta also paid an upfront fee of $2.36 million upon entering into the second lien credit agreement, and will pay (1) a commitment fee equal to 0.5% per annum of the daily calculation of available credit, (2) an annual agency fee of $30,000, and (3) with respect to each issued letter of credit an amount equal to 6.5% per annum of the daily amount available to be drawn under such letter of credit. Amounts paid with respect to drawn letters of credit bear interest at the rate of 4.5% over the base rate on issued letters of credit, increasing to 6.5% over the base rate in specified default situations. Subsequent to the signing of the investment and purchase agreement, each of the Bridge Lenders assigned approximately 30% of their participation in the second lien letter of credit facility to Goldman Sachs Credit Partners, L.P. and Laminar assigned the remainder of its participation in the second lien letter of credit facility to TRS Elara, LLC.

Danielson obtained the financing for its acquisition of Covanta pursuant to a note purchase agreement dated December 2, 2003, from the Bridge Lenders. Pursuant to the note purchase agreement, the Bridge Lenders provided Danielson with $40 million of bridge financing in exchange for notes issued by Danielson. Danielson repaid the notes with the proceeds from a rights offering of common stock of Danielson which was completed in June 2004 and in connection with the conversion of a portion of the note held by Laminar into 8.75 million shares of common stock of Danielson pursuant to the note purchase agreement. In consideration for the $40 million of bridge financing and the arrangement by the Bridge Lenders of the $118 million second lien credit facility and the arrangement by Laminar of a $10 million international revolving credit facility secured by Covanta s international assets, Danielson issued to the Bridge Lenders an aggregate of 5,120,853 shares of common stock.

Pursuant to registration rights agreements Danielson filed a registration statement with the SEC to register the shares of common stock issued to the Bridge Lenders under the note purchase agreement. The registration statement was declared effective on August 24, 2004.

As part of Danielson s negotiations with Laminar and it becoming a five percent stockholder, pursuant to a letter agreement dated December 2, 2003, Laminar agreed to transfer restrictions on the shares of common stock that Laminar acquired pursuant to the note purchase agreement. Further, in accordance with the transfer restrictions contained in Article Five of Danielson s charter restricting the resale of Danielson s common stock by five percent stockholders, Danielson has agreed with Laminar to provide it with limited rights to resell the common stock that it holds.

Also in connection with the financing for the acquisition of Covanta, Danielson agreed to pay up to $0.9 million in the aggregate to the Bridge Lenders as reimbursement for expenses incurred by them in connection with the note purchase agreement.

The Purchase Agreement and other transactions involving SZ Investments, TAVF and Laminar were negotiated, reviewed and approved by a special committee of Danielson s Board of Directors composed solely of disinterested directors and advised by independent legal and financial advisors.

As of January 31, 2005, Danielson entered into a stock purchase agreement with Ref-Fuel, an owner and operator of waste-to-energy facilities in the northeast United States, and Ref-Fuel s stockholders to purchase 100% of the issued and outstanding shares of Ref-Fuel capital stock. Under the terms of the Purchase Agreement, the Company will pay $740 million in cash for the stock of Ref-Fuel and will assume the consolidated net debt of Ref-Fuel, which as of September 30, 2004 was $1.2 billion, resulting in an

enterprise value of approximately $2 billion for Ref-Fuel. After the transaction is completed, Ref-Fuel will be a wholly-owned subsidiary of Covanta.

Danielson intends to finance its anticipated purchase of Ref-Fuel through a combination of debt and equity financing. The equity component of the financing is expected to consist of an approximately $400 million offering of warrants or other rights to purchase Danielson s common stock to all of Danielson s existing stockholders at $6.00 per share. In this Ref-Fuel Rights Offering Danielson s existing stockholders will be issued rights to purchase Danielson s stock on a pro rata basis, with each holder entitled to purchase approximately 0.9 shares of Danielson s common stock at an exercise price of $6.00 per full share for each share of Danielson s common stock then held.

SZ Investments and its affiliate and EGI-Fund (05-07) Investors, L.L.C., TAVF and Laminar representing ownership of approximately 40% of Danielson s outstanding common stock, have each separately committed to participate in the Ref-Fuel Rights Offering and acquire their respective pro rata portion of the shares. As consideration for their commitments, Danielson will pay each of these four stockholders an amount equal to 1.5% to 2.25% of their respective equity commitments, depending on the timing of the transaction. Danielson agreed to amend an existing registration rights agreement to provide these stockholders with the right to demand that Danielson undertake an underwritten offering within twelve months of the closing of the acquisition of Ref-Fuel in order to provide such stockholders with liquidity.

Danielson also expects to complete its previously announced rights offering for up to three million shares of its common stock to certain holders of 9.25% debentures issued by Covanta at a purchase price of $1.53 per share which Danielson is required to conduct in order to satisfy its obligations as the sponsor of the plan of reorganization of Covanta. The 9.25% Offering will be made solely to holders of the $100 million of principal amount of 9.25% Debentures due 2002 issued by Covanta that voted in favor of Covanta s second reorganization plan on January 12, 2004. On January 12, 2004, holders of $99.6 million in principal amount of 9.25% Debentures voted in favor of the plan of reorganization and are eligible to participate in the 9.25% Offering.

Danielson has executed a letter agreement with Laminar pursuant to which Danielson agrees that if the 9.25% Offering has not closed prior to the record date for the Ref-Fuel Rights Offering, then Danielson will revise the 9.25% Offering so that the holders that participate in the 9.25% Offering are offered additional shares of Danielson s common stock at the same purchase price as in the Ref-Fuel Rights Offering and in an amount equal to the number of shares of common stock that such holders would have been entitled to purchase in the Rights Offering if the 9.25% Offering was consummated on or prior to the record date for the Ref-Fuel Rights Offering.

Danielson has filed a registration statement with respect to the 9.25% Offering and intends to file a registration statement with respect to the Ref-Fuel Rights Offering with the SEC and the statements contained herein shall not constitute an offer to sell or the solicitation of an offer to buy shares of Danielson s common stock. Any such offer or solicitation will be made in compliance with all applicable securities laws.

Clayton Yeutter, a director of Danielson, is of counsel to the law firm of Hogan & Hartson LLP. Hogan & Hartson has provided Covanta with certain legal services for several years including 2004. This relationship preceded Danielson s acquisition of Covanta and Mr. Yeutter did not direct or have any direct or indirect involvement in the procurement or provision of such legal services and does not directly or indirectly benefit from those fees. The Board has determined that such relationship does not interfere with Mr. Yeutter s exercise of independent judgment as a director.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

In the normal course of business, Danielson s subsidiaries are party to financial instruments that are subject to market risks arising from changes in interest rates, foreign currency exchange rates, and commodity prices. Danielson s use of derivative instruments is very limited and it does not enter into derivative instruments for trading purposes. The following analysis provides quantitative information regarding Danielson s exposure to financial instruments with market risks. Danielson uses a sensitivity model to evaluate the

fair value or cash flows of financial instruments with exposure to market risk that assumes instantaneous, parallel shifts in exchange rates and interest rate yield curves. There are certain limitations inherent in the sensitivity analysis presented, primarily due to the assumption that exchange rates change in a parallel manner and that interest rates change instantaneously. In addition, the fair value estimates presented herein are based on pertinent information available to management as of December 31, 2004. Further information is included in Note 30 to the Notes to Consolidated Financial Statements.

Energy Business

Interest Rate Risk

Covanta and/or its subsidiaries have Project debt outstanding bearing interest at floating rates that could subject it to the risk of increased interest expense due to rising market interest rates, or an adverse change in fair value due to declining interest rates on fixed rate debt. Of Covanta s project debt, approximately $218.9 million was floating rate at December 31, 2004. However, of that floating rate Project debt, $126.7 million related to waste-to-energy projects where, because of their contractual structure, interest rate risk is borne by Client Communities because debt service is passed through to those clients. Covanta had only one interest rate swap outstanding at December 31, 2004 in the notional amount of $80.2 million related to floating rate Project debt. Gains and losses on this swap are for the account of the Client Community.

For floating rate debt, a 20 percent hypothetical increase in the underlying December 31, 2004 market interest rates would result in a potential loss to twelve month future earnings of $5.5 million. For fixed rate debt, the potential reduction in fair value from a 20 percent hypothetical increase in the underlying December 31, 2004 market interest rates would be approximately $32.5 million. The fair value of the Covanta s fixed rate debt (including $677 million in fixed rate debt related to revenue bonds in which debt service is an explicit component of the service fees billed to the Client Communities) was $750.2 million at December 31, 2004, and was determined using average market quotations of price and yields provided by investment banks.

Foreign Currency Exchange Rate Risk

Covanta has investments in energy projects in various foreign countries, including the Philippines, China, India and Bangladesh, and to a much lesser degree, Italy and Costa Rica. Neither Danielson nor Covanta enters into currency transactions to hedge its exposure to fluctuations in currency exchange rates. Instead, Covanta attempts to mitigate its currency risks by structuring its project contracts so that its revenues and fuel costs are denominated in the same currency. As a result, the U.S. dollar is the functional currency at most of Covanta s international projects. Therefore, only local operating expenses and project debt denominated in other than a project entity s functional currency are exposed to currency risks.

At December 31, 2004, Covanta had $102 million of project debt related to two diesel engine projects in India. For $87.7 million of the debt (related to project entities whose functional currency is the Indian rupee), exchange rate fluctuations are recorded as translation adjustments to the cumulative translation adjustment account within stockholders deficit in Danielson s Consolidated Balance Sheets. The remaining $14.3 million of debt is denominated in U.S. dollars.

The potential loss in fair value for such financial instruments from a 10% adverse change in December 31, 2004 quoted foreign currency exchange rates would be approximately $8.8 million.

Under CPIH s current financing arrangements, these risks are borne primarily by the CPIH Borrowers to the extent they affect the cash flow available to the CPIH Borrowers to repay CPIH indebtedness. These risks will continue to affect items reflected on Danielson s consolidated financial statements.

At December 31, 2004, Covanta also had net investments in foreign subsidiaries and projects. See Note 5 to the Notes to Consolidated Financial Statements for further discussion.

Commodity Price Risk and Contract Revenue Risk

Neither Danielson nor Covanta has entered into futures, forward contracts, swaps or options to hedge purchase and sale commitments, fuel requirements, inventories or other commodities. Alternatively, Covanta attempts to mitigate the risk of energy and fuel market fluctuations by structuring contracts related to its energy projects in the manner described above under Management s Discussion and Analysis of Financial Condition and Results of Operations, Contract Structures and Duration.

Generally, Covanta is protected against fluctuations in the waste disposal market, and thus its ability to charge acceptable fees for its services, through Service Agreements existing long-term disposal contracts at its waste-to-energy facilities. At three of its waste-to-energy facilities, differing amounts of waste disposal capacity are not subject to long-term contracts and, therefore, Covanta is partially exposed to the risk of market fluctuations in the waste disposal fees it may charge. Covanta s Service Agreements begin to expire in 2007, and energy sales contracts at Company-owned projects generally expire at or after the date on which that project s Service Agreement expires. Expiration of these contracts will subject Covanta to greater market risk in maintaining and enhancing its revenues. As its Service Agreements at municipally-owned projects expire, Covanta will seek to enter into renewal or replacement contracts to continue operating such projects. As Covanta s Service Agreements at facilities it owns begin to expire, Covanta intends to seek replacement or additional contracts for waste supplies, and because project debt on these facilities will be paid off at such time, Covanta expects to be able to offer disposal services at rates that will attract sufficient quantities of waste and provide acceptable revenues. Covanta will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. At Company-owned facilities, the expiration of existing energy sales contracts will require Covanta to sell its output either into the local electricity grid or pursuant to new contracts. There can be no assurance that Covanta will be able to enter into such renewals, replacement or additional contracts, or that the terms available in the market at the time will be favorable to Covanta.

Covanta s opportunities for growth by investing in new projects will be limited by existing debt covenants, as well as by competition from other companies in the waste disposal business. Because its business is based upon building and operating municipal solid waste processing and energy generating projects, which are capital intensive businesses, in order to provide meaningful growth Covanta must be able to invest its own funds, obtain debt financing and provide support to its operating subsidiaries. When Covanta was acquired by Danielson and emerged from its bankruptcy proceeding in March 2004, it entered into financing arrangements with restrictive covenants typical of financings of companies emerging from bankruptcy. These covenants essentially prohibit investments in new projects or acquisitions of new businesses, and place restrictions on Covanta s ability to expand existing projects. The covenants also prohibit borrowings to finance new construction, except in limited circumstances related to specifically identified expansions of existing facilities. In addition, the covenants limit spending for new business development and require that excess cash flow be trapped to collateralize outstanding letters of credit.

Covanta intends to pursue opportunities to expand the processing capacity where municipal clients have encountered significantly increased waste volumes without corresponding competitively-priced landfill availability. Other than expansions at existing waste-to-energy projects, Covanta does not expect to engage in material development activity which will require significant equity investment. There can be no assurance that Covanta will be able to implement expansions at existing facilities.

Insurance Services

Risk Related to the Investment Portfolio

NAICC s objectives in managing its investment portfolio are to maximize investment income and investment returns while minimizing overall market risk. Investment strategies are developed based on many factors including duration of liabilities, underwriting results, overall tax position, regulatory requirements, and fluctuations in interest rates. Investment decisions are made by management, in consultation with an independent investment advisor, and approved by the Board of Directors. Market risk represents the potential for loss due to adverse changes in the fair value of securities. The market risks related to NAICC s fixed

maturity portfolio are primarily credit risk, interest rate risk, reinvestment risk and prepayment risk. The market risk related to NAICC s equity portfolio is price risk.

Fixed Maturities

Interest rate risk is the price sensitivity of fixed maturities to changes in interest rate. Management views these potential changes in price within the overall context of asset and liability matching. Management estimates the payout patterns of NAICC s liabilities, primarily loss reserves, to determine their duration. Management sets duration targets for the fixed income portfolio after consideration of the duration of NAICC s liabilities that it believes mitigates the overall interest rate risk. NAICC s exposure to interest rate risk is mitigated by the relative short-term nature of its insurance and other liabilities. The effective duration of the portfolio at December 31, 2004 and 2003 was 2.3 years and 2.3 years, respectively. Management believes its portfolio duration is appropriate given the relative short-tail nature of the auto programs and projected run-off of all other lines of business. A hypothetical 100 basis point increase in market interest rates would cause an approximate 2.7% decrease in the fair value of the portfolio while a hypothetical 100 basis point decrease would cause an approximate 2.1% increase in fair value. Credit risk is the price sensitivity of fixed maturities to changes in the credit quality of such investment. NAICC s exposure to credit risk is mitigated by its investment in high quality fixed income alternatives.

Fixed maturities of NAICC include Mortgage-Backed Securities and Collateralized Mortgage Obligations, collectively (MBS) representing 24.3% and 22.0% of total fixed maturities at December 31, 2004 and December 31, 2003, respectively. All MBS held by NAICC are issued by the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC), which are both rated AAA by Moody s Investors Services. Both FNMA and FHLMC are corporations that were created by Acts of Congress. FNMA and FHLMC guarantee the principal balance of their securities. FNMA guarantees timely payment of principal and interest.

One of the risks associated with MBS is the timing of principal payments on the mortgages underlying the securities. The principal an investor receives depends upon amortization schedules and the termination pattern (resulting from prepayments or defaults) of the individual mortgages included in the underlying pool of mortgages. The principal is guaranteed but the yield and cash flow can vary depending on the timing of the repayment of the principal balance. The degree to which a security is susceptible to changes in yield is influenced by the difference between its amortized cost and par, the relative sensitivity to repayment of the underlying mortgages backing the securities in a changing interest rate environment, and the repayment priority of the securities in its overall securitization structure. NAICC attempts to limit repayment risk by purchasing MBS whose cost is below or does not significantly exceed par, and by primarily purchasing structured securities with repayment protection which provides more certain cash flow to the investor such as MBS with sinking fund schedules known as Planned Amortization Classes (PAC) and Targeted Amortization Classes (TAC). The structures of PAC s and TAC s attempt to increase the certainty of the timing of prepayment and thereby minimize the prepayment and interest rate risk. In 2004, NAICC recognized $0.2 million in gain on sales of fixed maturities.

MBS, as well as callable bonds, have a greater sensitivity to market value declines in a rising interest rate environment than to market value increases in a declining interest rate environment. This is primarily due to the ability and the incentive of the payor to prepay the principal or the issuer to call the bond in a declining interest rate scenario. NAICC realized significant increases in its prepayments of principal during 2004 and 2003. The prepayments mitigated the need to sell securities to meet operating cash requirements as noted previously. Generally, this trend will lower the portfolio yield in future years in a declining interest environment.

As interest rates at December 31, 2004 are at relatively historical lows, NAICC is subject to reinvestment risk as approximately 24% of its fixed maturity portfolio will be received in the following year. Absent changing its credit risk and extension profile, it is unlikely that NAICC could reinvest proceeds at yields similar to those recognized in 2004.

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Equity Securities

In the fourth quarter of 2003, NAICC sold nearly all of its equity investments capitalizing on the general stock market recovery and specifically the technology sector. In 2003, NAICC recognized $0.4 million as net realized gains from equity investments. In third and fourth quarter of 2004, NAICC began reinvesting in equity securities, generally limited to Fortune 500 companies with strong balance sheets, history of dividend growth and price appreciation. As of December 31, 2004 equity securities represented 2.6% of the total NAICC investment portfolio.

Economic Conditions

The operating results of a property and casualty insurer are influenced by a variety of factors including general economic conditions, competition, regulation of insurance rates, weather, frequency and severity of losses. The California non-standard personal auto market in which NAICC operates has experienced a recovery of rate adequacy coupled with stable competition. Frequency of claims improved from 2002 to 2003 and remained stable in 2004, while the average cost of settling claims has steadily improved from 2002 to 2004.

Item 8. ***Financial Statements and Supplementary Data Index***

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Management Report on Internal Control over Financial Reporting

The management of Danielson Holding Corporation (Danielson) is responsible for establishing and maintaining adequate internal control over financial reporting for Danielson. During 2004, Danielson acquired 100% of the ownership interest in Covanta Energy Corporation (Covanta) in connection with Covanta s emergence from chapter 11 proceedings. Danielson s internal control system was designed to provide reasonable assurance to its Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations including the possibility of human error and the circumvention or overriding of controls. Further, because of changes in conditions, the effectiveness of internal controls may vary over time. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even those systems determined to be effective can provide us only with reasonable assurance with respect to financial statement preparation and presentation.

Danielson s management has assessed the effectiveness of internal control over financial reporting as of December 31, 2004. In making this assessment, we followed the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control Integrated Framework.*

A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of our annual or interim financial statements will not be prevented or detected. We identified the following material weakness in our assessment of internal control over financial reporting as of December 31, 2004. During the course of its audit of our 2004 financial statements, our independent auditors, Ernst & Young LLP identified errors, principally related to complex manual fresh start accounting calculations, predominantly affecting Covanta s investments in its international businesses. Fresh start accounting was required following Covanta s emergence from bankruptcy on March 10, 2004, pursuant to Statement of Financial Position (SOP) 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code. These errors, the net effect of which was immaterial (less than $2 million in pretax income) have been corrected in our 2004 consolidated financial statements. Management has determined that errors in complex fresh start and other technical accounting areas originally went undetected due to insufficient technical in-house expertise necessary to provide sufficiently rigorous review. As a result, management has concluded that Danielson s internal control over financial reporting was not effective as of December 31, 2004.

Our independent auditors, Ernst & Young LLP, have issued an audit report on our assessment of internal control over financial reporting. This report appears on page 116 of this report on Form 10-K for the year ended December 31, 2004.

Anthony J. Orlando
President and Chief Executive Officer

Craig D. Abolt
Senior Vice President and
Chief Financial Officer

March 14, 2005

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Danielson Holding Corporation

We have audited the accompanying consolidated balance sheets of Danielson Holding Corporation and subsidiaries (the Company) as of December 31, 2004 and 2003, and the consolidated statements of operations, stockholders equity, and cash flows for the years ended December 31, 2004 and 2003 and the year ended December 27, 2002. Our audits also included the financial statement schedules listed in the Index at Item 8. These financial statements and schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that